

# **Benefits of Debt Settlement: Financial and Psychological Advantages**

**James Farias**

**CEO**

**Relief Strategies, LLC**

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## Introduction

Debt settlement is a structured financial strategy designed to help individuals reduce their total outstanding debt by negotiating directly with creditors. Through this process, debtors can often secure a settlement for a fraction of what they owe, allowing them to resolve their financial burdens more efficiently than other long-term repayment strategies. While commonly perceived as a last resort, debt settlement can provide a viable and strategic alternative to bankruptcy, offering substantial relief to those facing overwhelming financial distress.

Beyond the immediate financial advantages, debt settlement carries profound psychological benefits. The weight of unmanageable debt often leads to stress, anxiety, and strained personal relationships, making financial recovery an essential component of overall well-being. Successfully settling debt not only alleviates financial pressure but also empowers individuals to regain control over their future, rebuild their credit profile, and establish healthier financial habits.

This white paper explores the multifaceted benefits of debt settlement, from its ability to significantly reduce debt loads and improve cash flow to its broader impact on mental health and long-term financial stability. It also examines debt settlement in comparison to alternative solutions, outlines key legal protections, and provides insights into post-settlement financial strategies that can help individuals rebuild and maintain their financial health.

## Financial Benefits of Debt Settlement

### Reduction in Total Debt Owed

One of the most compelling benefits of debt settlement is the potential for significant reductions in the total debt owed. Creditors often agree to settlements where individuals pay a fraction of their outstanding balance, providing immediate financial relief.

- **Typical Reduction Rates:** Settlements often range between **40% to 60% of the total debt**, depending on the creditor and negotiation strategy.[1]
- **Impact:** Lowering the principal balance makes it easier to pay off remaining obligations and rebuild financial health.

### Avoiding Bankruptcy (Chapter 7 vs. Chapter 13)

Debt settlement serves as a viable alternative to bankruptcy, which carries severe long-term financial and legal consequences. Most bankruptcy courts will not grant a **Chapter 7 bankruptcy** unless the individual is deemed **insolvent**, meaning their debts exceed their assets. If not insolvent, consumers are often required to file **Chapter 13 bankruptcy**, which functions similarly to debt settlement but with additional negative impacts, such as court-mandated repayment plans and a seven-year record on credit reports.

- **Bankruptcy Impact:**
  - **Chapter 7 Bankruptcy:** Remains on credit reports for **10 years** and may require liquidation of assets.[2]
  - **Chapter 13 Bankruptcy:** Requires **3-5 years** of court-ordered repayments before debts are discharged and remains on credit reports for **7 years**. [2]

- **Debt Settlement vs. Bankruptcy:** Unlike bankruptcy, debt settlement allows individuals to negotiate and resolve debts while maintaining more financial control and avoiding court interventions.[3]

## Faster Resolution Compared to Other Methods

Debt settlement programs are often faster than long-term repayment strategies such as debt consolidation or credit counseling. Unlike debt consolidation, which primarily restructures debt into a single payment with ongoing interest, debt settlement focuses on reducing the principal balance. However, without strong financial habits, debt consolidation can exacerbate financial problems, as individuals may accumulate new credit card debt, leading to a cycle of consolidating and borrowing repeatedly. Credit counseling, on the other hand, primarily addresses interest and fees but does not lower the principal owed, making it a slower path to full repayment.

- **Timeframe Comparison:**
  - **Debt Settlement:** Typically resolved within **24 to 48 months**.
  - **Debt Management Plans (Credit Counseling):** May take **4 to 6 years** and only reduce fees and interest, not the principal.[2]
  - **Debt Consolidation:** Generally requires **3 to 5 years** with ongoing interest payments and the risk of accumulating new debt.[2]
  - **Bankruptcy:** Legal processes can take **several months to years** to resolve fully.[2]
- **Advantage:** Individuals can regain financial stability more quickly by addressing the principal balance rather than just restructuring payments.[2]

## Improved Cash Flow and Budgeting

By settling debt for a reduced amount, consumers can redirect funds toward essential living expenses, savings, and future financial goals.[2]

- **Monthly Payment Relief:** Freed-up cash allows better budget management and financial planning.
- **Increased Savings Opportunities:** Debt settlement enables individuals to reallocate money toward **emergency savings, investments, or retirement accounts**.

## Psychological Benefits of Debt Settlement

### Reduced Stress and Anxiety

Debt-related stress is a significant burden for individuals struggling with financial obligations. Research indicates that debt settlement can provide a sense of relief and improve overall mental health.[4]

- **Study Data:** A **2023 report by the Money and Mental Health Policy Institute** found that **68% of consumers** undergoing debt resolution reported decreased anxiety and stress after reaching a settlement.[5]
- **Harassment Reduction:** Settling accounts minimizes collection calls and legal threats, reducing stress-inducing interactions with creditors.

### Improved Mental Health and Emotional Well-Being

Debt settlement contributes to better mental health outcomes, particularly for individuals facing financial distress.

