CONSUMER ACTION NEWS

Non-Profit Org.
U.S. Postage
PAID
San Francisco, CA
Permit # 10402

Change Service Requested

221 Main Street, Suite 480 • San Francisco, California 94105 • www.consumer-action.org • Winter 08-09

Foreclosure prevention
What's working, what's not and why

By Ruth Susswein

A couple of hundred people gathered at a Methodist church in Stockton, CA, in December for a town hall meeting on foreclosure. One homeowner could not hold back tears as she told of her struggle to save her home.

She is not alone in her emotion. More than eight million homeowners are expected to lose their homes to foreclosure in the next four years. Millions more are already in foreclosure. Non-profit counseling groups, some lenders and loan servicers, many states and a few federal government agencies have stepped in to help save these families from financial ruin. Some of the programs are working, but unfortunately, more are not.

Here's a status report on efforts being made to save families from foreclosure.

The federal government has repeatedly opted to let banks solve the foreclosure crisis through voluntary measures, with little success to date.

Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke handed banks $350 billion in Troubled Asset Relief Program (TARP) funds with no strings attached and no commitment for relief from the burden of predatory loans that some homeowners are stuck with. Instead Secretary Paulson has supported industry efforts to rework millions of mortgages on a voluntary basis through the Hope Now Alliance.

Hope Now

Hope Now is an alliance of lenders, loan servicers and housing counselors that provides free foreclosure prevention counseling and arranges for loan modifications. A loan modification is a change in the terms of your mortgage. It can include a rate cut, rate freeze, extended repayment period, or forgiveness of part of the loan balance (temporarily or permanently). About 8,000 homeowners call the HOPE hotline (888-995-HOPE or 4673) everyday.

The Alliance says that it has succeeded in reworking 2.7 million home loans since 2007. But critics charge that more than half of these loan modifications are in fact repayment plans that simply extend the life of the mortgage to 40 years. According to MSNBC, over one million of these repayment plans actually increase the monthly mortgage bill to make up for missed payments.

These not-so-modified mortgages may explain why the latest default rates show that more than half of those with loan modifications have re-defaulted on their loans.

Hope Now admits that not all reworked loans have been successful but it says publicly it is very proud of its achievements. In early in 2009, it plans to produce a breakdown of the type of modifications it has completed, and it anticipates being able to help modify two million home loans this year.

While hundreds of thousands of homeowners are being helped, estimates are that millions more will lose their homes. Georgetown University Law professor Adam Levitan attributes

See "Foreclosure," page 6

About this issue

Since mid 2007, the U.S. has been reeling from an economic crisis that has hit Wall Street *and* Main Street with bad news and more bad news.

Predatory mortgages and ill-advised lending have led to a foreclosure crisis, real estate has lost substantial value, lay-offs are crippling communities, and the stock market, where many people invest their retirement savings, shed 40% of its value in 2008.

This issue focuses on our current state of indebtedness and how consumers can take charge and avoid long-term financial damage. The issue was created by our Managing Money Project, funded with a *cy pres* award from the *Griego v. Rent-A-Center* settlement. ■

Get rid of debt by yourself

By Linda Sherry

Being in debt means that finance charges are eating up income that could provide a buffer in these uncertain times. With discipline, many people can tackle debt reduction by themselves.

In deciding how to reduce your indebtedness, it may help to think about "good debt" and "bad debt." Not all debt is bad. Mortgage debt, for instance, is usually considered to be good debt. After all, how many people can pull out their checkbooks and pay hundreds of thousands of dollars for a house? In the case of mortgage debt, homebuyers can use credit to buy an asset (a home) that provides several benefits: a place to live, a tax deduction and an asset that may appreciate in value by the time you sell it.

Long term and high-interest credit card debt and large credit card balances often are considered forms of bad debt. Consumers need to be careful in taking on credit card debt, especially if they cannot pay the balance in full over a short period of time. If you can't pay your credit card bills in full within a few months or so, stop using your credit cards. Use your debit card instead.

Here are some suggestions for regaining control of your debts:

Assess what you owe. Gather all your most current credit billing statements. Include your credit cards, overdraft loans, car loans, mortgage, home equity lines of credit, etc. Include personal debts, too. Make a list by hand or create a computer document.

Get your credit report. Request copies of your credit files for free from the three major credit reporting bureaus at www.annualcreditreport.com. If you recently ordered your reports, you can use them or purchase new copies

See "Pay down debt," page 5

Why are we so indebted?

By Michelle De Mooy

Compiling debt has replaced apple pie and baseball as America's pastime. According to the Federal Reserve, the total amount of credit card debt in the U.S. is a staggering $973 billion dollars or about $10,678 per household. Even as credit card companies charge higher and higher interest rates and fees, this number has continued to climb.

Are we just hamsters on the wheel of consumption? Or is something else going on?

The answer includes both concepts. Each time you purchase a product, you are at the mercy of an extremely well researched and targeted marketing machine. Many of today's businesses have become experts in how consumers make purchasing decisions, convening focus groups and consulting psychologists to understand the forces behind how we buy.

The goal is to make convenience and the perception of immediate need more important to you than accumulating debt or remaining financially secure.

Take the "exotic" interest-only, adjustable rate mortgages—they tempted many home buyers, but left many

See "Indebted," page 5

What's inside

2 Credit counseling

3 When you can't pay your credit card bill

4 Debt management plan or a scam?

7 Student loan debt

8 Lenders reach out

Consumer Action

www.consumer-action.org

Consumer Action is a non-profit 501(c)(3) advocacy and education organization founded in 1971. We publish surveys and distribute multilingual educational materials in printed form and on the Internet.

Consumer Action provides nonlegal advice and referrals on consumer problems. Chinese, English and Spanish are spoken. Call or write:

(415) 777-9635 • (213) 624-8327

hotline@consumer-action.org

San Francisco

221 Main St., Suite 480
San Francisco, CA 94105
(415) 777-9648
Email: info@consumer-action.org

Ken McEldowney
Executive Director

Michael Heffer
Business Manager

Kathy Li
Director, San Francisco (S.F.) Office

Mikael Wagner
Director of Training/Outreach

Nani Susanti Hansen
Associate Director, S.F. Office

Yamin Chai
Assistant Director, S.F. Office

Audrey Perrott
Associate Director, Training/Outreach

Jamie Woo
Community Outreach Manager

Joseph Ridout
Consumer Services Manager

Angela Kwan
Web Manager

Hazel Kong
Office Manager

Cui Yan Xie
Project Associate

Kinny Li, Tasneem Pitalwala
Administrative Assistants

Ricardo Perez
Mail Room Operations

Ruth Gilbert, Schelly Gartner
Consumer Advice Counselors

Loven Ko, Wilson Ku, Robert La, Dennis Wong
Support

Los Angeles

523 West Sixth St., Suite 1105
Los Angeles, CA 90014
(213) 624-4631

Cher McIntyre
California Legislative Director

Nelson Santiago, Linda Williams
Community Outreach Managers
(Training/Outreach Department)

Guo Guang Zhuo
Support

Washington, DC

P.O. Box 70037
Washington, DC 20037
(202) 544-3088

Linda Sherry
Director, National Priorities
(Editor, Consumer Action News)

Ruth Susswein
Deputy Director, National Priorities

Michelle de Mooy
Associate, National Priorities

Sol Carbonell
Associate, National Priorities

Healthy Children Organizing Project

221 Main St., Suite 480
San Francisco, CA 94105
(415) 777-9648, Ext. 307
Web site: www.healthychildrensf.org

Neil Gendel
Director

Consumer Action News is printed by the Alonzo Printing Company, using recycled paper and soy-based ink.

© Consumer Action 2009

Credit counseling can help

By Michelle De Mooy

In a volatile and downward spiraling economy, many Americans are struggling just to make ends meet. If you are among the millions of households buried under a mountain of credit card balances and other debt, it's even harder to stay afloat.

