MODULE 6:

Dealing with debt

If you have a 10 minute session...	If you have a 30 minute session...	If you have multiple sessions...
▪ *Tool 2: Debt-to-income worksheet*	▪ *Tool 1: Debt worksheet* ▪ *Tool 5: When debt collectors call: Steps you can take*	▪ *Tool 3: Reducing debt worksheet* ▪ *Tool 4: Repaying student loans*

What is debt?

Debt is money you owe another person or a business. When you owe someone money, you have a liability.

When you owe money, you have to pay it back, sometimes in scheduled payments. You will often use money from your future income to make those payments.

While borrowing money may give you access to something today, you may have monthly payments for months or years to come. This obligation can decrease your options in the future.

Debt is different from credit. Credit is a complicated topic. For our purposes, credit is the

Student loan debt

For many people, student loans make up a big portion of the debt they owe. Sometimes people borrow more than they will be able to afford, given the likely pay they will earn in their profession. Sometimes people get into trouble because they don't understand the terms of their loans and the consequences of letting interest build up.

ability to borrow money. Debt results from using credit. You can have credit without having debt. For example, you may have a credit card on which you don't currently owe money because you paid the balance off and haven't made new purchases with it.

Good debt, bad debt?

Sometimes people label debt as "good" debt or "bad" debt. Some debt can help you reach your goals or build assets for the future. People will often say that borrowing for your education, for a reliable car, to start a business, or to buy a home can be a good use of debt.

But it's not always that simple. For example, **borrowing to further your education** may be a good use of debt because earning a certification or a degree may lead to a better paying job and more job security. But if you take on the debt and don't earn a certificate or degree that helps you get a better job, this student debt has set you back instead of helping you reach your goals.

Taking out a loan to get a reliable car to get to and from your job can help you pay your bills and save for goals. However, if you borrow 100 percent of the car's value, you may end up owing more than the car is worth. Or if you buy a more expensive car than you need, you'll have less money for other bills each month. While it may get you to work, it might keep you from getting to your financial goals.

Borrowing money to start a business may help create income for yourself and others. If the business fails, however, you may end up owing money and not having any income you can use to make the payments.

Finally, **taking out a loan to buy a home of your own** may be a way to reach your personal goals. But if you are unable to keep up with the payments or if you end up owing more than your home is worth, that debt may set you back for a long time.

That's why even debt that many people consider "good" should be approached with caution.

Some people consider loans such as credit card debt, short-term loans, and pawn loans "bad" debt. This is because they may carry high fees and interest, and when they have been used for things you consume (like meals out, gifts, or a vacation) they don't help build assets. But, these sources of debt can help cover a gap in your cash flow if you have a way to repay them.

So, there is no one type of debt that is “good” or “bad.” That’s why it’s important to first understand your goal or your need. Then you can shop for the credit you need, especially for large purchases like a car or a home, before you make your final decision on your purchase.

Secured and unsecured debt

Another way to understand debt is whether it is secured or unsecured.

Secured debt is debt that has an asset attached to it. When debt is secured, a lender can take that asset if you don’t pay. Here are examples of secured debt:

- A home loan – The debt is secured with the home you are buying. If you don’t pay your loan, the lender can foreclose on your home, sell it, and use the money from the sale to cover some or all of your loan.
- An auto loan – The debt is secured with your car. If you don’t pay your loan, the lender can repossess (repo) your car and sell it to cover some or all of the loan.
- A pawn loan – The debt is secured with the item you have pawned. The lender physically holds the item during the loan. If you don’t make the payment when it is due, the pawned item is eventually sold.
- A secured credit card – The debt is secured by funds you deposit at a bank or credit union. Your credit limit will generally equal your deposit. For example, if you deposit $300, your credit limit will be $300.

Unsecured debt does not have an asset attached to it. Here are examples of unsecured debt:

- Credit card debt from an unsecured card
- Department store charge card debt
- Signature loans
- Medical debt
- Student loans

If you do not pay these loans, since there is no asset to repossess, they often go directly to collections. For more information on student loan debt, see *Tool 4: Repaying student loans*.

In *Tool 1: Debt worksheet*, you can list all of your debts and determine whether they are secured or unsecured.

Debt-to-income ratio

The debt-to-income ratio is a simple calculation:

Total of your monthly debt payments ÷ monthly gross income (income before taxes)

The result is a percentage that tells you how much of your income is going toward covering your debt. For example, if you have a debt-to-income ratio of 36 percent, you have 64 cents out of every dollar you earn to pay for everything else, including all of your living expenses and taxes.

How much debt is too much?

One way to know if you have too much debt is based on how much stress your debt causes you. If you are worried about your debt, you may have too much.

A more objective way to measure debt is the debt-to-income ratio. The debt-to-income ratio compares the amount of money you pay out each month for debt payments to your income before taxes and other deductions. The resulting number, a percentage, shows you how much of your income is dedicated to debt – your debt load. The higher the percentage, the less financially secure you may be because you have less left over to cover everything else. Everything else is all of the other needs, wants, and obligations you pay each month that are not debt. These include:

- Rent
- Savings
- Taxes
- Insurance
- Utilities
- Food
- Clothing
- Childcare
- Recurring healthcare expenses, including medications
- Child support and other court-ordered obligations
- Charitable contributions and gifts
- Other family expenses

In *Tool 2: Debt-to-income worksheet*, you will determine what your debt load is. And if you find out that it is higher than you want, you can use *Tool 3: Reducing debt worksheet* to make a plan to get out of debt.

Rent-to-own arrangements

In rent-to-own arrangements for consumer goods such as furniture, fixtures, electronics, or appliances, you lease the items and typically have the option to purchase the item by continuing to make payments for some specified period of time, or by paying off the balance during the term of the lease. Items rented/purchased this way tend to be more expensive than items purchased outright. If the payments are not made as agreed, the lessor/seller can take the item back. You have the option to return the item at any time. If you return the item or the lessor/seller takes it back, you do not get a refund of money already paid. In most states, these transactions are treated as leases, but in some states they are considered credit sales under state law.

