THE TRUTH ABOUT DEBT CONSOLIDATION

LifeBack Law Firm, P. A.
Est. 1972
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formerly Kain & Scott

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INTRODUCTION

Financial struggles are some of life's most complicated and stressful situations. These difficult situations are very common. National Public Radio reported "Nearly 44 percent of Americans don't have enough savings or other liquid assets to stay out of poverty for more than three months if they lose their income, [...]. Almost a third have no savings accounts at all."

According to Nerd Wallet the US household consumer debt profile is as follows2:

- **Average credit card debt: $15,204**
- **Average mortgage debt: $148,818**
- **Average student loan debt: $33,005**

So if you are between a rock and a hard place with your finances, know you are not alone and there are options available to help you get out of your situation. Many in this situation turn to debt consolidation. In fact, between 2 and 2.5 million Americans consult a credit counselor every year to elude bankruptcy.3 However, this may not be the best alternative.

Financial terminology is confusing, contracts are complex, and creditors don't take the time to explain so you end up confused and unsure of exactly what you are getting into. The goal of this eBook is to clearly define debt consolidation and provide all details involved including those glossed over by creditors and debt consolidation companies. Additionally, we will introduce Chapter 13 bankruptcy and provide comparisons against debt consolidation options and justification for why this is a viable alternative to getting out of financial trouble. More often than not Chapter 13 is your best solution.

WHAT IS DEBT CONSOLIDATION?

Debt consolidation is a very confusing concept. The term itself can be used to describe a group of debt solutions but is also used synonymously as an individual option. For simplification purposes we are going to use the term 'debt consolidation' to describe the general concept of combining multiple unsecured debts into one.

There are four options commonly sought by those looking to get out of a difficult financial bind through debt consolidation.

1. UNSECURED DEBT CONSOLIDATION LOAN

An unsecured debt consolidation loan involves you taking out a personal loan and using it to pay off your unsecured debts. From that point on you will make one monthly payment toward this loan. This option is managed and executed by you; no help is provided from a third party company or professional.

To pursue this option you need a good credit score in order to be approved and secure a low enough interest rate. This type of loan is not secured against any asset or collateral thereby increasing the risk for lenders. You will need to prove you are responsible, trustworthy and capable of making full and timely payments. Additionally, the interest rate must be low enough to decrease your total monthly payments if it is going to be a worthwhile debt consolidation option.

This option doesn't eliminate your debt; an unsecured debt consolidation loan merely moves your debt from one place to another. It may simplify your payment process and give you some extra breathing room if you are able to lower your monthly payment. But if you are already in financial trouble, this may just lengthen an already stressful situation.

2. HOME EQUITY LOAN

A home equity loan functions the same as an unsecured debt consolidation loan but it requires you to secure the debt against your home. This reduces the risk of the lender because if you don't make payments they can take your house. The reduced risk also lowers the credit score requirement. Your credit score doesn't need to be great in order to be approved for a home equity loan.

