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# When Your Income Drops: Plan to Pay Creditors and Protect Family Welfare

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In an ideal world, income exceeds expenses and your decisions concern investment or savings alternatives. Your goal is to better your family's welfare.

In the everyday world, however, where many circumstances can lead to a loss or drop in income, instead of being able to plan for investments, you may be caught unprepared with many unpaid bills. Simply maintaining family welfare is now your goal.

Loss of income often forces changes in financial decision making strategies. Don't leave these decisions to chance. In other words, if you face too many debts, you must choose which bills are high priority and which can be deferred, renegotiated or otherwise settled.

Decide which creditors to pay first by listing all bills and balances due. You may also want to refer to MU publication GH3342, *Reducing Consumer Debt*, for a debt analysis worksheet.

## Bills/creditors

- Housing
- Medical
- Utilities
- Phone
- Credit cards
- Gas
- Store accounts

## Reread the credit contract for each bill to determine:

- Balance due
- Minimum payment (weekly, monthly, annually)
- APR (annual percentage rate)
- Finance charge

- Late penalty clause
- Repossession clause (or other collateral that could be forfeited)
- Discontinued service agreement (if bill is unpaid)
- Bill collection procedures
- Debt renegotiation

### Set priorities. Pay those bills that:

- Maintain shelter (rent or mortgage)
- Maintain vital services (utility, phone, transportation, insurance).
- Cost the most to postpone (bills with late penalty, repossession or disconnect/reconnect charges).
- May be vigorously collected.

Prepare a payment plan before you talk to creditors, and contact them before your bills are due. Give them your proposed payment plan, a copy of your net worth statement and your financial plan. When you compromise with creditors, follow the agreement.

There are alternatives if you cannot arrange to pay your creditors with current or expected resources. Consider a debt consolidation loan or filing for bankruptcy, but visit a financial counselor and/or seek legal advice first.

# Debt consolidation

While a debt consolidation loan may simplify your life, remember you are taking on a new debt to finance the new loan at a higher interest rate. Before you commit to this strategy, make sure you have exhausted all of the possibilities for arranging payment with your creditors.

If, however, you do decide to obtain a consolidation loan, shop around for the best terms. Most lenders offer a better interest rate for a secured loan. Don't be deluded into thinking a consolidation loan solves your financial troubles. You still need to exercise financial care to meet all financial responsibilities and to plan for future welfare.

Debt consolidation loans are issued in Missouri by licensed banks, savings and loans, credit unions and finance companies. You arrange a cash loan to pay your creditors. Your new debt is to the financial institution making the loan.

This type of loan is useful when you cannot meet current obligations. Your monthly loan payment may be less than the individual debt total. Commercial debt consolidation loans cost money, however, and usually extend the length of indebtedness. Debt consolidation loans in Missouri are regulated under Section 408.100 of the Small Loan Act. The maximum annual percentage rate (APR) that could be charged on a debt consolidation loan is shown in the following table:

| Loan amount | Maximum APR |
|---|---|
| $0 to $1200 | 26.6 percent |
| over $1200 | 20.04 percent |

If you consider a consolidation loan, contact several financial institutions and ask what their annual percentage rate (APR) is on a loan in the amount you need. Ask if other finance charges are associated with the loan. Ask what happens if you default on a payment and what is required for collateral (property pledged by the borrower).

# Bankruptcy

If your financial affairs have deteriorated beyond repair, bankruptcy is a last recourse. Bankruptcy laws were designed to absolve persons of insupportable debts and spare them undue harassment by creditors. Bankruptcy may be a consideration if:

- Your creditors are unwilling to renegotiate debts;
- You cannot obtain a consolidation loan; and
- No other help is available.

You should view bankruptcy seriously. It is on your credit history for 10 years and jeopardizes your credit rating.

Bankruptcy includes two choices — Chapter 13 and Chapter 7. Chapter 13, formerly the wage-earner's plan, is designed for persons who wish to pay their bills with a source of regular income and less than $100,000 unsecured debts. This choice allows the debtor to act through a bankruptcy trustee and work out a whole or partial repayment plan if half of all creditors agree. Payments are made to the court, interest charges on your debts stop the day you file for bankruptcy, and the payment schedule is established for 36 months.

Chapter 7 bankruptcy is called voluntary or straight bankruptcy. When a petition is filed for bankruptcy under this choice, it includes a list of all assets and liabilities. With exception of certain personal possessions, the court liquidates major assets. Chapter 7 bankruptcy theoretically clears your financial record.

An advantage of Chapter 13 over Chapter 7 is that successful completion of the payment schedule appears more favorable on a credit history. The potential stigma of taking bankruptcy should be carefully considered, however, no matter which choice you favor.

Since bankruptcy laws were liberalized in the Bankruptcy Reform Act of 1978, the number of personal bankruptcies in the United States has tripled. Too many people are relying on bankruptcy to ease their financial burden rather than working with creditors to be financially responsible. This jeopardizes the credit business. Therefore measures are before Congress to reduce the apparent appeal of the bankruptcy option.

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