



## Debt Traps: The Good, the Bad, & the Ugly

Americans of all ages continue to struggle to reduce debts. While student loan debt continues to be a challenge for many Millennials, those 60 and older are the fastest growing age group with this type of debt. The average household credit card debt has hit new highs, and student loan debt now exceeds **\$1.3 trillion** (increasing by [\\$163,560 per minute](#)).

These trends have inspired more firms to advertise debt relief and help with improving low credit scores for those with debt problems. Debt collection is [big business](#) today, yet there's also a lot of confusion surrounding various services and a minefield of debt traps related to the predators providing them.

One of the major problems for consumers today is that many of the smaller firms fly under the radar of federal regulators monitoring these services, the [Federal Trade Commission](#) (FTC) and the [Consumer Finance Protection Bureau](#) (CFPB). See the latest [enforcement actions](#) taken by the CFPB toward all types of lenders and scam artists.

We covered this topic a few years ago, but have updated the information and resources to reflect the constantly evolving scams and the newest regulations to deal with them. While there are professional companies and scam artists in any industry, we've classified debt service providers as the good, the bad, and the ugly based on the overall solutions they offer, their tendency to mislead clients, and the predatory abuses common within that particular industry.



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### The Good: Credit Counseling Firms

Credit counseling firms are generally hired to help consumers manage and work out a debt reduction plan. There are major differences between firms in this diverse industry, so do your research and avoid the potential traps highlighted here:

- Most are non-profit organizations, but this is often misleading since their services – other than the initial consultation – are typically *not* free.  
**Example:** Randall was reeled in by a credit counseling firm promoting their “free” service, but ended up paying **\$9,500** to the firm throughout the length of his contract.
- Average fees can range from **10%-50%** of the total debt owed.
- They focus more on *debt consolidation*, but can sometimes negotiate lower payoff amounts (debt reduction).
- Claims to improve your credit can be misleading. Any debts that might be “forgiven” will create a tax liability for the borrower, and can remain as “unpaid” on a credit report for up to seven years.
- Many firms require clients to sign a *Debt Management Plan (DMP)* agreement, which clients cannot get out of until the debt is completely paid, which can last up to ten years.
- A DMP requires clients to close credit card accounts and not open new accounts, both of which can negatively affect the client's credit score for years.
- Borrowers are unable to obtain a mortgage or refinance their home while locked into a DMP contract.



**Example:** Sheila contacted a credit counseling firm to help eliminate **\$12,450** of old credit card debt. They wanted her to sign a DMP that could extend over the next seven years. She and her new husband wanted to purchase a home, so she contacted the lenders herself, negotiated lower payments, and was able to buy a home within 18 months.

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- **Caution:** Those who focus on student loan debt aren't always knowledgeable about the pitfalls of consolidation. Borrowers could miss out on lower [payment options](#), [special consolidations](#), or [debt forgiveness](#) programs on federal student loans. And remember, you can possibly lower your student loan payments yourself by using the [Repayment Estimator](#).

**Example:** Julia lost out on \$21,380 of debt forgiveness because of mistakes made by the credit counseling firm.

- Many will reach up-front agreements with creditors so the harassing phone calls will stop. This can be one of the biggest benefits of a credit counseling firm.
- Many require a minimum of \$5,000-\$10,000 in credit card debt before they'll accept a new client since they may also be paid by the credit card companies for debts collected.
- Counselors are responsible for paying creditors. Unfortunately, some fail to do so and flee with the client's money. Be sure to follow up with creditors to ensure timely payments are being made.
- Go to the [National Foundation for Credit Counseling](#) (NFCC) to locate a credit counselor near you, but keep in mind that just because they're listed with NFCC does not mean you're guaranteed to avoid the problems noted above. Proceed with caution, and be sure to ask a lot of questions before signing on the dotted line.

## The Bad: Credit Repair Firms

The credit repair industry has exploded over the past few years, and now exceeds over 100,000 firms nationally, according to IBISWorld. Let's take a look at the reality of many firms' operating tactics and the latest abuses in this field:

- Since their services typically do not include contacting creditors, they can't negotiate a lower payment, stop harassing phone calls, or prevent lawsuits.
- Credit repair firms send letters to credit bureaus to correct errors, but that's typically all they do. Many even contain fake or fraudulent information. See [FTC: Bogus Letters Earn an "F"](#).
- Many illegally charge up-front fees. The firm noted above charged \$40 million in illegal advanced fees for this service.
- Credit repair firms cannot change correct data, so if a score is low due to a foreclosure, bankruptcy, or tax lien, there's nothing they can do. Yet, many promise to fix the problem...for a fee.
- They often claim they can provide a new "credit identity" using a nine-digit CPN (Credit Profile or Privacy Number) rather than using a Social Security number.

