Lesson 6.6: Strategies for Getting Out of Debt

Standards and Benchmarks

See page 5.

Lesson Description

In this lesson, students list the potential causes of debt. Then, through readings and a video, students analyze potential solutions for getting out of debt. To obtain answer keys for the handouts and assessment in this lesson, create an account on FederalReserveEducation.org

Concepts

Bankruptcy
Credit Counseling
Credit Repair
Debt
Debt Consolidation Loan
Debt Settlement

Objectives

Students will be able to:

- list strategies for paying off credit card debt.
- summarize options for getting out of debt.
- explain the benefits and costs associated with different methods of getting out of debt.

Compelling Question

What steps can individuals take to get out of debt?

Time Required

45-60 minutes

Materials

- Visual 6.6.1: Daisy's Credit Card Debt, one copy for teacher
- Handout 6.6.2: Options for Overcoming Debt, one copy for each student
- Handout 6.6.3: Consumer Financial Protection Bureau Reading, one copy for each student
- Page One Economics: What Is the Best Strategy for Paying Off Credit Card Debt? (https://web.archive.org/web/20240801141021/https://files.stlouisfed.org/files/htdocs/publications/page1-econ/2023/02/01/what-is-the-best-strategy-for-paying-off-credit-card-debt_SE.pdf), one copy for each student

Procedure

1. Begin the lesson by asking students to list common reasons for getting into debt. (*Answers will vary but students will likely suggest overspending or loss of income/job. Other answers include medical bills, student loans, car loans, mortgages, and divorce.*)

2. Tell students that in today's lesson, they will be considering ways that they can get out of debt. Explain that sometimes getting out of debt can be as simple as selling items, getting more hours at work, or revisiting budgets by reducing spending and adding a dedicated category for paying back loans.

3. Display Visual 6.6.1: Daisy's Credit Card Debt. Tell students Daisy has budgeted $200 to apply to her credit debt. Ask students:

    a. How much does Daisy need to pay towards Card 1? (*$85*)

    b. How much does Daisy need to pay towards Card 2? (*$40*)

    c. After paying the minimums, how much money does Daisy have left? (*$85*)

    d. How would you advise Daisy to use the remaining $85? (*Answers will vary but will be one of the following three options: All extra money to Card 1 until it is paid off [Card 1: $85, Card 2: $0]; All extra money to Card 2 until it is paid off [Card 1: $0, Card 2: $85]; Split the money between cards [example: Card 1: $42.50, Card 2: $42.50].*)

4. Distribute one copy of Page One Economics: What Is the Best Strategy for Paying Off Credit Card Debt? to each student. Have students work in pairs to read the article and answer the questions.

    Note: This procedure step can also be done virtually through FederalReserveEducation.org. The reading and questions can be found at: https://www.federalreserveeducation.org/teaching-resources/personal-finance/managing-credit/what-is-the-best-strategy-for-paying-off-credit-card-debt

5. Review the answers as a class. Answers can be found in the answer key.

6. Display Visual 6.6.1 and ask students if they would change their advice to Daisy. If students changed their minds, have them justify their new position.

7. Tell students that sometimes the amount of debt is too large to tackle without professional help. One solution is declaring **bankruptcy**. Define bankruptcy as a legal process for declaring that a person is unable to pay his or her debts. The process may involve a court-supervised process of selling the bankrupt person's belongings to pay part of the debts owed to creditors.

8. Distribute Handout 6.6.2: Options for Overcoming Debt and tell students to answer the questions as they watch a video about how bankruptcy works.

9. Show the following video to students: https://youtu.be/tpI0XWjIsqI?si=DGusNrpG36pyKh4B.

10. Review the answers as a class. Suggested answers are provided in Answer Key 6.6.

11. Tell students that although bankruptcy is an option, there are other options that involve outside help, as well. Distribute Handout 6.6.3: Consumer Financial Protection Bureau Reading to each student.

12. Have student volunteers read the article aloud to the rest of the class.

13. In pairs, have students fill out the graphic organizer on Handout 6.6.2. The graphic organizer asks students for a definition of the strategy, why they might use it as a strategy to get out of debt, and why they would not use it as a strategy to get out of debt.

