

## When debt settlement makes sense

It's not for everyone, and the industry is largely unregulated, so you'll need to exercise caution if you hire a company. Despite that, it may be worth considering.



By [Liz Pulliam Weston](#)

MSN Money

Computer salesman Dennis Firenze tried to build a real estate empire -- and wound up with \$270,000 in credit card debt he couldn't pay.

Firenze, 51, hadn't counted on the high vacancy rate and tenant-caused damage that plagued his properties: two condos in Chicago and a 22-unit apartment complex in Phoenix. At one point, he said, he was shelling out \$20,000 more a month than the properties were taking in.

The Vista, Calif., man tapped his 401(k), drained his children's college savings and used 0% credit card offers to keep the properties afloat, eventually carrying balances on 13 cards. But then he was a day late with a payment. His interest rates soared, and collectors began to call.

"They're brutal," Firenze said of the calls, which sometimes came every 15 minutes. "They were like, 'You need to give us \$80,000 *today*.' "

Firenze attempted, and failed, to negotiate settlements with his creditors. Then he turned to [Debt Settlement USA](#), a Scottsdale, Ariz., company that assured him it could do what he couldn't.

So far, so good, Firenze said. Within three months, the negotiator assigned to Firenze's case settled a \$60,000 credit card bill for \$18,000. A few months later, another \$60,000 debt was settled for \$20,000.

After 11 months in the program, Firenze has settled a total \$221,000 of his debt for \$75,000 -- and paid Debt Settlement USA a fee of nearly \$38,000 for its help.

"Their fee is exorbitant," Firenze said. But the settlements were "a heck of a lot better than I could do . . . I'm thrilled with what they've done."

### Plenty of perils

Largely unregulated and filled with perils for consumers, the debt-settlement industry has nonetheless found a niche among troubled borrowers who are trying to avoid [bankruptcy](#).

Debt settlement is sometimes confused with [debt consolidation](#), where borrowers are offered one big loan to pay off their smaller debts, and with [credit counseling](#), where agencies attempt to set up low-interest repayment plans so borrowers can pay off credit card debt over time.

But debt settlement is a different animal. Instead of offering a loan or repayment plan, debt settlement companies typically advise their clients to stop paying their bills and instead save up cash, which the company will then use to negotiate lump-sum settlements.

The dangers are many, including:

- **Fraud.** Some companies offering debt settlement are fly-by-night scams, eager to take big upfront fees and then disappear. Others are too inept or inexperienced to negotiate effective deals. Either way, the result is the same: money down the drain at a time when you can ill afford the loss.

- **Credit score damage.** Failing to pay your bills on time will trash your credit scores. The better your scores, the greater the toll. Settling a debt for less than what you owe can do additional damage.
- **Lawsuits and wage garnishment.** Creditors increasingly are using debt collection law firms that are quick to file lawsuits when borrowers default, as I wrote in "[Don't ignore that debt collector.](#)" **A successful lawsuit can lead to wage garnishment or liens on your property. In fact, some creditors are so resistant to working with debt settlement companies that they immediately "go legal," or file a lawsuit against a debtor as soon as they are contacted by his or her debt-settlement company, said Jamie Welsh, a director with Kaulkin Ginsberg, which tracks the collections industry.**
- **Lack of regulation.** The federal government doesn't regulate debt-settlement companies, although the Federal Trade Commission is considering imposing some rules. Few states regulate the industry, and "where those states are, the debt-settlement companies aren't," Welsh said. So -- for now at least -- it's completely "buyer beware."

Was one of your New Year's resolutions to pay off debt? Here's some advice to help you reach your goal.

- **Taxes.** The difference between what you owe and what you pay in a settlement typically is considered taxable income by the IRS. So if you're in the 25% federal tax bracket, you could owe \$2,500 for every \$10,000 in debt that's forgiven. (Firenze said he has enough capital losses from his properties to offset the additional income, but many people in similar situations would be stuck with a five-figure tax bill.)
- **Cost.** Debt settlement doesn't come cheap. Some companies charge 14% to 18% of the total face value of the debt you want settled, while others require a large percentage of the amount they actually settle for you. Firenze paid Debt Settlement USA 14% of the \$270,000 he originally owed, a total of \$37,800, in monthly payments spread out over a year.
- **Time.** In addition to not being cheap, debt settlement typically isn't fast. Although the bulk of Firenze's debt was settled in less than a year, the average debt settlement process takes closer to two years, said Jack Craven, president of Debt Settlement USA.