There are some ways to make a dent in the mountain. For people consistently late paying their credit card bills, who have trouble making the minimum payment, who are hounded by creditors and collection agencies, or even considering bankruptcy, consumer credit counseling may be the next best step.

Over nine million people in the U.S. sought help from a credit counseling agency in 2003, mostly as an alternative to bankruptcy, according to Consumer Federation of America and the National Consumer Law Center.

Credit counseling is a professional service that offers personalized financial education and debt management. While there are some agencies that are "for profit," most credit counseling organizations are nonprofit and are legally obliged to provide education and counseling services to consumers. However, just because an organization says it's "nonprofit," doesn't guarantee that its services are legitimate.

To find out if an agency is the real deal, check to see if it's affiliated with the National Foundation for Credit Counseling (NFCC), the agency that first developed credit counseling, or accredited by the Council on Accreditation or the Association of Independent Credit Counseling Agencies (AICCA). It's always helpful to check with the Better Business Bureau in your town to see if there are complaints about an agency and how they were resolved.

Most counseling services are offered in-person, online, and by phone. Universities, military bases, credit unions, housing authorities, and branches of the U.S. Cooperative Extension Service operate nonprofit credit counseling programs. Visit the Department of Justice website (http://www.usdoj.gov/ust/eo/bapcpa/ccde/cc_approved.htm) for a list of approved credit counseling agencies in your state.

Though there is almost always a fee for these services, it should not be included in the monthly amount you pay to creditors. According to the NFCC, any set-up fees should be "reasonable" (defined as $50 or less) and any monthly fees should not exceed $25. You should have the ability to waive all fees in case of hardship and the agency is required to disclose any fees to you before you even start a counseling session.

Debt Management Plans

The goal of credit counseling is to come up with an affordable long-term plan—called a debt management plan or DMP—to pay off your debt. When you begin the process of credit counseling, you'll work with a counselor who will take a thorough look at all of your debts. A typical counseling session should last about 60 to 90 minutes, and can take place in person, on the phone, or online. Opt for an in-person appointment when possible. The counselor will review your monthly income, your bills and how current you are on your payments. Based on this information and your input, your counselor will create a repayment plan that locks you into fixed, monthly payments for a period of two to five years. Generally, if it will take longer than five years to pay off your debts, most counselors will tell you that bankruptcy may be a better option.

In fact, if it's determined that you are too deeply in debt, you may not be able to create a DMP because the credit counselor may not be able to cut your payments enough to dig you out. This doesn't mean they can't help you. Reputable credit counseling services offer a host of services alongside DMPs, including free educational information and classes on the basics of budgeting and money management. Some organizations require you to participate in these classes as a part of creating a DMP.

If a DMP can be created, you must then approve it. Next the plan is sent to your creditors for approval. This is where a credit counseling service can be of most value to a consumer. They will negotiate with your creditors to reduce your monthly payments (usually by waiving fees and greatly reducing finance charges).

At this point, you will be asked to cut up all of your credit cards. Virtually all DMPs are voided if you take on more debt or miss any payments.

When all parties have agreed to the new repayment plan, you'll pay the credit counseling service each month, and they will divide up the payment among your creditors, in accordance with the plan.

It's critical to continue monitoring your monthly bills to ensure that the counseling service is honoring your plan, paying the agreed-upon amount on time every month. You are ultimately responsible for any late or missed payments, so keep checking!

If you discover that the credit counseling agency has underpaid or missed any payments, contact each of your creditors immediately to explain the situation and pay what you owe. Then sever your relationship with the agency.

Debts arising from illness and serious injury are a major cause of personal bankruptcy in the U.S. with those who are uninsured or low-income suffering the brunt of rising health care costs. Families are frequently unprepared for the steep financial burden that comes from an unexpected medical crisis. Often insurance does not cover all costs and there simply may not be enough savings to cover the difference.

Medical bills are considered "unsecured" debt and can be included in a DMP. The counseling agency will reach out to the doctor or hospital, to work out a reasonable repayment plan. The Internal Revenue Service (IRS) allows you to deduct your medical expenses if they exceed 7.5% of your adjusted gross income. Be sure to ask your counselor about whether you qualify.

Be aware that if you think you're eligible for Medicaid benefits, based on your medical debt, do not put these debts on a credit card. Medicaid does not consider debt on a credit card to be medical debt. This could disqualify you from receiving Medicaid benefits.

Credit scores

Creating and implementing a DMP may or may not affect your credit record. It depends on the lender and how they report your account to credit bureaus. Some lenders may report you as delinquent until a series of consecutive payments is made by the credit counseling service. This scenario would probably damage your credit score. Others note that the consumer is enrolled in a credit counseling service, which is not likely to affect your score.

Many lenders view credit counseling as a sign that the customer plans to pay off his debt. Yet others may refuse to lend to you even after you've paid the debt. Ask your counselor upfront about their experiences in working with your particular creditors to find out how your credit score might be affected. FICO, probably the most important credit score, ignores any reference to credit counseling.

Do it yourself?

Most of what a credit counselor can do, you can do yourself. You can assess your total debt, figure out a realistic payment plan, call your creditors and negotiate lower or reduced payments, even implement a DMP. However, some counselors have relationships with creditors that help them negotiate better terms. *(For more information, see "Get rid of debt by yourself," page 1.)*

Other services

Most reputable counseling agencies offer a host of services related to consumer debt, including help with foreclosure prevention. For this type of assistance, look for an agency certified by the U.S. Department of Housing and Urban Development (HUD) to provide housing counseling. This service can include anything from the basics on buying a house to more complex mortgage loan modifications and negotiations with banks to help people keep their homes. Counseling agencies generally offer information and classes on rebuilding credit, creating and maintaining a budget, and long-range financial planning.

The Federal Trade Commission advises consumers to look for a nonprofit organization that offers counselors who are trained and certified in consumer credit, money and debt management, and budgeting. Check to see if the agency is accredited by the Council on Accreditation (www.coanet.org). ■

Support
Consumer Action

Give Now Online!
www.consumer-action.org/join/donate

Fast, safe, secure

Credit cards

What to do when you can't afford the minimum payment

By Ruth Susswein

Americans owe close to one trillion dollars in credit card debt. If you're having trouble making the minimum payment on your credit cards each month you're not alone.

Credit card delinquencies spiked in the last quarter of 2008, according to the Fitch Retail Credit Card Index, and a wave of credit card defaults is expected in 2009. While some issuers are more willing to negotiate these days, a growing number of cardholders find themselves with few alternatives for a workable way out.

Contact the issuer

If you contact your card issuer to request help in dealing with your debt, would you know what to say, whom to ask for or what is realistic to expect? Issuers vary as to how far they're prepared to go in reducing a cardholder's debt, but most say they are interested in talking to you.

Issuers tell Consumer Action that there's more flexibility than you might think. Without access to home equity loans and other lines of credit, lenders realize that consumers have run out of options to pay down their credit card balances. As these debts become tougher to collect, some card companies are more willing to forgive part of a balance in order to get paid.

Typically lenders make these decisions on a case-by-case basis, depending on how long you've been a cardholder, how often you've run into problems paying, how late your payments are and how likely it is that you will pay the company back.

Is the reason you can't pay because you're out of work or have a medical problem? Is the problem temporary? If so, issuers may give you a temporary payment plan that reduces your minimum monthly payment.

Start with a call to your card company's customer service line, and ask to be transferred to the collections or risk department. Explain your problem and say that you are willing to work with the lender to come up with an affordable alternative payment plan.

For instance, if you were out of work and fell behind on a couple of payments, but you've found a new job, you might want to ask the lender to wipe out the missed payments and bring the account current.

Some lenders are willing to reduce your interest rate, waive late and over-limit fees, and even eliminate part of the principal balance owed. For a possible reduction in principal, investigate a debt management plan (DMP).