14. Once the pairs have completed the handout, review the answers to the questions as a class.

Closure

15. Review the important concepts from the lesson by asking students:

    a. What are two popular strategies for paying off balances? (*After paying the minimums on all cards, pay extra towards lowest balances [Snowball], or pay extra towards highest interest rates [Avalanche]. As cards are paid off, continue allocating the money towards the card that meets the strategy.*)

    b. Which repayment strategy is the most preferred? (*The one that credit card holders can follow.*)

    c. What does it mean to declare bankruptcy? (*Declaring bankruptcy is a legal process where an individual declares they cannot repay their debts.*)

    d. What do credit counselors do? (*Credit counselors advise you on managing money and debts. They can help you set up a debt-management plan.*)

    e. What is a debt consolidation loan? (*A debt consolidation loan is money you borrow to repay all your separate loans and pay back just one amount.*)

    f. What do debt settlement companies do? (*Debt settlement companies offer to remove debts from your creditors for a fee using money that you have saved.*)

Assessment

16. Your older sibling was a manager at a store that went out of business. Since becoming unemployed, they are struggling with making full payments on their credit cards. What do you suggest your sibling do to overcome this setback? Explain. (*See Answer Key 6.6 for detailed grading guidance.*)

Related Resources

- Debt getting in your way? Get a handle on it. CFPB
- Avoiding medical debt, CFPB
- Repaying student loans, CFPB
- Bankruptcy: When All Else Fails, FRE
- Bankruptcy Basics, FRE

Standards and Benchmarks

National Standards for Personal Financial Education

Standard 5: Managing Credit

Credit allows people to purchase and enjoy goods and services today, while agreeing to pay for them in the future, usually with interest. There are many choices for borrowing money, and lenders charge higher interest and fees for riskier loans or riskier borrowers. Lenders evaluate creditworthiness of a borrower based on the type of credit, past credit history, and expected ability to repay the loan in the future. Credit reports compile information on a person’s credit history, and lenders use credit scores to assess a potential borrower’s creditworthiness. A low credit score can result in a lender denying credit to someone they perceive as having a low level of creditworthiness. Common types of credit include credit cards, auto loans, home mortgage loans, and student loans. The cost of postsecondary education can be financed through a combination of grants, scholarships, work-study, savings, and federal or private student loans.

Benchmarks Grade 12

10. Borrowers who face negative consequences because they are unable to repay their debts may be able to seek debt management assistance.

11. In extreme cases, bankruptcy may be an option for people who are unable to repay their debts.

Visual 6.6.1: Daisy's Credit Card Debt

	Balance	Minimum Payment	Interest Rate
Credit Card 1	$5,000	$85	20%
Credit Card 2	$2,500	$40	14%

Adapted from What is the Best Strategy for Paying Off Credit Card Debt? (Federal Reserve Bank of St. Louis), 2023

Handout 6.6.2: Options for Overcoming Debt (page 1 of 3)

Answer the questions related to PBS' Two Cents "How Bankruptcy Works" Video.

1. Bankruptcy provides relief to people who are unable to meet their financial obligations to lenders. True or False?

2. Filing for bankruptcy eliminates all debts. True or False?

3. What is the difference between Chapter 7 and Chapter 13 bankruptcy?

4. Bankruptcy is a quick solution for debt forgiveness. True or False?

5. Why might you choose bankruptcy?

6. Why might you reject bankruptcy as an option?

Handout 6.6.2: Options for Overcoming Debt (page 2 of 3)

Directions: Use Handout 6.6.2: CFPB Reading to fill out the table below.

Credit Counseling	
Definition	
Why might you choose credit counseling?	
Why might you reject credit counseling as an option?	
Debt Settlement Companies	
Definition	
Why might you choose debt settlement?	
Why might you reject debt settlement as an option?	