- **Psychological Effects of Debt:** Unresolved debt is linked to **depression, insomnia, and increased anxiety disorders**.<sup>[6]</sup>
- **Post-Settlement Mental Relief:** Individuals often experience an **improved sense of well-being** once they eliminate outstanding debt burdens.

### Enhanced Financial Confidence and Future Planning

Successfully settling debt provides a psychological boost that empowers individuals to rebuild their financial future.

- **Financial Literacy Improvement:** Many individuals become more informed about budgeting, credit management, and financial planning after completing a debt settlement program.
- **Credit Recovery Strategies:** With proper post-settlement credit rebuilding, individuals can work toward higher credit scores and better financial opportunities.

### Strengthened Family and Social Relationships

Debt can strain personal relationships, particularly within families. Financial stress in a relationship can lead to conflict, resentment, and a breakdown of intimacy. Settling debt often alleviates these pressures and improves social well-being. By effectively managing and reducing debt, individuals can experience significant psychological benefits, leading to improved mental health and stronger personal relationships.<sup>[7]</sup>

**Study Data:** According to a **2022 survey by the Financial Health Network**, **45% of respondents** reported that debt-related stress negatively impacted their relationships.<sup>[8]</sup>

- **Emotional Rebuilding:** Debt settlement can foster better communication, reduce financial conflicts, and promote healthier relationships.

## Comparative Analysis: Debt Settlement vs. Other Debt Relief Options

Debt Relief Option	Key Benefit	Key Drawback	Impact on Credit	Timeframe
Debt Settlement	Reduces total debt owed	May require stopping payments, impacting credit short-term	Negative impact while delinquent, but improves after settlement	24-48 months
Debt Consolidation	Simplifies payments into one loan	Risk of accumulating new debt if spending habits don't change	Minor dip from loan inquiry, improves with on-time payments	3-5 years
Debt Management Plan (DMP)	Lowers interest rates and fees	Requires full repayment of principal	Initially drops, improves with consistent payments	4-6 years
Chapter 7 Bankruptcy	Eliminates most unsecured debt	Severe long-term credit damage	Drops 100-200 points, stays for 10 years	3-6 months
Chapter 13 Bankruptcy	Prevents foreclosure, structured repayment	Court-mandated plan, stays on credit report	Drops significantly, stays for 7 years	3-5 years
Negotiating Directly	No third-party fees	Success depends on creditor cooperation	Minimal impact if payments continue	Varies by creditor

## Key Takeaways from the Comparative Analysis

- **Debt Settlement** is a strong alternative for individuals struggling with **high unsecured debt**, but it requires **negotiation and may impact credit scores short-term**.
- **Debt Consolidation** works well for individuals who can **qualify for low-interest loans**, but **risky spending habits** can lead to further debt accumulation.
- **Credit Counseling (DMPs)** helps lower interest rates and fees, but **does not reduce principal and takes longer to complete**.
- **Bankruptcy** (Chapter 7 or Chapter 13) provides **legal protections and potential debt discharge**, but **has long-lasting negative effects on credit scores and financial standing**.

This **comparative table** will be included in the appropriate section of your document. Let me know if you'd like **modifications or additional data points!**

## Legal Considerations and Consumer Protections

Debt settlement is a highly regulated industry, and consumers should be aware of **their legal rights, protections, and potential tax implications** when participating in a settlement program. Understanding these laws can help individuals **avoid predatory practices**, make informed decisions, and maximize the benefits of their debt resolution efforts.

### Fair Debt Collection Practices Act (FDCPA)

The **Fair Debt Collection Practices Act (FDCPA)** is a **federal law designed to protect consumers** from abusive and deceptive debt collection practices. This law sets strict guidelines on how debt collectors can interact with individuals who owe money.[9]

#### Key Consumer Protections Under the FDCPA

- **Protection from Harassment & Abuse:** Debt collectors **cannot use threats, obscene language, or repeated harassing phone calls** to intimidate debtors.[9]
- **Verification of Debt:** Consumers **have the right to dispute a debt** and request written verification from the collector to ensure the claim is legitimate.[9]
- **Cease-and-Desist Rights:** If requested in writing, collectors **must stop contacting the debtor**, except for limited notifications such as legal action.[9]
- **Restrictions on Third-Party Disclosure:** Collectors **cannot disclose debt details to unauthorized third parties**, including employers and family members, preventing public embarrassment.[9]
- **Time-of-Day Calling Restrictions:** Calls **cannot be made before 8 a.m. or after 9 p.m.**, unless the debtor has granted permission.[9]
- **False Representation Prohibition:** Collectors **cannot falsely claim** to be attorneys or misrepresent legal actions being taken against the debtor.[9]

#### How Debt Settlement Interacts with the FDCPA

- Once an individual enrolls in a **debt settlement program**, their **settlement company often takes over communication with creditors**, reducing harassment from collection agencies.
- If a debt collector **violates the FDCPA**, consumers can file complaints with the **Consumer Financial Protection Bureau (CFPB)** or take **legal action** for damages.