A non-profit credit counseling agency can help you set up a DMP to include all your credit accounts. For one account, you can deal directly with the issuer. A DMP can be a lump sum settlement that reduces your debt by up to 60% and usually must be paid in three to six months. Or it can be a multi-year repayment plan without any reduction in principal. *(For more on DMPs see "Debt management plan or a scam?" on page 4.)*

Credit counselors are dealing with an increasing number of consumers who are not eligible for a short-term debt management plan. These cardholders can't afford a reduced payment either. The remaining options are ignoring the debt while it grows even bigger or filing for bankruptcy.

Card issuers must adhere to regulatory guidelines that limit what they can offer people who fall behind. Last year, Consumer Federation of America (CFA) and the Financial Services Roundtable, representing the country's biggest banks and insurers, recommended to the Office of the Comptroller of the Currency (OCC) that lenders should be allowed to forgive larger amounts of credit card debt than current guidelines permit.

For people so deeply in debt that they don't qualify for a DMP, a repayment plan was recommended that would reduce the principal owed by up to 40%, charge no interest, and extend the repayment period to five years. Regulators have not allowed lenders to combine such a long repayment window with substantial reductions in principal. Under current rules, a repayment plan with deep cuts in principal would typically require repayment within three to six months.

"If people had that kind of money laying around they wouldn't be in trouble," said Travis Plunkett, CFA's Legislative Director. "The goal is to allow for serious debt reduction over time."

CFA and the Roundtable believe the proposal would help people who would otherwise file for bankruptcy. Bankers would also benefit by recouping a portion of what was owed, instead of having to take a total loss.

However, the OCC rejected the proposal because lenders asked to delay writing off the forgiven debt until the repayment plan was completed. The OCC wants lenders to account for any losses at the time the repayment plan begins.

The National Foundation for Credit Counseling (NFCC) recommends steps creditors can take to help people, even when the outstanding balance cannot be reduced:

- Reduce minimum payments to less than 2% of the outstanding balance.
- Cut interest rates as low as necessary to pay off the debt within five years.
- Require consumers to set aside a cushion of at least $25 a month for emergencies.

The NFCC says this plan is a way for people who are willing but unable to pay to meet their obligations. ■

Personal bankruptcy: 7 vs. 13

Many people are confused by the difference between Chapter 7 and Chapter 13 personal bankruptcies. Here are the basic differences:

- **Chapter 7.** Through Chapter 7—also called liquidation—filers are able to wipe out (discharge) all debts (except student loans, child support and alimony, and most taxes) and get a fresh start. Valuable assets (like cars, homes, etc.) usually are sold and their cash value is divided among creditors. Under some state homestead laws it may be possible to keep your home if you do not have a mortgage. You must complete a "means test" to qualify for Chapter 7. If your means (funds and other assets) are too great you will have to file under Chapter 13.
- **Chapter 13.** In Chapter 13—also called reorganization—the court helps debtors set up a repayment plan to pay off most debts in three to five years at a reduced rate. Chapter 13 bankruptcy may allow you to keep certain valuables that you cannot retain under Chapter 7. Chapter 13 allows you to stop a foreclosure and catch up on overdue mortgage payments over the 3-5 year life of the repayment plan. However, under current law your principal residence mortgage debt cannot be reduced. You must pay your agreed-upon mortgage payments as part of the Chapter 13 bankruptcy repayment plan, otherwise the bankruptcy court can lift the stay and the mortgage company can resume foreclosure proceedings.

Debtors must complete a credit counseling class before filing for bankruptcy and a debtor education course before receiving a discharge. To find approved organizations that offer these classes, visit the U.S. Trustee web site (http://www.usdoj.gov/ust/eo/bapcpa/ccde/cc_approved.htm).

Learn more

- **Consumer Action** offers a free booklet on personal bankruptcy. Visit our web site (www.consumer-action.org) and pull down the tab on the upper right-hand side of the home page called "Select a Training Module." Then choose "Personal Bankruptcy." The free guide, available online and as a PDF download, is titled "Personal Bankruptcy: Your right to a financial fresh start."
- **The National Consumer Law Center** (NCLC) offers a valuable "Guide to Surviving Debt." The book can be purchased at book stores or from the NCLC web site (www.consumerlaw.org) for about $20.
- **Nolo Press** (www.nolo.com) offers excellent, clearly written books for consumers on filing Chapter 7 or Chapter 13 bankruptcy. Check your library or order from the web site.

To find a bankruptcy attorney near you, contact the National Association of Consumer Bankruptcy Attorneys (www.nacba.org) or search Nolo's Lawyer Directory (www.nolo.com). ■

— *Ruth Susswein*

Shake that 'all alone' feeling

By Michelle De Mooy

Trying to pay off debt can be a lonely and depressing place. Blowing off steam no longer includes dinner and a movie, just "Grey's Anatomy" on TV and peanut butter and jelly sandwiches.

Because of the stigma attached to being in debt, many people don't talk openly about their financial situations. Except when they are online.

Like so many issues, the Internet has spotlighted debt. Online support groups for people dealing with debt have become commonplace. Unlike credit counseling or other professional services, these informal groups provide a forum for people to discuss the emotional impact of being in debt. Consumers are able to commiserate and share advice on the everyday aspects of financial and debt management.

Support online

iVillage Debt Support Group (www.ivillage.com—under Household Finances) hosts a range of forums, from "debt discussions" for those new to the site to "check-ins" for compulsive spenders. The site allows users to anonymously solicit and provide financial advice, and offers professional tips on money management, such as "66 Ways to Save Money Every Day." The site also features financial quizzes to test your credit card smarts, help you determine your money style, and discover if you're a smart shopper.

Debtors Anonymous is one of the most well-known support groups. The program is based on the 12-step model used by Alcoholics Anonymous. Search online for meetings near you at www.debtorsanonymous.org.

Blogs

Blogs have also become a respite for debtors seeking support. A few of the best free ones include:

Get Rich Slowly (www.getrichslowly.org/blog) says it is devoted to "sensible personal finance" and was named "Most Inspiring Money Blog" by Money Magazine in 2008. It offers useful tips on budgeting, saving, getting out of debt (the blogger even tells a story about how he paid off $35,000 worth of debt), book reviews, and community forums.

Wise Bread (www.wisebread.com) is geared towards living well on a budget. It offers advice on how to save money on everything from batteries to hosting a good party without breaking the bank. It also features a forum on "Deals and Coupons" that highlights good retail deals on the

See "Support," page 7

Debt management plan or a scam?
How to tell the difference

By Linda Sherry

It can be very stressful if you have large debts looming and you doubt your ability to repay them. In this situation, people may be vulnerable to offers to consolidate debts or enroll in for-profit debt management plans (DMPs). Beware: Many of these offers may be scams that will make your debt problems much worse.

If you are in serious debt, it probably took you a long time to get there, so a "quick fix" is not realistic. Your choices probably boil down to legitimate debt consolidation (a difficult thing to achieve), a debt management plan administered by a non-profit credit counseling agency or filing for bankruptcy.

Debt management plans

When you enter a DMP, the credit counseling agency may negotiate with your creditors to accept a smaller monthly payment. The DMP will take up to 60 months to complete, depending on your overall debt.

Entering a plan can bring your accounts current, stop late fees and end collection calls. Make sure you include all your debts. When you have completed a debt management program, check your credit reports (www.annualcreditreport.com) to make sure the debts in the DMP are reported as "satisfied in full."

Legitimate debt management plans are offered by accredited non-profit consumer credit counseling organizations. The best way to find an organization is through an association of credit counselors. The National Foundation for Credit Counseling (800-388-2227; www.nfcc.org) and the Association of Independent Consumer Credit Counseling Agencies (866-703-8787; www.aiccca.org) offer referrals.

Take the time to learn your state's licensing requirements for credit counselors. To check on non-profit status, call the state agency that regulates charitable organizations. To locate your state agency, visit the National Organization of State Charity Officials (www.nasconet.org/agencies). Also check with your local Better Business Bureau (www.bbb.org) to make sure the organization has a record of good customer service.