### Bankruptcy is cheaper; debt settlement is faster

Contrast that with a [Chapter 7](#) bankruptcy, which wipes out most unsecured debt and is usually over within four months. People who file such bankruptcies get a fresh start that allows them to begin rebuilding their credit immediately. They no longer owe their creditors, and the upfront cost for filing is usually around \$1,200 to \$1,500 -- far less than the cost of debt settlement. (See "[Your 5-minute guide to bankruptcy.](#)")

Clearly, if you can't pay your bills and you can file a Chapter 7, that's a better course than debt settlement.

But Firenze's six-figure income disqualified him from filing for a Chapter 7 bankruptcy. His only option would have been [Chapter 13](#), which requires a five-year repayment plan.

Firenze wanted out from under his crushing debt faster than that. In fact, he's hoping to be debt-free by his wife's July birthday. The family has sold its cars and is steadily selling off unused possessions on eBay to raise more money for settlements.

"We'll own nothing, but we'll owe nothing," Firenze said. "We'll be starting over."

### Where to begin

If you're contemplating debt settlement, first talk to an experienced bankruptcy attorney about your situation. If you decide to hire a debt-settlement company, be prepared to do plenty of research -- with little regulation and no guarantees, you'll want to choose carefully.

Fortunately, the FTC [offers some guidance](#) (pdf file). Legitimate companies, it says, are those that:

- Don't guarantee any results.
- Won't accept you if you can actually pay your debt.

- Have written policies and procedures about their debt-settlement program.
- Are members of the [Better Business Bureau](#).
- Have a customer-dispute resolution and review process.
- Have in-house attorneys with significant experience in credit industry compliance.
- Handle clients in-house, never referring them to a third party.
- Offer full disclosure of all program fees and costs before the start of a debt-settlement program.
- Inform customers that the IRS classifies any forgiven debt above \$600 as income that can be taxed.
- Require prospective clients to commit to saving money on their own to fund settlements.
- Don't handle or escrow money saved by clients because of the risk of embezzlement and fraud.
- Negotiate on an ongoing basis with creditors and present all settlement offers to the customer for his or her exclusive approval.

Was one of your New Year's resolutions to pay off debt? Here's some advice to help you reach your goal.

### When to steer clear

In addition, credit expert Gerri Detweiler of [UltimateCredit.com](#) says you should avoid any company that makes unrealistic promises, such as saying that you won't be sued or that it can stop creditors from calling you. (Debt-settlement companies can and do send "cease contact" letters, but they can't prevent creditors from ignoring these requests.)

Detweiler also said any of the following should be cause for concern:

**The company isn't a member of TASC.** [The Association of Settlement Companies](#), the largest trade association serving the debt-settlement industry, has strict industry standards to which its members voluntarily agree.

**Fees aren't based on performance or results.** Detweiler doesn't like companies that collect money up front or based on a percentage of your debt.

**Counselors are paid on commission.** Detweiler believes this increases the chances counselors will lie to get you in the door.

**No money-back guarantee.** You should have at least 30 days to change your mind and receive a refund of at least some of your fees if none of your debts are settled.

**Inexperience.** Many companies have sprung into existence recently and have little experience successfully negotiating settlements. Detweiler said, and I agree, that you shouldn't let them practice on you.

*Liz Pulliam Weston's new book, "Easy Money: How to Simplify Your Finances and Get What You Want Out of Life," is now available. Columns by Weston, the Web's most-read personal-finance writer and winner of the 2007 Clarion Award for online journalism, appear every Monday and Thursday, exclusively on MSN Money. She also answers reader questions on the [Your Money message board](#).*

**Published Jan. 5, 2009**

© 2009 Microsoft