Co-signers: Agree to repay the loan

If you co-sign a loan, you should understand the extent of your obligation. A co-signer is a co-borrower and has the same obligation to pay a debt as the borrower. In most cases a lender or creditor does not even have to first attempt to seek repayment of a debt from the borrower before seeking repayment from you as a co-signer. Co-signing a loan is not simply serving as a character reference for someone else: a co-signer is at risk of having to repay any missed payments. And, if the borrower defaults on the loan, you as a co-signer have generally agreed to repay the entire loan. Your credit score may also be affected, for example, if the borrower is late with or fails to make any payments.

Co-signing a loan may also affect your ability to obtain a future loan because a creditor may take into account the increased amount of debt that you have as a result of co-signing for a loan.

Lenders sometimes ask for a co-signer when they are concerned that a prospective borrower will not be able to repay a loan. The co-signer helps decrease a lender's concern about repayment. If you decide to co-sign for a loan, you should read the terms of the loan and consider carefully before taking on the risk of co-signing.

Special protection for active duty servicemembers

There are special obligations on creditors under the Military Lending Act (MLA) for active duty servicemembers and their covered dependents. For example, as of October 3, 2016, the MLA caps certain credit costs on most types of consumer loans to an annual rate of 36 percent (referred to as the Military Annual Percentage Rate or “MAPR”).

Included in the MAPR are costs like finance charges, credit insurance premiums or fees, and additional fees associated with credit, such as application or participation fees, with some exceptions. These restrictions apply to most types of consumer credit, such as credit cards (beginning October3, 2017), payday loans, and deposit advance products. There are some exceptions, such as residential mortgages and certain secured loans for the purchase of personal goods and vehicles. Credit agreements that violate the MLA are void from the start.

Payday loans

A payday loan – which might also be called a “cash advance” or “check loan” – is a short-term loan, generally for $500 or less.

Payday loans generally come due on your next payday. You must give the lender access to your checking account by electronic debit (ACH) or write a check for the full balance in advance that the lender has an option of depositing when the loan comes due.

Depending on your state law, other loan features can vary. For example, payday loans are often structured to be paid off in one lump-sum payment, but interest-only payments – "renewals" or “rollovers” – are not unusual. In some cases, payday loans may be structured so that they are repayable in installments over a longer period of time. These installments are typically due on the consumer's payday and with the lender generally having the ability to automatically collect payments from the consumer's bank account by means of depositing post-dated checks or ACH authorizations. Loans like this are offered at a traditional storefront payday lender or online.

Some ways that lenders might give you the loan funds are providing cash or a check, loading the funds onto a prepaid card, or electronically depositing the money into your checking account.

The cost of the loan (finance charge) may range from $10 to $30 or more for every $100 borrowed. A typical two-week payday loan with a $15 per $100 borrowed fee equates to an annual percentage rate (APR) of almost 400 percent. By comparison, APRs on credit cards can range from about 12 percent to 30 percent.

State laws and other factors can influence how much you can borrow and the fees you are charged. Some state laws do not permit payday lending and in other states lenders may choose not to do business.

How do payday loans work?

Here is an example of how a 14-day payday loan generally works:

Borrower visits a storefront payday lender and completes an application. (There is generally no traditional credit check or consideration of ability to repay the loan; the borrower only needs a bank or credit union account, so he can write a post-dated check or provide electronic access to the account. Lenders periodically require a borrower to provide a paystub or benefits receipt.) Loans can also be taken out online.

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Borrower gets loan (the median loan amount is $350) and pays $10-$30 per $100 borrowed ($15 per $100 is the median fee for storefront payday loans).

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The borrower provides the lender with 14-day post-dated check for the amount of the loan + the fee ($350 + $52.50 = $402.50) or authorization to take the money out of the borrower's bank or credit union account.

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In 14 days, the loan is due. Often, the borrower does not have $402.50 to satisfy the debt. Instead he will pay the fee again ($52.50) and renew the loan for another 14 days.
(Note: 14 days is used for example purposes only. Repayment may fall on the next payday or another minimum period as specified by state law.)

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Every 14 days, the borrower must pay the full amount or renew the debt by paying another fee of $52.50. The average borrower takes out five loans in a row before repaying (and not borrowing again shortly thereafter). Applied to this loan example, that would mean a fee of $262.50 to borrow $350.

If you are thinking about using a payday loan, it's important to be aware of co**mmon misunderstandings** and the facts about payday loans.

- Consumers only use payday loans for emergencies.

  Fact: Most borrowers do not use their first loan for emergency expenses. The Pew Charitable Trusts' Payday Lending in America[35] found that 69 percent of first-time borrowers use the loan to pay for regular bills, while only 16 percent use them for emergencies such as a car repair.

- Borrowers can pay back the loan without reborrowing.

  Fact: While they may pay it back on time, many borrowers have to either immediately take a new loan or take another one in the same pay-period. The Pew Charitable Trusts[36] found on average, payday borrowers are in debt for five months out of the year and pay an average of $520 in fees on top of the money they have borrowed.

Avoiding debt traps

If you are considering short-term loan products to meet an immediate need, it's important to avoid debt traps so they don't stop you from reaching your goals. Short-term loans that have to be paid back in just one payment or a couple of payments may lead to a debt trap.

A debt trap is a situation in which people take a loan and have to repeatedly take new loans to make the payment on the first loan. For many people, it can become difficult to escape the cycle of borrowing to cover the loan payment and still be able to pay for other expenses like food, rent, and transportation.

A debt trap can happen when people use short-term loans that have to be paid back in just a couple of payments, and they do not have the money to repay the loan and the finance charges when they are due. These loans have many things in common. They:

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[35] The Pew Charitable Trusts State and Consumer Initiatives. Payday Lending in America. October 2013. http://www.pewtrusts.org/en/multimedia/data-visualizations/2012/payday-lending-in-america.