Handout 6.6.2: Options for Overcoming Debt (page 3 of 3)

Debt Consolidation Loan	
Definition	
Why might you choose credit counseling?	
Why might you reject credit counseling as an option?	
Credit Repair Company	
Definition	
Why might you choose debt settlement?	
Why might you reject debt settlement as an option?	

cfpb Consumer Financial Protection Bureau

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What is the difference between credit counseling and debt settlement, debt consolidation, or credit repair?

Credit counseling organizations are usually nonprofits that advise and educate you on managing your money and debts. Debt settlement companies, debt consolidation lenders, and credit repair companies are typically for-profit companies that promise to fix your credit and debts and charge you money for taking actions you can do yourself for free.

Credit counseling

Credit counseling organizations (cfpb.gov/askcfpb/1451) are usually nonprofit organizations that advise you on managing your money and debts. They usually offer free educational materials and workshops. An initial counseling session typically lasts an hour, with an offer of follow-up sessions.

Credit counselors can work with you to set up a debt management plan (also called a payment plan) for all your debts. They can't erase your debts. Under a debt management plan, you make a single payment to the credit counseling organization each month or pay period. The credit counseling organization then makes monthly payments to your creditors. Credit counseling organizations are permitted to charge you fees for their services.

Under debt management plans, credit counselors do not always negotiate reductions in the amounts you owe. Instead, they work to lower your overall monthly payment. They might get the creditor (cfpb.gov/askcfpb/1387) to lengthen the time you have to repay a loan. They might also get the creditor to lower the interest rates (cfpb.gov/askcfpb/1417). The arrangement usually does not affect your taxes.

How do I recognize a credit counselor?

- Usually works for a nonprofit organization
- Advises you on managing your money and debts
- Helps you set a up budget for your repayments
- Sets up a payment plan with your creditors, including getting the creditors to agree not to pursue collection efforts or charge late fees while on the plan
- Works to lower your overall monthly payment, rather than trying to negotiate reductions in the amounts you owe
- Never advises you to stop paying your debt

Debt settlement

Debt settlement companies (cfpb.gov/askcfpb/1457) offer to remove your debts to lenders or debt collectors for a fee. They typically offer to pay off your debts with lump sum payments that you have to save up before a settlement. Under the law, money you save up in an account for use by a debt settlement company still belongs to you. The account must be administered by an independent third party and must be under your control. You are entitled to withdraw funds held in that account at any time without penalty. In practice, many debt settlement companies collect money from you and consider it fees you paid to them, instead of money they should be using to settle your debts.

Before you start working with a debt settlement company

- Many lenders do not negotiate with debt settlement companies.
- Many lenders and debt collectors do not negotiate a settlement amount for your individual situation—instead, they have standard policies about how much loan principal can be forgiven when you haven't made payments for a certain amount of time.
- Debt settlement companies usually can't get better terms than you could get by negotiating with your lenders and debt collectors yourself (cfpb.gov/askcfpb/1447).
- Debt settlement companies cannot guarantee the amount of money or percentage of debt that you might save by using their services, and they cannot guarantee how long the process takes.
- Debt settlement companies cannot erase all your debts.

How do I recognize a debt settlement company?

- Usually a for-profit company that charges a fee for their services
- Offers to arrange settlements of your debts with lenders or debt collectors
- Generally has no up-front agreements with lenders
- Typically offers to pay off your debts with a lump sum payment
- Usually advises you to stop paying your creditors until a debt settlement is negotiated with creditors, even though this can mean fees and interest charges keep adding up, your credit is further damaged, and you are left open to more debt collection efforts and lawsuits
- Tries to get some of your debts forgiven, which could mean you owe taxes on the amount forgiven

Beware of debt settlement companies that charge upfront fees. A debt settlement company could be breaking laws if they charge you a fee before three things happen:

1. **A successful result is reached**. The debt settlement company must have renegotiated, settled, reduced, or otherwise changed the terms of at least one of your debts.
2. **An agreement is made between you and the creditor or debt collector**. You must agree to the settlement agreement, debt management plan, or other result reached by the debt settlement company with your creditor or debt collector.
3. **You have made a payment to the creditor**. You must have made at least one payment to the creditor or debt collector as a result of the agreement negotiated by the debt settlement company.

