

MARKETWATCH | NOVEMBER 8, 2009

Beware of 'Debt-Relief' Offers

Article

Comments (10)

MORE IN INVESTING >

[Email](#) [Print](#) [Save This](#)
[+ More](#)
[Text](#)

By ANDREA COOMBES

For consumers drowning in thousands of dollars of debt, the lure of paying "pennies on the dollar" to their creditors in a process known as debt settlement is tough to resist.

But the television and radio ads that blare "pay just 50% of what you owe" too often neglect the fine print. Debt settlement -- which entails not paying your bills until your creditor agrees to accept only a portion of the total owed -- works only for a few of the consumers who attempt it.

And consumers who enter the process may endure months of creditors' angry phone calls, plus a growing debt load as fees, penalties and interest are tacked on to their original balance due. Plus, there's a distinct possibility creditors will sue.



Now, as more consumers are overwhelmed by debt in these tough economic times, regulatory agencies are taking note.

"The number of complaints the states have received against debt-relief companies, particularly debt-settlement companies, have consistently been rising and have more than doubled since 2007," according to an Oct. 23 letter from 40 state attorneys general to the Federal Trade Commission, in support of the

FTC's proposal in August to change the rules governing such firms.

Proposals for Disclosure, Fees

The FTC is proposing to require firms to better disclose how these programs work, as well as limit firms' ability to charge fees up front.

Fee structures vary, but a common variant is that the consumer pays about 40% of the fee in the first few months, and the rest within the first year -- though the settlements, if successful, may not occur for months or even years beyond that. Fees vary but often range from about 10% to 15% of the consumer's debt.

And customers often are on the hook whether they get help or not. A debt-settlement trade group found in a survey of its members that "completion rates" ranged from 35% to 60%, though the FTC says companies define completion differently.

Meanwhile, in New York, one debt-settlement company promised consumers they'd pay just 60% of their balance owed, but just 1% of customers enjoyed that result, according to the New York attorney general's office, which sued two debt-settlement companies in May.

Fewer than 10% of customers of 42 debt-settlement and credit-counseling companies operating in Colorado paid off or settled their debts, according to a study by that state's attorney general's office.

"There's no guarantee that a debt-settlement company is going to be able to in fact settle your debts for pennies on the dollar, if at all," says Susan Grant, director of consumer protection at the Consumer Federation of America, a Washington-based advocacy group. "And the question is, should consumers be paying large fees up front when there's no guarantee that they're going to get the relief that they were led to expect?"

Tips for Consumers

Before you go the settlement route, visit a consumer-credit counseling agency for advice. It won't hurt your credit rating to talk to them, and the first visit is free.

The National Foundation for Credit Counseling (www.nfcc.org) has a tool for locating counselors nationwide. Credit counselors offer debt-management plans. Under these, creditors agree to reduced monthly payments or lower interest rates in return for the consumer agreeing to pay the full debt on a set schedule. But consumers who can't afford the monthly payment won't qualify.

Next, talk to an attorney to assess whether bankruptcy makes sense. Debt settlement: "is not a decision you make without talking to a bankruptcy attorney, because you could be sued" by

going the settlement route, says Gerri Detweiler, a personal-finance adviser with Credit.com, a consumer information site.

Try working out a settlement yourself. It requires a thick skin to work with creditors, and a clear idea of how much you can afford to pay back. "People will say, 'How little can I settle for?'" Ms. Detweiler says. "Debt settlement should not be about trying to wiggle out of your debts. It's really about coming to an agreement with your creditors to pay what you can afford and getting them to understand that you can't pay any more than that."

Consider the tax hit. Unless you can prove to the Internal Revenue Service that you were insolvent at the time of the settlement, you may owe income tax on any forgiven debt.

Read the contract. If you decide to go to a debt-relief company, find one that demands the bulk of its fee **only** after successful settlement.

Write to Andrea Coombes at andrea.coombes@dowjones.com