[36] Ibid.

- Are small dollar loans – generally under $500
- Must be repaid quickly – 14 days is a typical payday loan term, for example
- Require you to give the lender your bank account information, so that the lender can automatically take payment from your bank account if you fail to pay back the loan

Make sure you understand how your loan will be repaid and how much the loan could ultimately cost you before agreeing to use this form of credit. If you find that you cannot make your loan payment and cover your other expenses without taking a new loan, ask the provider for a repayment option that gives you more time to pay off the loan.

Alternatives to high-cost credit

There are ways to avoid the risk of a debt trap if you're in a situation where you need money quickly.

If you are short on cash, consider some alternatives:

- Use your own emergency savings.
- Use lower-cost short-term loan alternatives from a credit union or bank.
- Borrow from a friend or family member.
- Use a credit card – while it will increase your monthly card payment, it could be cheaper in the long run.
- Negotiate for more time to pay if the loan is for a bill that is due.
- Think about what you are borrowing the money for. Is it a need, an obligation, or a want? If it's a want, consider whether it's possible to spend less money for it, not purchase it, or wait until you have the money for it.

Consider this scenario using different options for taking care of an emergency expense. It looks at the costs of paying for an unexpected auto repair with emergency savings, a credit card, or a payday loan.

COST OF UNEXPECTED AUTO REPAIR= $350

Cost information	Emergency savings	Credit card	Payday loan
Amount needed	$350	$350	$350
Annual Percentage Rate (APR)	None	15.99 percent APR	$15 for every $100 borrowed for 14 days – This means a 391 percent APR.
Repayment terms	None	Must pay at least a certain amount each month – For the purposes of the example, we are choosing a fixed monthly payment of $25.	Must pay back loan amount ($350) plus fee ($52.50) within 14 days
Total interest and fees	$0	$40 over 16 months	$52.50 for every 14-day loan
Time to repay	None	16 months[37]	14 days
Total cost of auto repair	$350	$390	$402.50

The total cost of a payday loan depends on how long it takes you to save up to pay back the entire loan. In the example above, if you renew or roll over this loan four times, you would be in debt for 10 additional weeks and could pay up to $262.50 in fees plus the $350 you borrowed, for a total of $612.50. The average borrower takes out five loans in a row before repaying (and not borrowing again shortly thereafter). [38]

[37] Most credit card companies allow customers to pay a percentage of the amount owed, which makes the minimum payment vary from month to month. To pay off this credit card balance in full, the individual will have to make $25 payments for 15 months, and then pay just over $15 in the sixteenth month.

[38] See the CFPB's *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products*, June 2016: http://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf.

Dealing with a debt collector

Often people find out they have a debt in collection when they receive a letter or phone call from a debt collection agency. Sometimes, they don't remember owing a debt, so they are surprised when they find out that a debt is in collection.

Debt collectors use persuasive techniques to get you to send in money to pay your debt. Before you send in money, you should confirm that you actually owe the debt. You should also confirm that the collection isn't fraudulent and is legitimate.

You may be able to confirm this information during an initial or follow-up discussion with the debt collector, but be careful of fraudulent debt collectors. Make sure that you recognize the debt, and confirm that you have not already paid it.

When the phone rings…

Sometimes it's hard to know if a caller is really a debt collector. To avoid falling victim to a scam, ask for the name, number, and address for the debt collector and request information about the debt in writing.

Be wary of sharing your personal information by phone. If a stranger asks for your Social Security number, date of birth, or bank account information, this can be a red flag.

Many people know they do owe the debt and are able to confirm that the collector is the right person to pay when they receive the first phone call or letter. If you are sure it is your debt and that you haven't paid, paying right away can benefit you because it allows you to resolve the matter. If you pay the debt, it's important to request a receipt so that you have a record confirming that you paid the debt.

If you are uncertain that the debt is yours or that the collector has the authority to collect it, you can ask the debt collection agency to verify the debt. You can do this by sending a letter within 30 days of the debt collector's providing you with certain information regarding the debt. That information includes the name of the creditor, the amount owed, and statements concerning how to dispute and seek verification of the debt. Use the sample letters in *Tool 5: When debt collectors call: Steps you can take.*

Even if the debt may be yours, the Fair Debt Collection Practices Act (FDCPA) gives you the right to tell the debt collector to stop contacting you. Once you make this request, the collector can contact you to tell you that they will stop. Or they may notify you that they or the creditor plans to take other action (for example, file a lawsuit against you). After that, they must stop all contact by phone, mail, or otherwise. **Stopping contact does not cancel the debt.** The debt collector can still sue you and can still report your debt to the credit reporting companies (Equifax, Experian, and TransUnion).

You can ask a debt collector to stop contact at any time, so keep in mind that you could ask them for more information first.

What to do if a debt collector sues you

If you're sued, you should respond to the lawsuit. You can respond by filing a written “answer” yourself or through an attorney, but you must do so by the date specified in the court papers. When you answer the lawsuit by denying that you owe the debt or some part of it, the debt collector must show the court evidence that proves you owe the debt.

Tip: If you dispute the debt or the amount owed, you should do that in the court action before the court makes a judgment. You may lose the ability to dispute that you owe the debt if a court issues a judgment against you.

Judgments against you give creditors and debt collectors much stronger tools to collect the debt from you. Depending on your state’s laws, the creditor or debt collector may be able to:

- Garnish your wages
- Place a lien against your property (that may prevent you from selling it or getting a loan against your property)
- Garnish or freeze the funds in your bank account
- . While there is an appeal process after a judgment has been entered, you have a much better chance to fight a collection in court if you defend the case before the court decides the case and enters a judgment against you. In other words, don’t ignore the lawsuit – respond to the court documents.