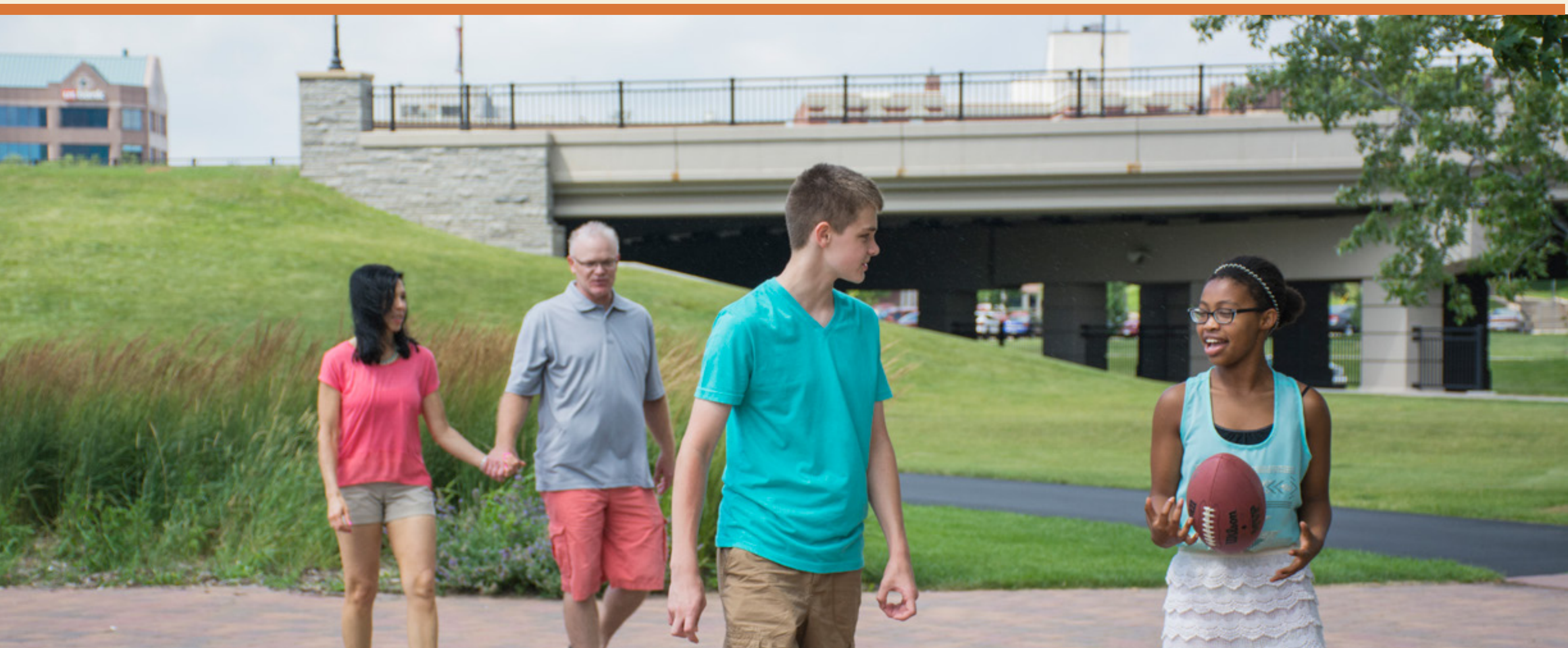
However, this is a highly risky option for paying off unsecured debt because you run the risk of losing your house. If you file Chapter 13 bankruptcy you will get to keep your home. This debt consolidation option is managed and executed by you with no third party involvement. It is not a recommended plan for dealing with financial difficulty.

3. DEBT SETTLEMENT PROGRAM

A debt settlement program halts all payments you are making to creditors and requires you to close your accounts. Instead you will make monthly payments (usually lower than your current payments) to a trust account. When that account is built up enough to pay off your debt the debt settlement program company will begin negotiations with your creditors. They will also attempt to negotiate a lower debt amount by offering to pay the new amount in full.

This option negatively affects your credit score because you have to close your accounts, work with a debt settlement company, and you don't pay your debts in full.

Furthermore, creditors do not have to comply with your debt settlement program; creditor participation is voluntary. A debt settlement program stops creditor harassment but cannot stop collection actions. Creditors still have the right to file a lawsuit against you or garnish your wages, for example.



4. DEBT MANAGEMENT PROGRAM

A debt management program enlists the help of a third party. You work with a debt consolidation company or credit counseling agency to consolidate your unsecured debts into one monthly payment. Essentially you will make one monthly payment to your debt consolidation company or credit counseling agency. They will disperse payments to creditors on your behalf. You do not need a good credit score to qualify for a debt management program.

This program does not erase your debt; it simply moves it into a program. You are still required to pay off your debt. You may be given lower monthly payments and time and distance from your creditors, however, the extended timeline often means you will end up paying more due to interest and fees. Although your debt management company has halted creditor harassment, creditors do not have to comply with your proposed program or negotiations and they can continue to perform collection actions.

Each debt consolidation option is dependent on your specific financial situation. Each option transfers your debt to another location in an attempt to make your short-term financial situation a little easier to handle. None of the above options eliminate your debt. You cannot (and should not) borrow your way out of debt.

