Debt Settlement vs. Debt Management

Debt settlement is settling a debt for less than what is actually owed.

Debt settlement will have a very negative impact on a FICO credit score, often with a drop of 100-150 points.

Paying less than the total amount owed will cause the account to be shown as "settled" on a credit report, which tells future potential lenders that the original agreement was not paid in full.

Typically, debt settlement companies will charge you a fee of around 15%-25% of your total enrolled debt. These companies are prohibited by federal law from charging you any fees until after they have successfully negotiated a settlement and you have accepted your creditor's settlement offer.

The IRS will tax you on forgiven debt of $600 or more. For example, If you owe $10,000 and settle the debt for $4,000, the $6,000 forgiven amount is treated as taxable income.

It's estimated that 15%-30% of people enrolled in debt settlement end up in lawsuits. Creditors do not legally have to stop collection efforts or lawsuits even though someone hired a debt settlement company. If a creditor files a lawsuit and wins a judgment, wage garnishment or bank levy can result.

A **debt management program (DMP)** helps people to truly become debt free.

A DMP is a formal agreement between a debtor, a credit counseling firm and creditors.

FICO does not take any points off of someone's credit score for going on a Debt Management Program.

The debtor agrees to make a single, regular monthly payment to the counseling firm, which distributes it among creditors on an agreed-upon schedule.

Credit card companies offer some concessions to debtors who enter a debt management plan by typically lowering interest rates, lowering monthly payments and re-aging accounts as current after a few months of payments.

A DMP can stop late fees and over-the-limit fees.

Debtors can repay the principal amount owed in full within 3 to 5 years, so the debt is not settled for less.

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