

How to Use a Credit Counseling Service to Get Out of Debt

Credit counseling services, also known as debt counseling services, are agencies that provide debt management and debt consolidation services. Many credit counseling services operate as nonprofits. You should never work with a for-profit service. Generally, these services will only work to help you get out of bad debts, such as credit card balances, and won't help you consolidate debts such as student loans or auto loans.

What Credit Counseling Services Do

When you go into credit counseling you turn over your debt to a third party whom you then repay (with interest) each month. Credit counseling services will also work with you to come up with a debt management plan (DMP) to consolidate and pay off your existing debts. Typically, their programs work like this:

You meet with a credit counselor: At the initial meeting, the counselor will inquire about the type and amount of all of your debts. After the initial consultation, the counselor will ask you to submit an application that includes your personal information, as well as paperwork documenting the consumer debts you'd like the agency to help you consolidate.

The service creates a debt management plan (DMP) for you: Under the DMP, you'll deposit a certain amount of money into an account set up by the counseling service. The service will then use that money to pay off your creditors month by month. The amount of your monthly deposits will include interest at a fixed rate that should be lower than the overall APR on the debts you're consolidating.

The service negotiates with your creditors: Once you're approved for a credit counseling program and have agreed to the terms of your DMP, the service will contact your consumer-debt creditors and attempt to negotiate better rates on your outstanding balances. You won't be involved in these discussions at all.

You pay a monthly bill to the service: You'll make one monthly payment—usually with one fixed APR—to the counseling service each month. They'll use that money to continue to pay off your debts on an ongoing basis, usually over a period of 3–5, years depending on the amount of your debts and the APRs that the service was able to negotiate on your behalf.

Debtor Education

In addition to helping you pay down your existing debts, credit counseling services also offer debt counseling, or debtor education. Working with a counseling service can help you resolve your current debt problems and learn how to prevent getting back into debt. The debtor education that most counseling services provide includes:

A monthly repayment plan: A good credit counseling agency will work with you to develop a DMP before they take over your debt. That way you'll be able to confirm up front that using their service will help you save money (by paying lower rates) and get out of debt.

A debt-prevention plan: Most credit counseling agencies will continue to work with you after you get your loan to ensure that you don't fall back into debt. For instance, they might help you develop a budget or help you get started saving and investing once you're debt-free.

How Credit Counseling Affects Your Credit

Some people fear that working with credit counseling services will harm their credit score and mark them indelibly as debtors. This is somewhat of a myth. Working with a credit counseling service can actually improve your credit score in two ways:

Working with a credit counseling agency will typically improve your credit score by eliminating your current debt and helping you get back on track with your payments.

Creditors will often re-age your account once you begin making regular payments through the credit counseling service. Re-aging can involve canceling fees for late payments made before you entered counseling or agreeing not to notify credit bureaus about payments that you recently missed or made late.