Don’t ignore court documents

You won’t be able to stop a lawsuit by a debt collector by refusing to accept service of the lawsuit or by refusing to sign the receipt that shows you got the lawsuit. By doing these things you’ll essentially be ignoring the lawsuit. If you ignore a lawsuit, it's likely that a judgment will be entered against you for the amount the creditor or debt collector claims you owe. Often the court also will award additional fees, including attorney fees, against you to cover collections costs.

If you would like to speak with an attorney about a debt collection lawsuit, you can learn how to find a lawyer at http://www.consumerfinance.gov/askcfpb/1433.

Your rights in debt collection

Debt collectors may not harass, oppress, or abuse anyone they contact. They are not allowed to:

- Call repeatedly or continuously to annoy, abuse, or harass you or any person at the called number
- Use obscene or profane language
- Threaten to use physical violence or to harm anyone's reputation or property
- Publish lists of people who refuse to pay their debts (Reporting correct information to a credit reporting company is legal.)
- Call you without telling you who they are
- Make false threats that they may have you arrested
- Lie or mislead you

It's illegal for a debt collector to misrepresent the amount owed, to falsely claim to be an attorney, or to threaten to do things that cannot legally be done or that the debt collector has no intention of doing.

Tip: It is a good idea to keep a file of all letters or documents a debt collector sends you, and keep a copy of anything you send to a debt collector. If you send in proof of payment, send only a copy and keep your original. Record the dates and times of your conversations and take notes about what you discussed. These records can help you if you have a dispute with a debt collector, meet with a lawyer, or go to court. You can submit a complaint to the Consumer Financial Protection Bureau about problems with debt collection, regardless of whether it's a debt on a credit card, mortgage, or anything else. To submit a complaint, go to http://www.consumerfinance.gov/complaint or call 855-411-CFPB (2372).

Medical debt[39]

For many Americans, a large portion of the money they owe is medical debt. Thirty-six percent of working age adults in America reported having trouble paying medical bills in 2014.[40]

Medical debt has increasingly been a major factor in the decline in credit scores for some individuals. And medical debt is becoming a greater factor in the decision to file for bankruptcy, as people find that they could make ends meet were it not for their medical debts.[41] The majority of individuals who filed for bankruptcy due to medical debt had health insurance.[42]

Once people have medical debt, they are much less likely to seek medical care.[43] This can increase the amount that patients spend on treatment because their conditions may become worse – and more expensive – by the time they get medical care.

What are the factors that can lead to medical debt?

Medical debt is almost always the result of someone suddenly becoming ill or injured. Even with health insurance, co-pays and deductibles can add up. This is one reason that emergency savings is important.

Secondly, the cost of care is almost never fully known upfront. Unlike the cost of a house or car, where you should know what you will pay when you sign the loan agreement, when you accept responsibility for payment of your treatment at a hospital or other medical provider, you generally have no idea how much the treatment will cost. You may also not know your share of the cost.

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[39] For more information on medical debt and its impact on consumers, see the CFPB's *Consumer Credit Reports: A study of medical and non-medical collections* at http://www.consumerfinance.gov/reports/consumer-credit-reports-a-study-of-medical-and-non-medical-collections.

[40] Collins, Sara R., Rasmussen, Perta W., Doty, Michelle M., and Beutel, Sophie. *The Rise in Health Care Coverage and Affordability Since Health Reform Took Effect*, The Commonwealth Fund, January 2015. See: http://www.commonwealthfund.org/publications/issue-briefs/2015/jan/biennial-health-insurance-survey.

[41] Associated Press, *New Medical Billing Standards*, February 13, 2014. See http://bigstory.ap.org/article/new-billing-standards-help-patients-debt.

[42] See http://www.cnn.com/2009/HEALTH/06/05/bankruptcy.medical.bills.

[43] Kalousova, Lucie and Burgard, Sarah A. *Debt and Forgone Medical Care*, University of Michigan Institute for Social Research, July 2012.

Invoices and bills may be confusing. In situations where you are treated by multiple health care providers, you may receive several bills rather than one itemized bill – and these bills may be sent over a period of weeks or months. This causes confusion because it may be harder to recognize the charges contained in each bill. You may hesitate before paying or delay payment because you have questions about the amount covered by insurance or the treatment you're being charged for.[44]

Unless you know how much the treatment should cost, how much the insurer will cover, and how much you will be responsible for paying, it's difficult to figure out whether you are being charged the right amount. This means that you must review each medical bill carefully and contact providers or insurers when you have questions.[45]

Uninsured individuals are generally charged more for services. Insurance companies negotiate discounts for services. This means that if you are uninsured, your bill will likely be higher than the bill that someone who has insurance receives for the same procedures and care.

What you can do to avoid medical debt

While there are no easy answers, there are specific things you may be able to do to lessen the impact of medical debt:[46]

- **Get health insurance.** When you choose a plan, think about both the cost of the monthly premium and the out-of-pocket costs, such as deductibles, co-pays, and co-insurance. While a plan with higher out-of-pocket costs may save you money on monthly premiums, if you or someone in your family needs to go to the doctor or hospital, you

[44] See Consumer Financial Protection Bureau, *Consumer credit reports: A study of medical and non-medical collections*, December 2014. See http://www.consumerfinance.gov/reports/consumer-credit-reports-a-study-of-medical-and-non-medical-collections.

[45] See Consumer Financial Protection Bureau, *Consumer credit reports: A study of medical and non-medical collections*, December 2014. See http://www.consumerfinance.gov/reports/consumer-credit-reports-a-study-of-medical-and-non-medical-collections. The Healthcare Financial Management Association (HFMA) notes, "There is confusion among healthcare consumers about how to obtain clear, understandable pricing information. The differences among healthcare charges and prices and the widespread variations in service, quality, and outcomes all are shrouded in an air of uncertainty and complexity. The all-too-common result is misunderstanding." (Brian Workinger, *Front-Line Perspectives on price Transparency and Estimation*, HFM Magazine, Sept. 2014).