The settlement and management programs enlist the help of a third-party which charge fees for their services. Often the amount you pay in third-party fees plus creditor late fees, penalties and interest rates add up to be more than the amount you are trying to save by enrolling in these programs. Fraudulent businesses and scams litter the debt settlement and consolidation industry making it difficult to find and trust reputable agencies and companies.

Before you enter into one of these options, consider a Chapter 13 bankruptcy. A Chapter 13 bankruptcy offers the same benefits as the options listed above, plus more.

CHAPTER 13

Chapter 13 bankruptcy, also called a "wage-earners" bankruptcy, is essentially a repayment plan based on what you can afford. It allows you to make payments based on your income. This plan is best for those who need to get their financial situation under control.

In a Chapter 13 you will create and propose a repayment plan that will span three to five years with monthly installments based on your ability to pay. Essentially, Chapter 13 acts like a consolidation loan by consolidating all of your debt and allowing you to make one payment. The added benefits include:

1. **COSTS LESS THAN DEBT CONSOLIDATION**
2. **GETS COMPLETED FASTER & TIMELINE IS SET**
3. **MONTHLY PAYMENTS ARE SET BASED ON WHAT YOU CAN AFFORD**
4. **CREDIT SCORE IMPROVES UPON DISCHARGE!**
5. **REQUIRES CREDITOR COMPLIANCE**
6. **REPUTABLE HELP**
7. **UNPAID DEBT IS ERASED FOREVER**
8. **PROTECTED IN THE FUTURE**

1. COSTS LESS THAN DEBT CONSOLIDATION

In traditional debt consolidation plans, most of your debt gets paid in full. For example, if you owe $50,000.00 in credit card debt, you might end up paying $50,000.00 plus some interest or $60,000.00.

In a Chapter 13 bankruptcy, if you owe $50,000.00 in debt but can only afford to pay $200.00 a month for 36 months (plan payments are based on your budget- your family eats first)(plan length is typically 36 months unless gross family income exceeds the median income then the plan length is 60 months), then your total payments into the plan is $7,200.00. What happens to the $42,800.00 that did not get paid off? That remaining debt is wiped out, forever, upon your discharge. Plus, any forgiven debt is not taxable in a Chapter 13 bankruptcy.

Why would anyone do traditional debt consolidation after reading this? We wonder ourselves!

2. GETS COMPLETED FASTER & TIMELINE IS SET

As soon as you see the benefit of filing a Chapter 13 bankruptcy vs debt consolidation, relief is literally only days away!

As soon as you file a Chapter 13 bankruptcy, your creditors are barred from collecting from you while you are in the bankruptcy.

Your Chapter 13 bankruptcy payment is based on what you can afford to pay creditors, not what they want you to pay them. So, your family eats first, your creditors second.

Once filed, you feel your life becoming manageable again because the payment made to creditors is controlled by rules set by the government, not creditors. This results in a plan payment you can live with.

3. MONTHLY PAYMENTS ARE SET BASED ON WHAT YOU CAN AFFORD

Want to make one payment back to your creditors based on what you can afford to pay? If so, a Chapter 13 bankruptcy is for you. Not only do you make a payment you can afford to pay comfortably, any remaining debt not paid off at the end, gets wiped out, forever, tax free! Now folks, this is the type of relief clients are looking for.

4. CREDIT SCORE IMPROVES UPON DISCHARGE!

Most people who file bankruptcy experience AN INCREASE in their credit score upon discharge. Why? Because when you receive a discharge, you have received a court order making you not liable for most unsecured debt. Thus, with less debt, your credit score rises immediately.

5. REQUIRES CREDITOR COMPLIANCE

Want to make one payment back to your creditors based on what you can afford to pay? If so, a Chapter 13 bankruptcy is for you. Not only do you make a payment you can afford to pay comfortably, any remaining debt not paid off at the end, gets wiped out, forever, tax free! Now folks, this is the type of relief clients are looking for.