The FTC reports this is a [scam](#), and those who use this type of false identity are committing a felony, which can result in a steep fine or prison sentence.

Some will even recommend that you establish an EIN to create a clean slate on your credit report. However, an EIN is an *Employer Identification Number*, and cannot be used as a substitute for your Social Security number.



**Example:** Bart paid \$625 supposedly for a new "identity," but quickly learned it was bogus. When he contacted the firm for a refund, their doors were closed and the phone was disconnected. These fly-by-night firms are very mobile; many move from city to city, which makes them hard to hold accountable for unethical or even illegal behavior.

- The [Credit Repair Organizations Act](#) (CROA) makes it illegal for credit repair firms to lie about what they can do for you, or to charge a fee before they've performed a service. For options to remedy abuse, see [FTC: CROA](#) or call 877.FTC.HELP.
- According to the FTC, you know you're seeing a clear [sign of a credit repair scam](#) when the company...
  - Requires an up-front fee
  - Insists you do not contact credit reporting agencies yourself
  - Encourages you to dispute every debt on your credit report, even if you know the information is correct
  - Tells you to give false information on credit or loan applications
  - Fails to disclose your legal rights when stating claims of what they can do for you
- You can repair errors yourself by going to [FTC: DIY Credit Repair](#).

**Example:** Josh contacted a credit repair firm to help him improve his credit score after his identity was compromised by malware on his computer. The firm was going to charge \$195 up front and \$89/month for 24 months for the service. Instead, he used the FTC guidelines to repair his credit himself. He spent a total of 21 hours, but saved over \$2,300!

## The Ugly: Debt Settlement Firms

Debt settlement firms are flourishing since many promise a quick fix to make bills “disappear.” While debt elimination could be helpful if it works, there are also significant risks:

- Those offering the service are generally for-profit companies or law firms.
- They promise to settle with creditors for much lower amounts than what is owed.
- Many illegally charge an up-front fee, plus a monthly fee, which can total up to **10%-50%** of the debt initially owed.
- Most recommend clients immediately stop communicating with creditors and cease making all payments. This is the worst strategy a borrower can use since these actions will trigger additional fees and penalties, defaults on loans, a lower credit score, and possible liens, garnishments, or an immediate lawsuit by the lender.
- While many claim they have special arrangements in place with creditors, this is generally not true. In fact, some creditors actually refuse to work with debt settlement companies.
- They can't stop harassing phone calls.
- Many claim that the collected amount – minus the fee charged by the firm – will go into a trust account in the client's name, but many clients are never able to access that money if they drop out of the program, especially when working with smaller firms.

**Caution:** If you were one of the thousands of clients of Morgan Drexen, who has now gone out of business, see this [CFPB report](#) for steps to collect the money in your trust account.

- Those offering to settle tax liens are most likely scam artists since an [offer](#) to settle for less than you owe is rare. This [FTC: Tax Relief](#) information states that most taxpayers don't qualify for the programs these fraudsters hawk, their companies don't settle the tax debt, some send no information to the IRS, and debtors end up further in debt.

**Example:** D’Nelle lost **\$1,600** to a debt settlement firm that promised to settle an old tax bill, but was told after months of follow-up that his situation didn't qualify for one of the “new” programs. In the meantime, the IRS added over **\$4,300** in penalties and fees to his outstanding tax balance.

- Any amount “forgiven” is considered taxable income.
- They often contact prospects through robo-calling, a practice that is now illegal.
- Since it can sometimes take years to build up enough to settle the debt, the FTC reports that most clients drop out of the program and eventually file bankruptcy...but are then even further in debt.



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We hope this will help those struggling with debt to be more informed when selecting the right firm. Go to these specific sites to learn more [FTC: Settling Credit Card Debt](#) and [CFPB: Debt Settlement Help](#). If you've been a victim of a dishonest firm, go to [FTC: Complaint Assistant](#) or [CFPB: Submit a Complaint](#).

“Debt is like any other trap, easy enough to get into, but hard enough to get out of.”

– [Henry Wheeler Shaw](#)



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