If you simply cannot afford to pay what you owe, you could consider filing for bankruptcy. Consult a bankruptcy attorney to find out more (cfpb.gov/askcfpb/1433) about how this process works.

Debt consolidation lenders

Debt consolidation loans can be offered by banks, credit unions, and other lenders. A debt consolidation loan is money you borrow to repay all your separate loans and pay back just one amount. You pay back the debt consolidation loan over time. This simplifies the number of payments you have to make. The debt consolidation loan might have a lower interest rate than what you're paying on your debts.

Before you take out a debt consolidation loan

- Keep in mind that a low interest rate could be a "teaser rate" that applies only for a limited time.
- After the teaser rate expires, your payments could go up because your lender can increase the interest rate.
- Although your monthly debt payment might be lower, it could be because you're paying over a longer time.
- Taking the loan's length of time, fees, and costs into account, overall you might pay more for the convenience of a consolidated loan than you would have had to pay for your original debt payments.

Credit repair

Credit repair companies make promises to fix your credit or improve your scores, typically by doing things you can do yourself for free. They often use advertising and social media promotions. They operate usually by noting negative items on your credit report and then sending disputes to consumer reporting companies, including the three nationwide credit reporting companies (Equifax, Experian, and TransUnion). The reporting company has an obligation to contact the creditor to verify the negative item. If the creditor does not respond within 30 days, the information is removed from your credit report.

There is a catch, however. If the reporting company decides that the dispute is "frivolous," it does not have to investigate. This can happen if the reporting company gets multiple requests or requests that seem formulaic, which sometimes fits the profile of a credit repair company.

The only time you should dispute information is when it's inaccurate. But credit repair companies typically dispute accurate items on your report, too. This could mean accurate items disappear temporarily while the credit reporting company verifies the information. After the item is verified, it reappears on your credit report. Your credit scores could change—and then change back—because of these actions.

Negative items that are accurate remain on your credit report for the appointed timeline. Negative information such as collections, charge-offs, judgments, and accounts reported late during the loan's term remain on the credit report for seven years from the last activity or first delinquency date. Items are removed from the credit report once the seven years are up.

Before you start working with a credit repair company

- Keep in mind that there are no shortcuts to achieving a strong credit history or high credit scores.
- Consumer reporting companies, including the three nationwide credit reporting companies, remove negative items on

- your reports once they are found to be inaccurate or incomplete, or if they cannot be verified—whether the negative items are disputed by you or a credit repair company.
- You can dispute mistakes in your credit reports (cfpb.gov/askcfpb/314) yourself, for free.
- Errors on your reports can be investigated and resolved, but credit repair companies cannot legally get information removed if it is accurate and timely.

How do I recognize a credit repair company?

- Usually a for-profit company that charges a fee for their services
- Often promises a quick increase in your credit scores
- Offers to remove negative items from your consumer reports, including credit reports generated by the three nationwide reporting companies (Experian, Equifax, and TransUnion)
- Often charges a monthly fee, which they justify by disputing the same negative items on your credit reports over and over

Beware of monthly subscription fees. Many credit repair companies use telemarketing to sell their services. By law, a credit repair company that signed you up for services through telemarketing is not allowed to send you a bill or receive payment until two things happen:

1. **The timeframe ends when they told you they would provide you their services**. This means they cannot charge you an upfront fee or ongoing monthly service fee, so sometimes the company calls it a “subscription fee” instead.
2. **They have sent you a report from a consumer reporting company**. The report must show that they achieved the promised results, and it must be created six months after the results were achieved.

Don't see what you're looking for?

Browse related questions

What is a debt relief program and how do I know if I should use one? (cfpb.gov/askcfpb/1457)

What is credit counseling? (cfpb.gov/askcfpb/1451)

Learn more about debt collection (cfpb.gov/consumer-tools/debt-collection/)

About us

We're the Consumer Financial Protection Bureau (CFPB), a U.S. government agency that makes sure banks, lenders, and other financial companies treat you fairly.

Learn how the CFPB can help you (cfpb.gov/about-us/the-bureau/)

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