To protect yourself, deal only with nonprofit agencies that are members of the Association of Independent Consumer Credit Counseling Agencies (AICCCA) or the National Foundation for Credit Counseling (NFCC).

Also check to see if the agency is accredited by the Council on Accreditation (www.coanet.org). COA is a non-profit accrediting organization for social service programs. On the COA web site, choose "Individual Seeking Information" at top, then "Who is Accredited?" on the left. Click on the U.S. flag and choose your state from the list. You will see all accredited agencies in your state.

Be aware that DMPs are not right for everyone. The Federal Trade Commission (www.ftc.gov) recommends you ask a lot of questions before enrolling in a DMP. Avoid any company or organization that pushes debt management plans as the only option. Look for an organization that offers a range of services, including budgeting, savings and debt management classes and that charges for its services on a sliding scale adjusted for income.

Don't commit to participate in a DMP over the telephone. Get all the terms in writing. Read documents and contracts carefully before you sign. If you are told you need to act immediately, look for another organization. High-pressure sales tactics are one sign of a scam.

Also avoid any agency that:

• Requires a large upfront fee as a condition of working with you.

• Does not disclose all fees and details upfront.

• Charges for the initial counseling session (in person or by telephone).

• Asks you to delay payments to your creditors for any length of time.

• Charges more than $50 per month for participation in a DMP.

• Does not perform a full budget analysis before making a recommendation. A full analysis should take at least an hour.

It will take time, effort and discipline to repay your debts in a way that will improve your credit. *There are no quick fixes.*

Debt consolidation

Sometimes debt management plans can be confused with debt consolidation. DMPs do not require you to open a new line of credit, while debt consolidation usually does.

Legitimate debt consolidation may be achieved by taking out a home equity loan, a personal loan or a new credit card in order to pay off and "consolidate" all your other debts. If the finance charge on the consolidated debt is lower overall, you achieve a cost savings. Otherwise the only benefit is convenience.

Taking out additional "secured debt" with a home equity loan guaranteed by your house can be risky—you could lose your home if you can't make the payments. You must have enough equity in your home to borrow against to pay off your other debts.

Some offers to consolidate debt may not mention that you will be asked to pledge your home as collateral until you are deep into the process.

Personal loans in limited amounts are available from banks, credit unions and online lenders, such as Credit.com. However, approval and the interest rate you will pay for such loans are tied to your credit history. If you have mismanaged credit in the past, you may have a low "credit score." This is a number derived from the information in your credit report. Lenders use it to decide whether or not to grant you credit, and what interest rate they will charge.

Your credit history also figures greatly in your ability to find a new credit card with a lower rate and a credit limit large enough to cover your existing debts.

Many companies advertise that they can reduce your debt, negotiate with creditors, and stop harassment from debt collectors. The ads usually don't mention the hefty fees for the service. There is no guarantee that a creditor will accept partial payment of a legitimate debt.

These companies can rarely work the kind of magic they promise. The Federal Trade Commission has brought actions against many of these companies for pocketing the fees and failing to provide the services.

Debt negotiation

These are some "red flags" for suspect debt negotiation deals:

• You are asked to stop making payments to your creditors and instead send the money to the debt negotiation company. Be sure that your creditors have a working relationship with this company. Otherwise, find a negotiator that does.

• Claims are made that using the service will have little or no negative effect on your ability to get credit in the future.

• Credit card debt can be paid off for 10%-50% of the existing balance.

• Companies that will not send free information about debt negotiation services unless you provide personal financial information, such as credit card account numbers and outstanding balances.

Many states have laws regulating debt negotiation companies and services. Contact your state Attorney General (AG) for more information. You can find contact information for your state AG at www.naag.org or in the government section of your phone directory.

Lawyers legitimately may be able to assist you with debt negotiation and settlement, but take their fees into account. To find an attorney who focuses on debt negotiation, seek a referral from your state bar association. If your debt is related to income taxes, consult with a professional tax attorney.

Remember that you may owe taxes on forgiven debts.

Foreclosure rescue scams

Foreclosure rescue scammers find homeowners in distress through public foreclosure notices in newspapers and in public files at local government offices. Fraudsters may advertise on the Internet, on television, or in the newspaper; place posters on telephone poles, roadways and bus stops, or leave flyers or business cards at your door.

These are some foreclosure related scams to beware of:

• The scam artist tells you that he can negotiate a deal with your lender to save your home if you pay a fee. Once you pay, the scam artist takes off with your money.

• You are asked to make all your mortgage payments directly to the scam artists while they negotiate with the lender. After collecting your payments for a few months, the scammer disappears with your money and you still owe the lender.

• You think you're signing documents for a new loan to make your existing mortgage current—but really you have given unscrupulous individuals ownership (the deed) to your home.

• You surrender the title to your home as part of a deal that allows you to remain in your home as a renter, and buy it back later. But you lose all rights, and the scam artist takes any available equity in your home.

• A scam artist offers to find a buyer for your home, but only if you sign over the deed and move out. Once you transfer the deed, the scam artist rents out the home and pockets the proceeds while foreclosure continues. You lose your home—and you're still responsible for the unpaid mortgage. (Transferring a deed to property does not transfer responsibility for the mortgage.)

• The scam artist promises to negotiate with your lender or to get refinancing on your behalf for a fee, but instead he pockets the fee and files a bankruptcy case in your name—even without your knowledge. You could lose the money you paid to the scam artist as well as your home—and end up with a bankruptcy filing that ruins your credit history.

Tips to avoid fraud

• Beware of offers or promises that seem too good to be true.

• Debt management plans (DMPs) are not for everyone, and may be harmful to your credit history if you do not include all outstanding debt, employ a trustworthy organization, or fail to complete the plan.

• It is against the law to charge in advance for credit repair services.

• If your English-speaking skills are limited, bring your own trusted translator to any financial or homeownership negotiations.

• Bankruptcy will remain on your credit report for ten years or more and, as a legal document, is recorded with your state and is a matter of public record.

• It will take time, effort and discipline to repay your debts in a way that will improve your credit. *There are no quick fixes.*

• Don't be pressured to sign any contract. Take your time to review all documents thoroughly.

• Don't sign away ownership of your house (transfer the deed) to anyone without advice from a housing counselor or a reputable lawyer.

• Filing for bankruptcy will not save your primary home from foreclosure.

• If you stop making payments on a credit card, the balance can continue to grow because of late fees and perhaps a higher interest rate. The debt can be resold to a third party collector who may hound you to pay.

• Federal and some state laws prohibit companies from charging for credit repair services until the services have been fully performed. Ask your AG's office for the details.

• Before doing business with any firm, check the company with your state AG, local consumer protection agency, and the Better Business Bureau. Ask if the company is required to be licensed and, if so, check the license. ■

Indebted

Continued from page 1

in dire financial straits. These loans allowed people to suspend disbelief and buy way more house than they could afford.

The exotic loans removed the deterrent of having to pay both principal and interest (P&I) on a fixed 30-year loan. Initial low "teaser" rates and interest-only payments were tantalizingly low by comparison.

Buyers were qualified for the loans based on whether they could pay the artificially lower initial payments—not on the eventual day of reckoning, when the loans would reset to unaffordable levels and no inroads had been made on the principal.

It's little wonder that so many people were seduced.

Credit card companies also bank on this philosophy. Whether or not you have paid off your debt, they have (until recently) increased credit lines, dangling the ability to buy more in front of you, as you become more indebted to them.

Distancing effect

Creditors capitalize on a "distancing effect" that occurs with credit—the "buy now, pay later" seduction. For some, credit isn't "real" money and racking up purchases feels more like adding random numbers to a sheet of paper than spending hard-earned dollars on wants instead of needs.

This effect can also happen when we purchase items online. Retailers make it easy to enter the numbers of your credit or debit card before you think twice—and with the click of a mouse any item is yours.