6. REPUTABLE HELP

Unlike debt consolidation companies, there doesn't have to be any concern or hesitation when hiring help for debt relief when you turn to an attorney, one who focuses 100 percent on bankruptcy. All bankruptcy attorneys are regulated by the State Bar. You can be assured a bankruptcy attorney will act in your best interests. An attorney focused 100 percent on bankruptcy, will keep you involved every step of the way so you retain most decision making authority when it comes to your finances and your future.

7. UNPAID DEBT IS ERASED FOREVER

At the end of your repayment period, if any debt remains, it is eliminated*. If your monthly payments don't fully pay off all your creditors, you don't have to continue to make payments to them. When you've successfully completed your repayment period your liability for any unpaid debt disappears, forever, tax free!

In traditional debt consolidation, you either pay the debt in full, or pay taxes on any debt forgiven. Either way, your credit is bruised.

*NON-DISCHARGEABLE DEBTS INCLUDE CHILD SUPPORT, STUDENT LOANS, CRIMINAL FINES AND OTHER SPECIFIC EXCLUSIONS OUTLINED IN THE BANKRUPTCY CODE.

8. PROTECTED IN THE FUTURE

The court protects you from creditor collection in the future. Filing bankruptcy is a legal procedure and therefore your creditors are legally bound to the outcome of your case.
A court order will be issued to your creditors preventing them from collecting on your debt after your repayment period ends. Your creditors may NEVER, in the future, try to collect on a discharged debt; now that is peace of mind!

WHAT DEBTS ARE ADDRESSED?

There are two types of debt you can incur; secured and unsecured. Secured debt is backed by an asset or property belonging to a debtor. For example, a mortgage is a secured debt because your house is the collateral tied to your debt. Secured debts don't carry as high of a risk with lending because there is a physical asset tied to it. If you are unable to make payments, your creditor has the option to take your asset/property/collateral to sell and pay off the debt.

Unsecured debt, on the other hand, is not secured by anything, as its name suggests. Other than your agreement to make payments, unsecured debts do not have anything to hold against or take away from you if you are unable to make payments. Examples of unsecured debts include credit cards, medical bills and student loans.

Debt Consolidation

Unsecured debts are capable of being consolidated through a debt management program or paid through a debt settlement program. These programs save you from multiple monthly payments, dealing with multiple creditors and creditor harassment.

However, debt consolidation programs require you to pay your debt in full, and then some. An example will most clearly illustrate this concept.

Sally has $50,000 in unsecured debt. $15,000 is credit card debt at 15% interest and $35,000 in loans. Sally has two loans, one is a two-year for $10,000 at 12% interest and the other is a four-year for $25,000 at 8% interest.

Sally currently makes three monthly payments:

1. **$720 toward her credit card debt**
2. **$512 toward her two-year loan**
3. **$563 toward her four-year loan**

Her total monthly payments add up to $1,795. When all of her debt is paid off she will pay $56,592.

A debt consolidation company offers her a 7% interest rate and a drop in her monthly payment to $1,065. However, she is required to pay this amount for five years. At this rate she will end up paying $63,900.

If Sally chooses to move forward with the debt consolidation program she will end up paying over $7,000 more than if she just stuck with her three monthly payments. This is how the debt consolidation companies make money.

CHAPTER 13 BANKRUPTCY

A Chapter 13 bankruptcy handles debts differently than debt consolidation programs. You can include secured and unsecured debts in your bankruptcy petition and repayment plan.

In order for your repayment plan to be approved by the bankruptcy court, all debts and plans to pay certain amounts toward each debt must be detailed. This can get very technical and overwhelming but a bankruptcy attorney will help you develop a successful repayment plan. You must include plans to pay priority debt (e.g. taxes and costs of bankruptcy proceedings) in full, pay secured debt, at minimum, the value of the asset and pay unsecured debt up to the amount creditors would receive if your assets were liquidated.

The advantage Chapter 13 offers above debt consolidation programs is that the monthly payment set for your repayment period is based off what you can afford. Generally speaking a repayment plan will take your actual monthly income and subtract monthly expenses to determine what your monthly payments will be.

Sally is also considering a Chapter 13 bankruptcy for relief from her difficult financial situation. Sally has recently become a single mom of two. The loss of her husband's income has left her drowning in debt. Sally's income minus her necessary monthly expenses only leaves $400 a month for debt repayment.