[46] Ibid.

may have to pay more for those services than you would with a different type of plan.[47] Visit https://www.healthcare.gov to find out more about your options for health insurance.

- **Get cost estimates up front** before deciding whether to proceed.
- **Find out if there's a prompt payment discount**, which can be substantial. This may mean cutting back in other areas for a few months in order to pay the bill and secure the discount.
- **Ask for a discount.**
- **Ask about "charity care"** from the hospital before or immediately following treatment. Applications are usually available at the intake desk and online. Remember: you may have a limited time to request charity care, so submit your application as soon as possible.
- **If you are asked to put a hospital bill on a credit card, watch out.** Many hospitals have some obligation to provide for charity care for those who can't afford treatment. Once you put your hospital bill on a credit card, you might not be eligible for the charity care program. Some medical providers even offer a credit card for you to use at the provider's office. Healthcare credit cards can have tricky terms, so make sure you know what you're getting into before you decide to use one.[48]
- If you can't afford to pay for the care even after charity care and discounts have been applied, **take steps to work with the provider to set up a reasonable repayment plan.** Get your repayment plan agreement in writing and request the following terms:
    - No interest on the debt
    - Monthly statements showing the amount paid and the outstanding balance

[47] For definitions of insurance terms and tips on using insurance coverage, see the U.S. Department of Health and Human Services *From Coverage to Care: A roadmap to better care and a healthier you* at https://marketplace.cms.gov/outreach-and-education/downloads/c2c-roadmap.pdf.

[48] For tips on healthcare credit cards, see http://www.consumerfinance.gov/about-us/blog/whats-the-deal-with-health-care-credit-cards-four-things-you-should-know.

- That the debt servicing stays with the healthcare provider and not be turned over to a third-party collection agency
- An agreement that you do not have to make full payment right away if you are late or miss a payment on your plan.

- **If you're insured as a Qualified Medicare Beneficiary** (QMB) and you receive an incorrect billing statement charging you for services that are covered by Medicare, you may want to dispute the bill. Remember to explain in your written dispute that as a QMB you have no legal obligation to make further payment for these costs. You can find more information about disputing a debt and a sample dispute letter in *Tool 5: When debt collectors call: Steps you can take*.
- **Check your credit report** to make sure debts you have paid are reported accurately and any errors are removed from your credit history. If the credit reporting company doesn't respond, contact your state's consumer protection agency, attorney general, or the CFPB.
- **If you do get sued by a medical service provider or hospital, respond.** Get legal assistance from the legal aid organization in your community or other lawyer.

Student loan debt

The CPFB has a section on its website dedicated entirely to helping you plan for ways to pay for education and training after high school. In fact, these tools will help you think through the entire process of planning for and paying for school, including:

- Choosing a loan
- Comparing financial aid packages and college costs across more than one school
- Managing your money while in college
- Repaying your student loans

If you have student loan debt, start with the Repay Student Debt section of the webpage, which can be accessed at http://www.consumerfinance.gov/paying-for-college/repay-student-debt.

Should you use a debt settlement service?

Debt settlement companies say they can renegotiate, settle, or in some way change the terms of your unsecured debt to a creditor or a debt collector. That may include reducing the balance, interest rates, or fees you owe. You can try to do this yourself by contacting your creditors. Debt settlement companies often charge expensive fees, and some charge illegal up-front fees. Some debt settlement companies advertise that they will help consumers, but they provide little or no assistance.

You should avoid doing business with any company that promises to settle the debt if the company:

- Charges any fees before it settles your debts.
- Touts a "new government program" to bail out personal credit card debt.
- Guarantees to you that it can make the debt go away.
- Tells you to stop communicating with the creditors.
- Tells you it can stop all debt collection calls and lawsuits.
- Guarantees that the unsecured debts can be paid off for pennies on the dollar.

Tool 1:

Debt worksheet

Before you can make a plan for your debt, you have to know where you stand. You can start by making a list of **who you owe money to and how much you owe them**. This is the first step in managing and reducing your debt.

Be sure to include debts owed to friends and family, credit card companies, banks, department stores, payday lenders, for court-ordered child support payments, and to local, state, or federal government for things like property taxes, student loans, and back income taxes.

To complete this worksheet, you may need to get all of your bills together in one place. For each debt, you will need to know:

- The person, business, or organization you owe money to
- The amount you owe them
- The amount of your monthly payment, which includes the principal, interest payments, and any fees you may owe
- The interest rate you are paying and other important terms

Debt worksheet

Use this worksheet to list who you owe money to and how much you owe them. This is the first step in managing and reducing your debt.

Type of debt	Lender	Total amount borrowed	Amount still owed	If secured, by what?	Interest rate	Payment due date	Total payment amount	Notes
Mortgage								
Vehicle loan								
Appliance / furniture loan								
Student loan(s)								
Credit card 1								
Credit card 2								
Payday loan								
Car title loan								
Other								
Other								

Total monthly debt payment: $______________________________

Tool 2:

Debt-to-income worksheet

Your debt-to-income ratio is like your blood pressure. Your blood pressure measures the amount of pressure on your heart; your debt-to-income ratio measures how much pressure debt is putting on your budget.

The debt-to-income ratio is a simple calculation. It is the total of your monthly debt payments divided by your monthly gross income. Gross income is the amount of your income before any taxes or other deductions are taken.

The result is a percentage. That tells you how much of your income is going toward covering your debt. Another way of seeing the debt-to-income ratio is that it represents how much of every dollar you earn goes to cover your debt.

For example, if your debt-to-income ratio is .45, or 45 percent, then 45 cents out of every dollar you earn goes toward your debt. This leaves you with 55 cents of every dollar to cover your rent, taxes, insurance, utilities, food, clothing, child care, and so on.

In addition to using the debt-to-income ratio to measure how much pressure debt is putting on your budget, you can also use it as a benchmark if you take steps to reduce your debt. As you pay down your debts, your debt-to-income ratio will also decline. This means money is being freed up to use on other things like saving for your goals, unexpected expenses, and emergencies.