Even ATMs seem to produce money from an anonymous place, rather than from your bank account. At most ATM machines you have to specifically request a printed receipt for the transaction or account balance. This can leave you so disconnected from your transactions that you may not realize the financial impact until the damage is done.

Yet at the end of the shopping day, we are responsible for our own actions and spending habits. No amount of savvy marketing can physically force you to buy, nor can it stop you from putting your card back in your wallet and walking away.

Eye of the beholder

Along with savvy marketing, our money decisions are swayed by our emotions. Having money is inextricably linked with a sense of security and well-being, and it makes us feel in control even when we, ironically, are not.

Rather than reaching out for help, many people may continue trying to keep up with the Joneses.

Parents might buy their children gifts they can't afford, as evidenced by the re-emergence of lay-away programs at discount stores like Kmart. We buy to make the kids happy and provide for them, even when the reality is that we are chipping away at family stability.

Studies show that people with low self-esteem tend to do more impulse buying, suggesting that our inner lives have a direct impact on our relationships with money.

Economic reality?

Perception is another critical piece in the psychology behind debt. According to Tahira Hira, founder of the Family Financial Counseling Clinic at Iowa State University, many consumers have a perception of their economic class that is not based on economic reality. They spend at that perceived level whether they can afford to or not. If you feel you "deserve" a nice vacation or should be able to buy a large screen TV, despite your debts, you might decide to ignore what's in your bank account and buy it anyway.

We have positive associations with having money, such as being in control of our destiny. Conversely, being in debt carries the stigma of shame. Rather than reaching out for help, many people may continue trying to keep up with the Joneses and maintain the illusion of wealth, even while their homes are being foreclosed upon. *(See the article on debt support groups on page 2.)*

Circumstances can play a major role in debt accumulation. Situational changes can intervene unexpectedly. The slippery slope of debt often begins with a traumatic, life-changing event such as the loss of a job, the end of a marriage, or a debilitating illness.

Many of us live on the edge of debt, making minimum payments on credit cards and living paycheck to paycheck, with little to no savings. Unexpected expenses can plunge us into financial disaster.

Wake up call?

The rude reality of being far behind on bills and unable to purchase necessities can be a wake-up call for some, but it can also tap into a kind of denial. Sometimes people continue racking up debt even after this happens. According to a Bankrate.com Financial Literacy Survey, many Americans live in a constant state of financial ignorance or denial. The non-profit financial health organization Myvesta found that nearly one-quarter of Americans don't look at their credit card statements every month.

There are ways to beat both the marketing and emotional factors contributing to debt. Here are a few suggestions to begin your own market research:

- **Knowledge is power:** Be real with yourself. Keep a budget. Know everything there is to know about your money. Know where it goes and how much you really have left after bills and taxes.
- **Avoid trigger points:** If you can't resist buying $200 worth of stuff at Wal-Mart, don't go there.
- **See a bigger picture:** Create long-term financial goals, like buying a house or saving for a child's college tuition. Use your goals as a reminder when you're tempted to live beyond your means.
- **You are not your money:** Find a purpose outside of material things, such as spending time with your family or volunteering at a local non-profit. There's more to life than spending.
- **Trick yourself:** Automate, automate, automate. Most banks make it easy to pay your bills automatically.
- **Pay yourself first:** When paying your bills, include a set amount each month for savings. Set up an automatic transfer to your savings account. Out of sight, out of mind.
- **Use cash:** Making your spending more real increases the chance that you'll use your money carefully.

Keep learning

To learn more about how we view money as a nation of consumers and ways to tackle our (mis)perceptions, here are a few books on the subject:

Your Money or Your Life, by Joseph R. Dominguez and Vicki Robin.

Money Harmony, by Olivia Mellan.

Consuming Passions: Help for Compulsive Shoppers, by Ellen Mohr Catalano and Nina Sonenberg.

Get these books and others like them from your local library! It won't cost a cent. ■

Pay down debt

Continued from page 1

for $10-$15 each. Compare the active credit accounts listed on your credit reports to your own list to make sure all outstanding debts are accounted for.

Rewrite the list. Copy your debt list again, this time listing the debts in the order you plan to repay them. For instance, at the top of the list, you could place your highest balance, highest interest rate credit card. Your 30-year, fixed rate mortgage would be the last debt to be fully repaid.

Set realistic goals for repayment. Provide "mile markers" that you hope to meet in six months, or a year. When you reach a mile marker, reward yourself in a way that does not require you to spend a lot or take out more debt. The reward gives you something to look forward to and keeps you motivated.

Reduce expenses. Shop only when necessary. Avoid recreational shopping. Consider thrift shops, garage sales and consignment shops for clothing and necessary household goods. Check out Craig's List (www.craigslist.org) and Free Cycle (www.freecycle.org) for things you need. Plan your grocery needs weekly, pack your lunch and cook at home. Seek out free entertainment such as magazines, books and DVDs at your local library. At the library, check out books on becoming debt free. Consider giving up your gym membership and start walking, biking or running outside. Or exercise at home with TV fitness programs.

Create a budget. There is lots of free help out there. Software you already own may provide free templates. Does your bank offer free tools? (Bank of America's My Portfolio or PNC Virtual Wallet are two—ask your own bank what it has available.)

Even a small extra payment can shorten the amount of time it takes to pay off your debts.

There are many free budgeting services on the internet including:

- CNNMoney.com—Instant Budget Maker (http://cgi.money.cnn.com/tools/instantbudget/instantbudget_101.jsp)
- Crown Financial Ministries—Spending Plan Online (www.crown.org/Tools/Calculators/Budgeting_SpendingPlan.asp)
- Mint.com (www.mint.com)

Anticipate major purchases or bills. Take note of the age and condition of things you own that will be costly to replace if they fail. Make a schedule of big bills like insurance or property taxes that come only once or twice a year. Keep this list in mind in transferring funds to your saving account. If a big car repair bill comes up unexpectedly you'll be more prepared to handle it.

Pay more than the minimum. Always pay more than the "minimum payment" asked for by your creditors. Even a small extra amount can shorten the amount of time it takes to pay off your debts. Paying one additional mortgage payment each year will retire your mortgage earlier. If you have an adjustable rate mortgage, paying part of the principal will mean that at your next adjustment, your payment will be figured on a lower balance.

Increase your income. Get creative! Sell household goods or seek additional employment (sewing, cooking, yard work, bookkeeping, etc.) on Craig's List. Run errands for housebound seniors. (But avoid "work at home" offers, as they are almost sure to be scams!)

Save, save, save. Set up an automatic transfer from your checking account to your savings account. Each time you cut an expense or pay off a debt, add the money you were paying to the transfer amount. Or contribute the "found" money to your retirement account.

Plan ahead for splurges. You need some fun in life. But try to plan your treats in advance and in small doses so you will stay in control of your money.

Fall off the wagon, but get right back on. Borrow a trick from successful dieters—accept lapses, don't beat yourself up, and start up where you left off.

Seek professional help. If you just can't do it on your own, seek help. Join or create a support group of like-minded people. Investigate credit card "work out" plans offered by your card issuer. Look into consumer credit counseling programs, which offer low-cost budgeting sessions and classes. The National Foundation for Credit Counseling (800-388-2227, www.nfcc.org) can help you find a program near you.

Share your secrets. In this economy, we need all the help and support we can get! If you have great tips for tackling debt, write to Consumer Action so that others can try your techniques. Email the Consumer Action editor: editor@consumer-action.org. ■

Foreclosure

Continued from page 1

the failure to solve the problem on lenders' focus on repayment plans vs. actual loan modifications that would permanently change a loan's interest rate or reduce the principal balance.

FDIC to the rescue

Sheila Bair, head of the Federal Deposit Insurance Corporation (FDIC), is the only bank regulator who has taken action to prevent foreclosures in a more systematic way. Since the FDIC took over failed lender IndyMac last summer, it has reworked mortgages for eligible IndyMac customers by reducing interest rates as low as three percent for up to five years and offering loan extensions. A loan extension increases the length of time allowed to repay the loan, while leaving the rate the same.

