WHITE PAPER

Debt Settlement vs. Debt Management Program

How the two approaches work, what they cost, and what to ask before choosing a path

The central distinction

A debt management program (DMP) coordinates repayment of enrolled debts, usually with creditor concessions on interest or fees. Debt settlement seeks a creditor's agreement to accept less than the full balance. Neither outcome is automatic. [1, 2]

Executive summary

For consumers who can afford a steady repayment amount, a DMP may offer a structured route to repay unsecured debt in full. A nonprofit counselor first reviews income, essential expenses and debts; the agency then submits a proposed plan to participating creditors. Creditor approval and concessions vary. [1, 3]

Settlement can reduce the amount paid to a creditor if an offer is accepted. Company-run programs commonly ask people to set aside money while stopping payments. During that period, balances may grow, credit may suffer, collectors may call and creditors may sue. Fees and possible federal income tax on canceled debt affect the final cost. [2, 4, 5]

This paper focuses on unsecured consumer debts such as credit cards. It provides general education, not a recommendation for every household or individual legal, tax or credit advice.

Prepared for Advantage CCS Premium Resources | September 2026

How each approach works

Debt management program

A credit counselor reviews the household budget and determines whether a regular payment can cover the proposed plan. If appropriate, the consumer enrolls eligible debts and pays the agency on a schedule. The agency distributes payments to creditors. Creditors may approve lower rates or waive some fees according to their own policies; no agency can guarantee those concessions. Principal generally remains payable. [1, 3]

Advantage CCS describes its DMP as a voluntary arrangement designed to repay enrolled debt within 60 months or less. Its published FAQ lists a $50 enrollment fee and monthly servicing fees of $10 to $50, depending on state and the number of creditors; eligibility for fee waivers and actual terms should be confirmed with a counselor. Its credit counseling session is free. [3, 6]

Debt settlement

A consumer or a hired settlement company proposes a lump-sum or other agreement to resolve a debt for less than the balance. Creditors can decline. A company may ask the consumer to accumulate money in a dedicated account while it seeks settlements; these programs often encourage consumers to stop paying creditors. A consumer may also try to negotiate directly and should obtain any agreement in writing before paying. [2, 4]

Under federal telemarketing rules described by the FTC, a covered debt settlement company cannot collect its fee before it settles or otherwise changes at least one debt and the required conditions are met. This rule does not mean settlement is free: consumers may still pay a substantial fee after each successful settlement and may pay account administration costs. [2]

Important qualification

A DMP is not a new loan and does not erase principal. A settlement is not guaranteed, even when money has accumulated in a dedicated account. [1, 2]

Side-by-side comparison

Question	Debt management program	Debt settlement
Core goal	Repay enrolled principal under a structured plan; seek creditor concessions.	Resolve individual debts for less than the full balance if creditors agree.
Payment path	One recurring payment to the counseling agency, which pays participating creditors.	Build funds for individual settlement offers; timing and acceptance vary.
Creditor choice	Each creditor must approve its proposed terms.	Each creditor may reject or counter an offer.
Fees	Counseling may be free; DMP setup and monthly fees vary by agency and state.	Company fee, possible dedicated-account costs and any added interest or late fees.
Credit effects	Account closures and the history of payments may affect scores; no score outcome is promised.	Missed payments can damage credit if payments stop; resolved accounts may also be reported.
Taxes	Usually no cancellation-of-debt tax issue if principal is repaid.	Canceled debt may be taxable unless an exception or exclusion applies.
Best starting question	Can I reliably afford the full proposed payment?	Can I withstand uncertainty, collection activity and a possible lawsuit?