✎ Figure out your debt-to-income ratio

Your total monthly debt payment (from Tool 1)	
Divided by **your monthly gross income** (Income before taxes)	
Equals **your current debt-to-income ratio**	

Understanding your debt-to-income analysis

If your debt-to-income ratio is higher than a certain percentage, it could be difficult to pay all your monthly bills because so much of your income will be going to cover debts. A high debt-to-income ratio may also impact your ability to get additional credit because creditors may be concerned that you wouldn't be able to handle their debt on top of what you already owe.

The following debt-to-income ratio ranges are guidelines, not rules. In fact, many creditors set their own rules. What is an acceptable level of debt to one creditor may not be to another.

- **For renters: Consider maintaining a debt-to-income ratio of 15-20 percent or less.**
  - This means that monthly credit card payments, student loan payments, auto loan payment, and other debts should take up 20 percent or less of your gross income.
  - If you have court-ordered, fixed payments, such as child support, count these as debt for this purpose.
- **For homeowners: Consider maintaining a debt-to-income ratio of 28-35 percent or less <u>just for the mortgage (principal and interest), taxes, insurance, and condo or homeowner association fees.</u>**
- **For homeowners: Consider maintaining a debt-to-income ratio for all debts of 36 percent or less.**
  - This means that if you have a mortgage and other debts – credit card payments, student loan payments, auto loan payment, and other loan payments – your debt-to-income ratio should be below 36 percent. Some lenders will go up to 43 percent or higher for all debt.[49]
  - If you have court-ordered, fixed payments, such as child support, count these as debt for this purpose.

[49] See https://www.fha.com/fha_requirements_debt.

If your debt-to-income ratio is above these limits, you may want to use *Tool 3: Reducing debt worksheet* to develop a plan to reduce your debt and lower your debt-to-income ratio.

Tool 3:

Reducing debt worksheet

There are two basic strategies to reduce your debt: the highest interest rate method and the snowball method. Look through the pros and cons for each method and decide what works best for you.

Highest interest rate method

Focus on the unsecured debt with the highest rate of interest, and eliminate it as quickly as possible, because it is costing you the most. Once it is paid off, focus on the next most expensive debt.

PRO	CON
You eliminate the most costly debt first. In the long-run, this method can save you money.	You may not feel like you are making progress very quickly, especially if this debt is large.

Snowball method

Focus on the smallest debt. Get rid of it as soon as possible. Once you have paid it off in full, continue with the payment, but now dedicate it to the next smallest debt. This way, you create “a snowball of debt payments” as you eliminate each debt. How? You keep making the payments, but you are redirecting them to the next debt as each debt is paid off.

PRO	CON
You may see progress quickly, especially if you have many small debts. For some people, this creates momentum and motivation.	You may pay more in total because you are not necessarily eliminating your most costly debt first.

✎ Debt reduction worksheet

Step 1: Pick your debt reduction strategy:

- ☐ **Highest interest rate method:** List your debts from highest interest rate to lowest.
- ☐ **Snowball method:** List your debts from smallest to largest in terms of the amount you owe.

Step 2: In the column labeled Extra Payment, list the extra payment you will dedicate to the payment of debts until you have it paid off.

Step 3: When this debt is paid off, allocate the entire payment (monthly payment + extra payment) you were making to the next debt on the list.

Lender	Total amount borrowed	Amount still owed	Monthly payment	Extra payment	Payment due date	Date paid off in full

Tool 4:

Repaying student loans

Repaying student loans

There are two general types of student loans: federal student loans and private student loans. **Federal student loans** are loans funded by the federal government. Older federal student loans may have been made by private lenders and guaranteed by the federal government. No federal student loans have been made by private lenders since 2010. **Private student loans** are nonfederal loans made by a lender such as a bank, credit union, state agency, or a school.

With both federal and private student loans, delinquent payments will impact your credit report and may result in collections. Private student loans do not generally offer the widely available, flexible repayment terms or borrower protections featured in federal student loans.

Federal student loan repayment

There are many options for paying back federal student loans. **Do not ignore student loan paperwork** – nonpayment and delinquency reduces options for repayment plans, as many repayment plans require loans to be in good standing to qualify. Not all loans are eligible for all repayment plans. Below is a summary of some of the repayment options.

- **Standard repayment** – Most borrowers start with this payment plan. This repayment plan has fixed payments of at least $50 per month for up to 10 years.
- **Income-based repayment (IBR)** – Payment is limited to 10 or 15 percent of discretionary income, which is the difference between your adjusted gross income and 150 percent of the Federal Poverty Guidelines. Payments change as income changes, but will never be higher than the standard payment amount. The length of repayment can last up to 25 years. After 20 or 25 years of consistent payment (you have missed no payments or caught up with payments), the loan will be forgiven. You may have to pay income tax on the portion of the loan that is forgiven. To qualify for this repayment plan, you must be able to show partial financial hardship.

A similar IBR plan is available to borrowers who received their first Direct Loans on or after July 1, 2014. The monthly payment cannot exceed 10 percent of your discretionary income, and the maximum repayment term is 20 years. This option is available only for borrowers with federal Direct Loans.

- **Pay As You Earn (PAYE)** – Payment is limited to 10 percent of discretionary income, but will never be higher than the standard payment amount. Payments change as income changes, and the length of repayment can last up to 20 years. After 20 years of payments, the loan is forgiven, and taxes may be owed on the amount forgiven. To qualify for PAYE, you must be able to show partial financial hardship. PAYE is only available for borrowers with federal Direct Loans.

- **Revised Pay As You Earn (REPAYE)** – Payment is limited to 10 percent of discretionary income, but may be higher than the standard payment. Payments change as income changes, and the length of repayment can last up to 20 or 25 years. After 20 or 25 years of payments, the loan is forgiven, and taxes may be owed on the amount forgiven. REPAYE is only available for borrowers with federal Direct Loans.