The FDIC's big breakthrough in its IndyMac refinancing plan was to base loan modifications on homeowner affordability. The FDIC was calculating mortgage payments at no more than 38% of a homeowner's income.

Mortgage buyers Fannie Mae and Freddie Mac took Bair's lead in November and streamlined its loan modifications to qualify homeowners based on 38% of income.

In November 2008, Bair called on the U.S. government to increase its efforts and modify more than two million troubled mortgages using TARP money (bailout funds). Bair's new and improved plan would:

- Limit a borrower's mortgage payment to 31% of monthly income.
- Guarantee that the federal government would pay the mortgage holder half of the loss.
- Lower interest rates to 3%.
- Defer some principal.
- Extend some loans.
- Pay the servicer $1,000 for modifying the loan.

However the Bush administration has not embraced the FDIC's foreclosure prevention plan. Instead the Administration has worked to reduce interest rates to spur investment, restart the housing market and raise home values. The Federal Reserve plan to buy up part of the debt behind Fannie Mae and Freddie Mac mortgages spurred interest rates to drop to their lowest levels in five years, but it is very tough to qualify for such loans.

The government also created FHASecure, a plan intended to help subprime borrowers refinance when their adjustable interest rates reset and become unaffordable. Subprime borrowers generally are people who are charged higher interest rates due to poor credit histories, but some borrowers have been put in this high cost category for no reason at all. FHASecure has only helped a limited number of homeowners refinance and is no longer accepting applicants.

Congress passed the Hope for Homeowners (H4H) plan, which offers relief by refinancing borrowers into 30-year fixed rate mortgages backed by the government. This program requires sacrifices from all parties. Lenders would refinance loans based on 90% of a home's current value. Homeowners would have to share future housing profits with the government. Fewer than 100 people are currently participating in the plan. The Federal Housing Authority (FHA) has since revised the program to encourage participation, but so far it has produced dismal results.

Many mortgages that are modified offer a reduced interest rate for only three to five years. Then the rate rises—sometimes to its original rate, other times to a current market rate. A five-year modification is typically used by Hope Now, Fannie Mae, Freddie Mac and many other players in the loan modification business. This solution will work for some homeowners, while many more borrowers may find themselves back in trouble five years from now.

Roadblocks

Servicers. The servicer is the company that sends you a bill and collects your mortgage payment, but usually does not own the loan. Servicers are blamed for many delays in loan modifications.

Days after you close on your home, your loan probably will be bundled with hundreds of other mortgages and sold to investors. Servicers collect payments and manage the loans for investors, but servicers may not have the authority to change the terms of the loan. Since about 80% of loans end up owned by investors, this makes modifying mortgages extremely difficult.

Second mortgages. Even if your lender agrees to modify your loan, the owner of your home equity loan, or second mortgage, must approve the deal or it won't happen.

Upside down houses. If your house is worth far less than what you owe, as is the case for many homeowners, who should take the loss? The lender, the investor, the homeowner, or the taxpayer? Some rescue programs try to make all parties share the loss.

No standardization. Unfortunately, there is no standard for loan modifications. Loan modifications or repayment plans can mean rate cuts, principal balance reductions, rate freezes, rate reset freezes, extended payment periods or all of the above. A unified approach might solve some of the problems,

Delinquency. Many programs, such as Fannie Mae and Freddie Mac, require homeowners to be 90 days delinquent on their mortgage before the loan can be modified. Homeowners with adjustable rate mortgages who know that their interest rates will increase (reset) shortly to unaffordable levels, often must wait until they're behind before they can find help.

Happily, some large lenders like Citi, Chase and Bank of America/ Countrywide are now willing to work with borrowers who are not yet delinquent.

Other debts. Whatever formula is used to calculate affordability must include other monthly debts such as a car loan, student loan, and second mortgage. Otherwise it is not a realistic repayment plan.

"Even the smallest problems become big when all of a homeowner's regular debts are not captured on the front end," says Bruce Dorpalen, director of loss mitigation and housing counseling for Acorn Housing. "We need sustainable, long-term loan modifications."

Who qualifies. While a recent *Los Angeles Times* poll found that a majority of Americans would support using tax dollars to help bail out homeowners, there is great debate about who should be eligible for mortgage modifications. Most agree that only those who genuinely can't pay through no fault of their own should qualify. Some loan modification programs have strict requirements that disqualify many candidates for not meeting arbitrary standards, such as the length of time you've been paying the loan.

Modifications that won't work. So far even the most effective housing counselors are only keeping about 25% of their clients out of foreclosure. Reasons ranging from job loss to huge medical bills make modification unrealistic for many. Some consumers were sold a mortgage with a reset rate they could not afford. Many people took out adjustable rate mortgages with a plan to refinance a home that was expected to rise in value. Many of them learned the hard way that home values don't always go up.

Workable prevention plans

This past fall, attorneys general (AGs) in 14 states reached agreement with Bank of America/Countrywide to freeze foreclosures and modify as many as 400,000 mortgages. BofA is contacting homeowners to offer this assistance. *(For details, see "Lenders reach out to customers," page 8.)*

Many states have set up their own foreclosure prevention programs. Check with your state AG's office to learn if there is such a program in your area. (Find your AG using the online directory at www.naag.org.)

Consumer groups have called on Congress to require lenders to enter into mortgage modification plans for the sake of individual families, neighborhoods and for the well being of the entire economy. With the exception of the AGs' lawsuits, none of the current plans require lenders to participate.

Judicial modifications

One approach to stemming the flood of foreclosures would be to allow bankruptcy court judges to modify the mortgages on primary homes when people file Chapter 13. This option is now available to people who want to save vacation homes, boats or farms. Currently judges are not allowed to apply the same protection to a person's primary residence.

The Helping Families Save Their Home in Bankruptcy Act (S.61) would change that. It would require lenders to modify loans—and at no cost to taxpayers. Consumer Action supports S.61 introduced by Senator

See "Foreclosure," page 7

Fight foreclosure with all you've got

You can't pay your mortgage bill. Denial won't help anything. It's time to make a call and see if you can get some help. Here are some things you can do to give your SOS its best shot.

Be prepared. Whether you plan to speak with your mortgage lender or servicer, or meet with a HUD-approved housing counselor, be organized and be prepared.

Have the right documents at hand, including your:

- Latest loan statement and loan number.
- Pay stub or proof of income.
- Homeowner's insurance .
- Property tax information.
- Information on other debts (monthly bills).
- Bank account statements (past two months).

Be clear. You'll need to explain why you can no longer afford your mortgage payment, and whether the problem is temporary or permanent. Write down your thoughts before the call.

Be patient. Housing counselors will spend at least 20 to 30 hours (often more) working to prevent your home from going into foreclosure. That includes meeting with you, examining your documents, negotiating with lenders/servicers, advocating for you and working out a modified mortgage plan, etc.

Be cautious. If you are able to modify your loan, be sure you understand the agreement that you've reached with your lender/servicer. Be able to answer these questions before agreeing to anything:

- Is the reduced interest rate temporary? If so, for how long and what does the rate change to?
- Does this payment include principal and interest (P&I)?
- Am I being asked to add missed payments to the original loan amount?
- Can I afford the modified monthly mortgage payment? Is it less than I was paying?
- Are there any fees for modifying the loan and can they be waived?

Be realistic. Not every home can be saved from foreclosure. Some home loans were never affordable in the first place and no modification will make them so. If a borrower has been unemployed for several months with no job prospects in sight, modification may not be attainable. If it is not a realistic goal for you, ask what you can do to avoid foreclosure and limit damage to your credit record and your chance of owning a home again in the future. Inquire about alternatives such as a short sale or deed in lieu of foreclosure.