If Sally chooses to file a Chapter 13 bankruptcy her repayment plan may extend five years with $400 monthly payments. At the end of five years at this rate she will have paid back $24,000. The remaining $26,000 gets eliminated tax-free and a court order is issued to prevent future creditor harassment and collection activity on this unpaid debt.

The amounts paid in Sally's debt consolidation and bankruptcy situations vary greatly. So the question becomes, why would anyone choose debt consolidation over Chapter 13 bankruptcy?

If you still aren't sure, keep reading for more advantages of a Chapter 13 over debt consolidation programs.

DEBT CONSOLIDATION PROGRAMS PROCESSES

DEBT MANAGEMENT PROGRAM

Every debt consolidation company handles debt management programs differently, but in general you can expect to experience the following steps.

1. NO-OBLIGATION FREE DEBT COUNSELING

This step is a counseling session with a consultant from a debt consolidation company. You will analyze your financial situation and complete an income vs. expenditure review. During this assessment you must ask the following questions:

- **Is debt consolidation right for me?**
- **Will it solve my financial problems?**
- **How much will I have to pay in fees?**
- **What is the tenure of the program?**

These points are often glossed over or ignored because they highlight the reality of the debt management program. Debt consolidation may not be right for you, this program may not solve your problems, the fees may be unmanageable and you may end up paying off your debt for years to come. You will not know unless you ask because debt consolidation companies don't regularly address these issues. And if the consultant cannot give you adequate answers, be hesitant about moving on to step 2.

2. ENROLL INTO DEBT MANAGEMENT PROGRAM

During this phase the consultant will send you documents to sign. You are responsible for understanding and interpreting the complex contract to know exactly what the debt management program will and won't do for you. These documents should also detail the debt consolidation company fees you will pay throughout the program. If you choose to sign the contract you are giving the consultant power of attorney. This means the debt management consultant may talk to your creditors on your behalf and your creditors should no longer contact you about your debt.

The debt consolidation company is able to stop creditors harassing you, but they have no power to prevent creditors from pursuing legal action or collection activities against you. This means your creditors can still file a lawsuit, garnish your wages, levy your bank accounts and more in an attempt to collect debts from you.

3. CONSULTANT BEGINS TO HANDLE CREDITORS ON YOUR BEHALF

This step is fairly self-explanatory. Your debt management consultant will contact your creditors and inform them you have enrolled in a debt management program. Any and all calls regarding your debt should be directed to your debt management consultant.

4. CONSULTANT NEGOTIATES WITH CREDITORS

Now your consultant will begin negotiating with creditors to try to get them to agree to a repayment plan. Your consultant will request the following from your creditors:

- **Reduced interest rates**
- **Reduced monthly payments**
- **Freeze, reduce or erase extra charges and late fees (in existence and future dues)**

Compliance or agreement to requests is completely voluntary for creditors. There must be value or benefits for creditors to agree to any of the above and your overall repayment plan. Your creditor may also request a review of your financial situation to ensure they are getting the maximum payment possible. This often means an extended repayment period so you have time to pay your debt in full.

5. YOU SEND MONTHLY PAYMENTS TO DEBT MANAGEMENT COMPANY

In a debt management program you will make monthly payments to the debt consolidation company. This amount will be set by your consultant based on your debt, added fees and timeline. Your consultant will disperse the funds to your creditors (assuming they have accepted your repayment plan) according to the repayment plan, often keeping some as payment (if your fee is a percentage).

6. CREDITORS RECEIVE YOUR PAYMENTS FROM DEBT MANAGEMENT COMPANY

After your payment is given to your creditors you will receive a creditor statement confirming receipt of payment.

The creditor has all of the power throughout this process. You are handing your debt and monthly payments over to a debt management company, trusting they will perform based on your best interests.

DEBT SETTLEMENT PROGRAM

A debt settlement program works a little differently than a debt management program. In a debt settlement program you will sign an agreement with a debt consolidation company to stop making monthly payments on your unsecured credit and close your accounts.