- **Graduated repayment** – The payment is lower the first year and then gradually increases every 2 years for up to 10 years.

- **Extended repayment** – The payment is fixed or graduated for up to 25 years. The monthly payments are lower than the standard or graduated repayment plans, but you will pay more interest over the life of the loan(s). You must have at least $30,000 in outstanding Direct Loans to qualify for extended repayment.

You may also qualify for **deferment** or **forbearance** in certain circumstances. In deferment, payment of both principal and interest is delayed. If you have a subsidized federal loan, the government pays your interest during the deferment. If you have an unsubsidized loan, you must pay the accruing interest or it will build up. When interest builds up on student loans, it may be capitalized, which means it becomes part of the principal loan amount that you owe. This means you will ultimately end up owing more and paying interest on the interest.

Deferments are only granted for specific circumstances including:

- At least half-time enrollment in college, trade school, a graduate fellowship, or a rehabilitation program for individuals with disabilities

- Unemployment

- Certain periods of military service
- Times of economic hardship
- Peace Corps service

Forbearance means that you stop paying or pay a lesser amount on your loan for up to 12 months.[50] Like deferment, interest continues to build up during forbearance, even on subsidized federal loans.

When applying for a different repayment option, be sure to continue making your loan payments under your current payment schedule until you receive written notification that you have been approved. This ensures your loan continues to be in good standing.

Finally, you may also apply for **loan forgiveness**, **cancellation**, or **discharge** in certain situations, including:

- Total and permanent disability
- Death (someone would apply on your behalf after you die)
- Closed school
- Teacher loan forgiveness (if you are a teacher working in certain educational settings)
- Public Service Loan Forgiveness (after making 120 consecutive loan payments while working in the public service sector)

Except in the above circumstances, it is very difficult to eliminate federal student loan debt, even in bankruptcy. If you are interested in filing for bankruptcy and have federal student loans, you may want to talk with a bankruptcy lawyer.

Private student loan repayment

Private student loan repayment options are generally more limited. Private lenders may offer forbearance options and alternative repayment plans, including plans where payments start low and gradually rise over the loan term (known as "graduated payment plans"). Some private lenders may also modify loans based on borrowers' financial circumstances, on a case-by-case

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[50] See https://studentaid.ed.gov/sa/repay-loans/deferment-forbearance#what-is-deferment.

basis. Finally, lenders may agree to cancel or forgive debt upon the death or disability of a borrower. To learn more about these options, contact your student loan servicer.

It's important to note that unpaid federal student loans can be collected in special ways, but private student loans cannot. For instance, the Department of Education can garnish some federal benefits, such as Social Security and certain Veterans' Assistance benefits without a court order. If you are afraid that your federal benefits could be garnished to pay off federal student loans, consider talking to a lawyer. Although private student loan collectors cannot garnish your federal benefits, they can sue you in court to try to collect the remaining debt.

Tool 5:

When debt collectors call: Steps you can take

Ask for more information

If you have questions about the debt, ask the debt collection agency for specific information before you send money or acknowledge the debt. You can do this by sending a "verification letter," asking the debt collector to provide you with certain information regarding the debt. The letter you receive from the debt collector should contain a notice about your right to request more information about the debt.

The notice should include the name of the creditor, the amount owed, and statements concerning how to dispute and seek verification of the debt.

The sample letter below asks for more information about a debt.

- Read the information below.
- Edit the letter as needed to fit your situation. Delete any bullets that don't apply to you.
- Print and send the letter as soon as you can. Keep a copy for your records.

Send this letter as soon as you can and, if at all possible, within 30 days of when a debt collector first provides you with certain information regarding the debt, including information about the validity of the debt. Most often, this information will be sent to you in writing. Even if 30 days have passed, you can still ask for the information.

If you ask in writing before 30 days have passed, a debt collector has certain legal responsibilities to give you some information.

If the debt collector makes vague statements about what will happen if you do not pay, read their response to your letter carefully. Consider replying to ask for more details. **Debt collectors are prohibited from** deceiving you by threatening to take actions they can't take or don't intend to take. But if they tell you that they intend to sue you, you should take that seriously.

State laws have statutes of limitations, or limited time periods when creditors or debt collectors can file a lawsuit to collect a debt. These periods of time can be two years or longer; the period of time varies by state and by the type of debt. In some states, affirming the debt or making a partial payment on the debt can restart the time period. You may want to consult an attorney in your state to know when the statute of limitations expires before making any payment on a debt. If you would like to speak with an attorney about a debt collection lawsuit, you can learn how to find a lawyer at http://www.consumerfinance.gov/askcfpb/1433.

Sample letters

You can use the sample letters below to respond to a debt collector. You can also find additional sample letters for disputing a debt, specifying how you wish to be contacted, or requesting that the collector contact you through your lawyer, at http://www.consumerfinance.gov/askcfpb/1695.

A debt collector may not have a legal obligation to provide some or all of the information you seek, even if you request it within the 30-day period. If the collector doesn't give you what you request, that doesn't necessarily mean the debt collector has broken any laws or has given up a legal right to collect from you.

Sample letter to a debt collector asking to verify the debt

____
Your name

____
Your return address

____
Your return address

____
Date

____
Debt collector name

____
Debt collector's address

____
Debt collector's address

Re: ____________________
Account number for the debt

Dear ____________________________:
Debt collector name

I am responding to your contact about a debt you are trying to collect. You contacted me by ________________, on ______________and identified the debt as
phone or mail date

____
any information they gave you about the debt

____
any information they gave you about the debt

Please supply the information indicated below so that I can be fully informed:

Why you think I owe the debt and to whom I owe it, including:

- The name and address of the creditor to whom the debt is currently owed, the account number used by that creditor, and the amount owed.
  - If this debt started with a different creditor, provide the name and address of the original creditor, the account number used by that creditor, and the amount owed to that creditor at the time it was transferred. When you identify the original creditor, please provide any other name by which I

might know them, if that is different from the official name. In addition, tell me when the current creditor obtained the debt and who the current creditor obtained it from.