Be heard. Counselors, lenders and servicers are overwhelmed by the number of people who need help. If you've had no success reaching a counselor or lender/servicer and you're at risk of losing your home, contact your Congressional representatives for help. Some legislators have devoted staff to help people prevent foreclosure and save their homes. ■

— Ruth Susswein

Renter's rights in foreclosure cases

Renters are often caught in the middle when a property owner faces foreclosure. Tenants typically are evicted from foreclosed properties even if they are up-to-date on rent.

Mortgage funder Fannie Mae made news lately when it agreed to let renters remain in their homes despite foreclosure. On properties acquired by Fannie Mae in foreclosures, tenants who stay current with the rent will not be evicted.

Responding to a threat of legal action by the New Haven Legal Assistance Association in Connecticut, Fannie Mae agreed to sign new leases with current tenants or help them find new housing.

While Fannie Mae deals with only a small portion of renters, it is hoped that the mortgage funder's actions will serve as a model for other lenders. ■

— *R.S.*

Support

Continued from page 3

web and off-line.

Money Smart Life was started by a 20-something chronicling his own bad money decisions. The site (www.moneysmartlife.com) features advice on topics from finding a job to reducing your restaurant bill.

Online counseling

Many credit counseling services have also begun to go virtual and offer online classes and counseling for people in debt. ■

Foreclosure

Continued from page 6

Richard Durbin (D-IL).

This approach is expected to encourage lenders and investors who have been unwilling to refinance home loans, to take action even before a homeowner files for Chapter 13 bankruptcy. *(See an explanation of Chapter 13 on page 3.)*

Major lenders, like Citigroup, have recently thrown support behind judicial modification, but only if the legislation is limited to existing loans and limits penalties to lenders for violating consumer protection laws. Industry support is likely to help the bill's passage.

Homeowner help

Homeowners can negotiate directly with lenders or they can have a reputable non-profit housing counseling agency represent them at no cost. If you are having no luck reaching the right people at your mortgage company or you are not comfortable negotiating, try contacting a housing counseling agency.

If you are seeking a loan modification, gather all the documents needed to make the case that you can no longer afford your mortgage payment. Have pay stubs, tax returns, copies of monthly bills and your mortgage account number handy to begin the conversation. ■

Student loan debt

Mortgaging the future

By Michelle De Mooy

Expecting a car or a trip to Europe as a college graduation gift? How about tens of thousands of dollars in debt instead?

As the costs of education rise, more and more students and families are being forced to take on huge sums of personal debt. A 2007 study from The Project on Student Debt reports that the average college student graduates with $21,900 in student loan debt, a six percent increase from 2006.

Making sense of complex student loans can in itself be an education, and because it could be the largest loan you'll take out—next to your mortgage—it's critical to understand your options.

There are two basic types of loans, federally-backed and private.

The U.S. government issues or backs federal loans, with (normally low) interest rates set by Congress each year, through two programs.

The Federal Direct Student Loan Program (FDSLP) provides loans to students directly from the government, while the Federal Family Education Program (FFEL) uses an intermediary, such as Sallie Mae, to loan money to students but then guarantees the loans against default.

Students qualify for federal loans based on demonstrated financial need.

The government sets the interest rate for its loans every July. Lenders who offer federal student loans are not allowed to increase this set interest rate but they may offer reductions depending on factors such as whether you pay electronically and on time. Federally backed loans cap how much money you can borrow in one year, so many students turn to private loans to fill in the financial gaps.

Interest

Interest on both private and federal loans starts accruing as soon as you take out the loan. However, many federal loans (but not all) are "subsidized" by the government. The subsidy covers the cost of interest that accrues on the loan while in school, during deferments, and for a short time after you graduate. Once out of school, you will be responsible for full repayment of the loan, including interest charges.

Private student loans are issued and backed by a variety of non-governmental organizations. The interest rates on private loans are variable and set by the organizations themselves, and can be as high as those on credit cards. Private loans are generally "unsubsidized" which means, once you begin repaying the loan, you will owe any interest that accrued while you were in school, and any that accrues during the grace period or deferment. Some private lenders may even require repayment of the interest while you are in school, so check the fine print on your loan contract.

Banks and credit unions usually offer a variety of student loan options, including federally-backed and private subsidized and unsubsidized loans.

Consolidation is the process of combining several student loans from different lenders into one bigger loan from a single lender. Consolidating should allow the loan holder to reduce the interest rate and pay a single monthly payment. The downside is there is usually an increase in the total interest paid over the life of the loan. The interest rate on a consolidation loan is determined by averaging the interest rates on all of the loans being consolidated, and has been capped at 8.25%.

Unfortunately, private student loans cannot, in general, be consolidated with federal student loans, nor would it be necessarily a smart thing to do. Federal loans offer more flexibility and protections to borrowers than private loans, which could disappear if you combine them. It is possible to consolidate private student loans with other private student loans.

Bankruptcy

U.S. bankruptcy law is not on the side of student loan borrowers. Private and federal student loans are not dischargeable, which means you would still owe them even after filing bankruptcy. Though federal loans offer some protection to students outside of bankruptcy, such as repayment flexibility in cases of unemployment, death, and disability, private loans provide no protection at all to borrowers and are essentially owed for life (or until they are paid off). This may mean that banks have a lot of incentive to give you a risky, large loan, even if you can't afford it because there is no avoiding paying it off.

There is one small provision in bankruptcy law that allows the borrower to file for "undue hardship," which is ultimately approved or denied by a bankruptcy judge. People who aren't able to both pay a modest rent and their student loan bills even after filing for bankruptcy can file a petition for this. Check with an attorney for details on this.

Wages garnished

Defaulting on your student loan can be financially devastating. Not only will the default greatly damage your credit score, but up to 15% of your salary can be garnished, or forcibly taken, by the lender. Lenders are also legally allowed to seize your IRS tax refund, if necessary, to pay off your debt.

However, it's possible to avoid these drastic scenarios. If you are struggling to make your monthly payments, call your lender to discuss a solution, which could be an interest rate reduction, a temporary period of no payments, or a consolidation loan. It's in both your interests to work out a repayment plan.

Credit score

Your credit score plays an integral role in determining the kind of private student loan you will get. (If you have a co-signer, his or her score also has impact.)

However, your score is not a factor for federal education loans. An exception is the federal Parent Loan for Undergraduate Students (PLUS) that requires the borrower not have an "adverse credit history," which might include things like defaulted loans, bankruptcy, or foreclosure.

Private lenders generally use the FICO score to determine eligibility and the interest rate for loans. To determine your interest rate, lenders use a tiered rating system that pits your score against other loan applicants. Students with poorer scores sometimes receive rates that are up to six percentage points higher than borrowers with good scores, according to FinAid.org. They also may be offered smaller loans with more restrictions on how the money is spent.

A small crop of private education loans has begun to use criteria other than credit scores. MyRichUncle offers a "PrePrime" loan that uses a host of alternative criteria, including your college's reputation and your GPA and major. The interest rate for this loan is based on the prime rate.

Some lenders have begun offering schools a small pool of money within their normal funding that they may use to make loans to students on criteria outside of credit scores. The schools determine how they will judge applicants—for example, some schools may weigh major and course load more heavily—and provide loans accordingly.

Tips

Closely examining all the disclosures for your student loans will not only help protect your credit, it will ensure that you aren't paying unnecessary and expensive loan fees now and in the future. Always read the fine print of your loan contract. Take note of the length of the loan term (normally 10 years), the monthly payments, and the interest rate, as well as how interest rates might fluctuate over time. Among the few benefits of paying off student loans is that any interest you pay, for private or public loans, is tax deductible within income limits.

Find out when repayment begins on your loans, which is generally after you graduate but varies by loan and lender. For many lenders, you may be expected to begin paying back the loan immediately if you drop out of school or fall below a certain number of enrollment hours. Alert your lender if you change your address or telephone number, so that you don't miss any payments or important communications.

Avoid default if at all possible. If you default on the loan, which generally occurs after you miss multiple payments in a row, you will owe the total loan balance immediately, plus any collection fees. You will also damage your credit record. A student loan in default stays on your credit record for seven years after it's paid in full.