This is not good for your credit score. Every month you don't make monthly payments on your debt your credit score suffers.

Instead of making monthly payments to creditors you will make monthly payments into a trust account managed by the debt consolidation company. Once this account is large enough the debt consolidation company will begin negotiating with your creditors, offering to make a lump sum payment that will eliminate your debt. The company will request a lower amount in exchange for a one-time payment.

The benefit for creditors is that you (the debtor) and your lack of responsibility to pay off your debt will go away. However, you are subject to collection activities and legal action if a creditor chooses not to enter into your debt settlement program.

Negotiations with creditors don't start until your account has built up enough money to make a one-time payment. Generally speaking, people in debt aren't able to make large monthly payments so this account buildup could take a long time.

There is no determined tenure of a debt settlement program because it is dependent on your ability and the speed of which you can build up your trust account. The longer it takes the longer your credit score suffers.

The longer it takes you to build up your account and pay off all your creditors, the better it is for the debt consolidation company. This is because they usually take a percentage of your monthly payment as fees for their service.

WHAT DEBT CONSOLIDATION PROGRAMS DON'T TELL YOU

FINE PRINT OF DEBT CONSOLIDATION PROGRAMS

In order to receive debt relief from consolidation programs you need to know if the program will work for you and your future. Debt consolidation companies are very good at painting a pretty, simple picture of their programs by leaving out some details that are only described in the fine print of the contract.

EFFECT ON CREDIT SCORE

It is a common misconception that bankruptcy negatively affects your credit score. In fact, people often turn to debt consolidation programs because they don't want to harm their credit score by filing for bankruptcy. However, debt consolidation programs can harm your credit score, plus this misconception about bankruptcy was proven false above. Missed, late and lower payments plus closed accounts negatively affect your credit score; debt consolidation program's purpose revolves around these three conditions.

COSTS

Discussions about fees are brief or don't happen at all unless the debtor specifically asks about it. It is very easy for debt consolidation companies to take a percentage of your monthly payments without you noticing.

Timelines for payment often get extended in these programs to ensure you are making fair and adequate payments to all of your creditors. This results in you paying more because your repayment period is longer and the debt consolidation companies make more because they are receiving a percentage of your payments.

CREDITOR INVOLVEMENT

As you now know, creditor compliance with a debt consolidation program is voluntary. Debt consolidation companies do not have the power to prevent legal action taken by your creditors. These points aren't always made clear in discussions with debt consolidation companies.

Debt consolidation programs are appealing because they promise lower interest rates and lower monthly payments, but what they don't make obvious is that creditors don't have to participate. If the negotiations aren't appealing for your creditors they can turn down the requests for lower payments or reduced interest and fees and other plan requests.

During initial conversations your debt consolidation company will also highlight the fact that creditors will need to direct all communication through their company which will stop the harassment you are currently receiving. On the surface this seems great because creditor harassment is frustrating and stressful, but debt consolidation companies are conveniently leaving out the fact that creditors can still engage in collection activities and legal action to collect on your debt.

You should be prepared to ask questions about the fine print and how the specific debt consolidation program will solve your current financial difficulties. If the debt consolidation company is unable to provide sufficient answers to your questions or present viable solutions for your financial situation you should consider an alternative for debt relief.

CONCLUSION

CLIENT SERVICE & PREPARATION PROCESS

When you hire an attorney to help you through a very personal situation, you don't expect to get the same customer service your cable company provides. Your attorney should be your rock – your constant, consistent source of support, advice and comfort.

At Kain & Scott, the attorney you first meet with is YOUR ATTORNEY throughout the entire case. When you call the firm with questions on your case, YOUR ATTORNEY is the one who you will talk to – we never send you to different people that you don't know, and who likely don't fully understand your case.

WHAT YOU MEAN TO THE FIRM YOU HIRED

When you are going through this emotional period in your life the last thing you need to feel is that you are just a bother or just another filing for the firm.

Our employees and attorneys are trained to have first class customer service skills. From the moment you call us you'll notice something is different. We have a relaxed atmosphere – and that includes our attorneys. There are no stuffy big-shots here to intimidate you – even their dress has a casual-esque tone!

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