- Provide verification and documentation that there is a valid basis for claiming that I am required to pay the debt to the current creditor. For example, can you provide a copy of the written agreement that created my original requirement to pay?
- If you are asking that I pay a debt that somebody else is or was required to pay, identify that person. Provide verification and documentation about why this is a debt that I am required to pay.

<u>The amount and age of the debt, specifically</u>:

- A copy of the last billing statement sent to me by the original creditor.
- State the amount of the debt when you obtained it, and when that was.
- If there have been any additional interest, fees, or charges added since the last billing statement from the original creditor, provide an itemization showing the dates and amount of each added amount. In addition, explain how the added interest, fees or other charges are expressly authorized by the agreement creating the debt or are permitted by law.
- If there have been any payments or other reductions since the last billing statement from the original creditor, provide an itemization showing the dates and amount of each of them.
- If there have been any other changes or adjustments since the last billing statement from the original creditor, please provide full verification and documentation of the amount you are trying to collect. Explain how that amount was calculated. In addition, explain how the other changes or adjustments are expressly authorized by the agreement creating the debt or permitted by law.
- Tell me when the creditor claims this debt became due and when it became delinquent.

- Identify the date of the last payment made on this account.
- Have you made a determination that this debt is within the statute of limitations applicable to it? Tell me when you think the statute of limitations expires for this debt, and how you determined that.

<u>Details about your authority to collect this debt.</u>

- I would like more information about your firm before I discuss the debt with you. Does your firm have a debt collection license from my state? If not, say why not. If so, provide the date of the license, the name on the license, the license number, and the name, address, and telephone number of the state agency issuing the license.
- If you are contacting me from a place outside my state, does your firm have a debt collection license from that place? If so, provide the date of the license, the name on the license, the license number, and the name, address, and telephone number of the state agency issuing the license.

I have asked for this information because I have some questions. I need to hear from you to make an informed decision about your claim that I owe this money. I am open to communicating with you for this purpose. In order to make sure that I am not put at any disadvantage, in the meantime please treat this debt as being in dispute and under discussion between us.

Thank you for your cooperation.

Sincerely,

____

Your signature

You can ask a debt collector to stop contacting you

The following example letter tells the debt collector to stop contacting you unless they can show evidence that you are responsible for this debt. Stopping contact does not cancel the debt. So, if the debt collector still believes you really are responsible for the debt, they could still take other action. For example, you still might be sued or have the status of the debt reported to one or all of the three national credit reporting companies (Equifax, Experian, and TransUnion).

You may not want to make a request to stop contact if the debt is your home mortgage.

Sample letter

____
Your name

____
Your return address

____
Your return address

____
Date

____
Debt collector name

____
Debt collector's address

____
Debt collector's address

Re: _____________________
Account number for the debt

Dear ______________________________:
Debt collector name

I am responding to your contact about a debt you are trying to collect. You contacted me by _________________, on _______________and identified the debt as
phone or mail date

____
anything they told you about the debt

____
anything they told you about the debt

Please stop all communication with me and with this address about this debt.

Record that I dispute having any obligation for this debt. If you forward or return this debt to another company, please indicate to them that it is disputed. If you report it to a credit bureau (or have already done so), also report that the debt is disputed.
Thank you for your cooperation.

Sincerely,

____
Your signature

Your benefits are protected from garnishment

If a debt collector sues you in court and gets a judgment, then it can ask your bank or credit union to turn over money in your bank account. This is called garnishment.

Social Security, VA benefits, and certain other federal benefits are generally protected from garnishment to pay a debt to a private person or company. If you receive these benefits, and they are your primary source of income, tell a collector when the collector first contacts you. When a collector knows that it cannot garnish your federal benefits, the collector may be less likely to sue you to collect the debt. There are exceptions for the collection of child support and debts due for federal or state taxes. For more information about protections for income from Social Security or VA benefits – and some limited exceptions – visit http://files.consumerfinance.gov/f/2015050_cfpb_consumer-advisory-your-benefits-are-protected-from-garnishment.pdf or AskCFPB at http://www.consumerfinance.gov/askcfpb/1981.

What you can expect

Even if your income is protected, a collector can still continue to communicate with you, and ask you to pay the debt. It may also offer a payment plan or attempt to settle the debt. If your benefits are protected from garnishment, you may have better options – so remember to let the debt collector know if your primary source of income is federal benefits.

You can use this letter to tell a debt collector that you receive income from Social Security or VA benefits.

Sample letter

____
Your name

____
Your return address

____
Your return address

____
Date

____
Debt collector name

____
Debt collector's address

____
Debt collector's address

Re: ____________________
Account number for the debt

Dear ____________________________:
Debt collector name

I am responding to your contact about a debt you are trying to collect. You contacted me by _________________, on _______________and identified the debt as
phone or mail date

____
anything they told you about the debt

____
anything they told you about the debt

Please record that my income comes from protected federal ____________________
Social Security and/or VA
benefits. These benefits are generally protected from garnishment to pay a debt owed to a private person or company. If you forward or return this debt to another company, please provide this information to them.

Thank you for your cooperation.

Sincerely,

____
Your signature

This tool is included in the Consumer Financial Protection Bureau's toolkit. The CFPB has prepared this material as a resource for the public. This material is provided for educational and information purposes only. It is not a replacement for the guidance or advice of an accountant, certified financial advisor, attorney, or otherwise qualified professional. The CFPB is not responsible for the advice or actions of the individuals or entities from which you received the CFPB educational materials. The CFPB's educational efforts are limited to the materials that CFPB has prepared.

This tool may ask you to provide sensitive information. The CFPB does not collect this information and is not responsible for how your information may be used if you provide it to others. The CFPB recommends that you do not include names, account numbers, or other sensitive information and that users follow their organization's policies regarding personal information.