Again, if you are having trouble making payments, there are options. Call or write your lender to let them know your situation and request forbearance (a delay in payment for a set period of time, although interest continues to accumulate) or ask to renegotiate a payment plan.

For assistance, start with the Department of Education's Federal Student Aid Ombudsman at www.fsahelp.ed.gov or 877- 557-2575. ■

Lenders are reaching out to customers at risk of trouble

By Ruth Susswein

After luring people into debt with unlimited credit card offers, unrequested credit limit increases and home loans that were too good to be true, lenders are reeling from record levels of delinquencies and foreclosures.

Some banks are coping with this new reality and cutting their losses by lowering credit limits, closing accounts, and raising interest rates.

These practices are hitting even good customers. In this rocky economy, banks are defensive because even good customers might become a credit risk.

To address the risk of default on a system-wide basis, companies are increasing credit card rates across the board because of "market conditions."

In December, Chase hiked minimum payments for some cardholders from two to five percent of the balance. When customers complained, Chase let cardholders avoid a higher minimum payment if they accepted a higher interest rate instead.

A helping hand

However, some lenders have adopted a proactive approach to reach out to customers to help them stay afloat.

"It's in the best interest of banks and their shareholders to help their cardholders," points out Linda Sherry, director of national priorities for Consumer Action. "If huge numbers of cardholders default, the companies themselves may face bankruptcy and there will be a lot of very unhappy investors."

Some mortgage lenders have agreed to modify some mortgages to avoid foreclosure. Both banks and mortgage holders benefit when loan modifications prevent foreclosures.

Housing values plunged in 2008, leaving many homeowners "upside down"—owing more than their homes are worth. With unemployment figures continuing to grow, there are record numbers of people who can no longer afford their monthly mortgage payments.

Bank of America, which now owns the nation's largest home loan lender, Countrywide, is offering eligible borrowers a variety of loan workout programs.

Through its Homeownership Retention Program, the company has been contacting customers who need or may soon need (after adjustable rate resets) to modify their mortgages by reducing interest rates, extending loan terms, and, as a last resort, even reducing principal balances. This approach is expected to help as many as 400,000 homeowners.

Agreement with AGs

In an agreement with 14 state Attorneys General, Bank of America is:

• Freezing foreclosures for anyone who is working on a modification.

• Working to offer the same modifications for the loans they service as well as the ones they own.

• Waiving delinquency fees.

For high priced subprime and option ARM (flexible payment mortgages), the bank is:

• Offering three to five year extensions on introductory rates (or dropping rates as low as 3.5%) and converting to a fixed rate in five years.

• For some homeowners, the principal is reduced to approach or equal the home's current value.

• Mortgage payments are targeted to 34% of monthly income.

Relocation funds are also available for homeowners who have completed foreclosure.

BofA /Countrywide may consider other types of modifications such as a repayment plan with temporary suspensions (forbearance) or reductions in mortgage payments. In some cases, these missed payments are added to the end of the loan, extending repayment and increasing the overall cost.

If one of these arrangements still is not affordable, homeowners may be offered the chance to avoid foreclosure by selling the house through a short sale in which the lender approves a sale for less than what is owed on the loan and writes off the balance.

Other options may be "deed in lieu of foreclosure" in which the borrower gives the deed to the lender. This approach results in losing the home, but it is less damaging to the homeowner's credit record.

Another arrangement, cash for keys, means you lose the home but are given some cash to move out quickly and leave the property in good condition.

BofA/Countrywide loan modifications also vary depending on whether the bank owns or services the loan.

When the bank owns the loans, it can control mortgage modifications.If it only services the loan, it may have less flexibility in making modifications. This has been a stumbling block for many troubled homeowners seeking loan modifications.

Some servicers and lenders are offering temporary modifications. For instance, some modifications last only three years, after which the loan reverts to its original rate.

"In three years, the homeowner may have other options. Their credit score may be improved or the house may have much greater value and the homeowner may be able to afford the [original] loan, or we may do another mod in three years. The goal is a sustainable, affordable loan," says Jerry Durham, Countrywide's vice president of homeownership preservation.

BofA/Countrywide's Homeownership Preservation Hotline is 800-661-9917.

Citi mortgage loans

Citigroup is contacting up to half a million homeowners in high default parts of the country (such as California, Arizona, Florida and the Midwest) to prevent defaults before homeowners fall behind.

The bank is offering a moratorium on foreclosures for homeowners who live in their homes and who have sufficient income to meet a modified repayment plan. Citi may offer rate reductions or loan extensions to homeowners.

Citi's Office of Homeownership Preservation can be reached at 866-915-9417 if you are already delinquent, or at 800-MORTGAGE if you are not behind. On the web, visit www.mortgagehelp.citi.com.

Chase mortgages

JP Morgan Chase (new owner of Washington Mutual) has frozen foreclosures and is working to lower interest rates or temporarily reduce loan balances, particularly for subprime borrowers. (Subprime borrowers typically pay higher interest rates for loans.)

Chase's Mortgage Modification Hotline is 866-550-5705.

Hope Now

To reach the lending industry's Hope Now hotline for free referrals, counseling and efforts at preventing foreclosure, contact 888-995-HOPE (4673) or www.hopenow.com.

Credit card issuers

Some card companies, such as American Express, are offering temporary customized payment plans, flexibility with rates, fees and the length of repayment time.

Discover says it is devoting more of its staff to borrowers who need help. Bank of America is waiving fees, reducing interest rates for some customers and adding collection staff. Citi offers a settlement program for cardholders who are very behind on their payments. Capital One offers APR reductions and is reaching out to cardholders who miss a payment to work out an early solution. Each issuer says debt reduction decisions are made on a case-by-case basis.

For more information on how to handle credit card debt, see "What to do when you can't make the minimum payment" on page 3.

Lenders state that the best way to arrange for a loan workout plan is to communicate with them. While many consumers say they get the cold shoulder when they contact lenders, the companies say it works the other way too. Attempts to contact troubled borrowers often are ignored, making it impossible to devise an affordable solution.

Some lenders are giving cardholders incentives to get in touch. Enticements include free phone cards being mailed to delinquent customers. When the customer calls to activate the card the collection department tries to negotiate a settlement for what is owed.

Always get the terms of any debt workout program in writing. ■

Debt collectors must follow the law

Under the Fair Debt Collection Practices Act, third party collectors (but not the original owners of the debt) are prevented from:

• Contacting you before 8 a.m. or after 9 p.m.

• Calling you at work if you tell them your employer disapproves of personal calls.

• Using threats of violence or harm, or obscene or profane language.

• Repeatedly harassing you by phone.

• Implying that you've committed a crime or will be arrested if you do not pay your debt.

• Telling anyone other than you and your attorney (if you have one) that you owe the debt.

For more information about your right to dispute a debt under the law, visit Consumer Action's web site (www.consumer-action.org) and click on Frequently Asked Questions under the Help Desk. See the Debt category.

You can also call or email our hotline (see page 3) for advice. ■

Join Consumer Action

Consumer Action depends on the financial support of individuals. All members receive a subscription to *CA News*. New members also receive our popular *How to Complain* booklet. In addition, members have the satisfaction of supporting our advocacy efforts in California and nationally, a free hotline and the distribution of more than one million free educational brochures a year.

☐ $25, Regular Membership.
☐ $35, Regular Membership (first class mailing).
☐ $15, Senior or Student Membership.
☐ $10, Low Income Membership.
☐ $50, Corporate Subscription (first class mailing, and all CA press releases).
☐ $_____ Additional donation to CA's Publication's Fund, supporting the free distribution of CA materials to consumers.

Name ________________ Address ________________

City ________________ State ________ ZIP ________

Mail to: Consumer Action, 221 Main St., Suite 480, San Francisco, CA 94105.

02/09

Donations to Consumer Action are tax-deductible.