The table describes common program structures, not universal outcomes. Creditors, debts, state rules and personal finances change the result. [1-6]

Compare the full cost, not the headline payment

A settlement advertisement may highlight a reduced balance. That figure does not show the complete expense. Add the amount actually paid to creditors, the company's fee, dedicated-account charges, interest and penalties accrued while payments were missed, and any tax due on canceled debt. Unsettled accounts remain payable. [2, 4, 5]

A DMP payment should be assessed against the amount paid to creditors over the full schedule plus setup and monthly program fees. Ask which rate concessions each creditor has approved, whether payments fully amortize the balance, and what happens if a creditor declines. The lower monthly bill is not necessarily the lower total cost. [1, 3]

A worksheet for any proposal

Write down: current balances; planned monthly contribution; all program fees; estimated months to completion; projected total paid; assumptions about creditor approvals; what happens if you miss a payment; and how much cash remains for essentials and emergencies.

Credit and collection risk

A DMP may require enrolled credit cards to be closed or restricted. Score changes depend on the individual credit file and continued payment history, so a promised score increase is not a sound basis for enrollment. Settlement programs that rely on missed payments expose consumers to late reporting, growing balances and collections before any offer succeeds. The FTC and CFPB warn that a creditor may sue while a settlement is pending. [2, 4, 7]

Tax treatment

Canceled debt is generally included in federal gross income unless an exception or exclusion applies. Insolvency and bankruptcy can change the result; a Form 1099-C does not by itself determine the amount that must be reported. Ask a qualified tax professional about your facts before counting a settlement as savings. [5]

Which path merits a closer look?

A DMP may be worth exploring when

• You have unsecured debts, steady income and enough room after essentials to make a consistent plan payment.

• Lower interest rates or waived fees would make full repayment realistic if creditors approve.

• You want counselor support, one payment schedule and an estimate of the total payoff cost. [1, 3]

Settlement warrants special caution when

• The proposal depends on stopping payments to accounts that are currently current.

• You cannot build settlement funds while also preparing for possible collections, litigation or tax consequences.

• A sales pitch promises a fixed discount, a guaranteed timeline, or protection from lawsuits. [2, 4]

Other options belong in the conversation

Before paying any company, ask creditors directly about hardship programs or reduced rates. A nonprofit counselor can review a budget even when a DMP is unsuitable. When debts cannot realistically be repaid, a qualified bankruptcy attorney can explain legal options and protections. The appropriate choice depends on income, assets, account status, and any active lawsuit. [2, 4, 8]

A useful first appointment

Bring recent statements, balances, interest rates, income information, essential expenses and any collection or court notices. Ask for a written budget and a realistic monthly amount before signing an agreement.

Questions to ask before enrolling

For a DMP provider

- Which debts qualify, and which creditors have approved the proposed terms?
- What are the setup and monthly fees, and can any fee be reduced or waived?
- What is the projected total paid and payoff date? What happens to my credit cards?
- When will my first creditor payments be sent, and how can I verify every payment?
- What happens if my income changes or I need to leave the plan?

For a settlement company

- When will the first offer be made, and what specific savings amount must I accumulate first?
- What fee is charged for each settled debt, and what does the dedicated account cost?
- Will you advise me to stop paying? What interest, penalties, collection activity and lawsuit risk could follow?
- If a creditor refuses, what happens to that debt and to the money in my account?
- Will you give me the exact settlement terms in writing before any payment?

Get written answers, read the entire agreement, and do not rely on a verbal promise. The FTC lists disclosures a debt settlement company must provide before enrollment and warns against guaranteed results. [2]

Conclusion and next step

A DMP and debt settlement address different problems. A DMP aims to make repayment of enrolled balances manageable through a coordinated schedule and possible creditor concessions. Settlement aims to reduce the amount accepted for a particular debt, while exposing the consumer to uncertainty about acceptance, fees, credit damage, collection and tax treatment. A comparison must include the full cost and the household's ability to follow through. [1, 2, 4, 5]

Talk through your options with Advantage CCS

Advantage CCS offers a free, confidential credit counseling session. A certified counselor can review your budget and debts, explain whether a DMP may fit, and discuss other options. Visit advantageccs.org to get started. [6, 9]

Sources and further reading

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[2] FTC, How To Get Out of Debt. https://consumer.ftc.gov/articles/how-get-out-debt

[3] Advantage CCS, How Does a DMP Work?. https://www.advantageccs.org/how-does-a-debt-management-program-work/

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