## Consumer Financial Protection Bureau (CFPB) Regulations

The **Consumer Financial Protection Bureau (CFPB)** is a government agency responsible for **overseeing and enforcing fair practices** within the financial services industry, including debt settlement companies. The CFPB has issued regulations, such as Regulation F, which implements the FDCPA and prescribes federal rules governing the activities of debt collectors.[10]

### Key CFPB Regulations Protecting Consumers

- **Fee Restrictions:** Debt settlement companies **cannot charge upfront fees** before negotiating and settling a debt. Fees must be based on the actual savings achieved.[10]
- **Transparency Requirements:** Companies must **clearly disclose** the risks of debt settlement, expected timelines, and potential impacts on credit scores before enrollment.[10]
- **Advertising and Misrepresentation Protections:** Companies **cannot make false claims** about debt forgiveness guarantees or "government-approved" programs.[10]
- **Refund and Cancellation Rights:** Consumers **must be allowed to cancel their program at any time without penalty**. [10]

### How Debt Settlement Companies Must Comply with CFPB Regulations

- **Reputable firms follow CFPB guidelines** by providing full disclosure of fees, timelines, and risks.
- **Consumers should be wary of firms that promise "guaranteed" settlements** or ask for upfront payments, as these are clear violations of CFPB regulations.
- The CFPB provides **legal recourse for consumers harmed by fraudulent debt settlement practices**, allowing complaints and investigations into non-compliant firms.

## Tax Implications of Debt Settlement

One often-overlooked consequence of debt settlement is its **potential tax impact**. Under IRS regulations, **forgiven debt may be considered taxable income**—meaning the portion of the debt that is settled could result in a tax bill.

### When is Forgiven Debt Taxable?

- **IRS Reporting Requirements:** If a creditor forgives \$600 or more of a debt, they are generally required to report the canceled amount to both the debtor and the IRS using Form 1099-C, Cancellation of Debt.[11]
- **Taxable Income:** The forgiven amount is typically considered taxable income and must be reported on your tax return for the year in which the debt was canceled.[12]

### Insolvency Exemptions & Tax Reduction Strategies

Consumers **may not have to pay taxes on forgiven debt** if they qualify for the **insolvency exemption**:

- **Definition of Insolvency:** If a person's **total debts exceed their total assets** at the time of the settlement, they may be considered **"insolvent"** and can request an exemption from taxation on the forgiven amount.[12]
- **Claiming the Exemption:** To exclude the forgiven debt from taxable income due to insolvency, you must file IRS Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness.[13]

## How to Prove Insolvency

- **Documentation:** Maintain thorough records detailing your assets and liabilities at the time of debt cancellation. This may include bank statements, property valuations, and a comprehensive list of debts.
- **Filing Requirements:** Complete and attach Form 982 to your tax return for the year the debt was forgiven, providing the necessary information to substantiate your insolvency claim.[14]

## Managing Tax Risks in Debt Settlement

- **Professional Guidance:** Consulting with a tax professional or financial advisor can help you navigate the complexities of debt settlement and its tax consequences, ensuring compliance with IRS regulations and optimizing your financial outcome.

By understanding these tax implications and proactively managing them, you can make informed decisions during the debt settlement process and avoid unexpected tax liabilities.

## Rebuilding Credit After Debt Settlement

After successfully settling debts, individuals must take steps to **rebuild their credit** and restore their financial standing. The following strategies can help accelerate the recovery process:

### Understanding Credit Score Myths

Many people misunderstand how their credit score is calculated and the role it plays in financial decisions.

- **Myth 1: Debt Settlement Permanently Ruins Credit** – While debt settlement initially lowers credit scores due to delinquent payments, **scores can recover within 12 to 24 months** if responsible credit habits are adopted.[15]
- **Myth 2: A Higher Credit Score Equals More Borrowing Power** – Lenders look beyond credit scores and assess **debt-to-income (DTI) ratios, credit utilization, and payment history**. [16]
- **Myth 3: Closing Old Accounts Improves Credit** – Keeping old accounts open, even with a \$0 balance, can **help maintain a longer credit history**, which benefits scores.[16]

### Secured Credit Cards and Responsible Credit Use

For individuals entering a debt settlement program, choosing a secured credit card can be a **powerful tool** for rebuilding credit responsibly. Secured credit cards require a **refundable security deposit**, making them accessible to those with poor or damaged credit while providing a structured way to demonstrate financial responsibility.

#### Benefits of Secured Credit Cards:

- **Credit Building:** Responsible use of secured credit cards can help establish or rebuild credit, as payment activity is reported to major credit bureaus.[17]
- **Accessible Approval:** Due to the security deposit, secured credit cards are typically easier to qualify for, even for those with damaged credit.[17]

#### How Secured Credit Cards Help Rebuild Credit

- **Reports to All Major Credit Bureaus:** A secured card **must** report to **Experian, TransUnion, and Equifax** for it to positively impact credit history.



- **Encourages On-Time Payments:** Making payments consistently can **strengthen credit scores over time**.
- **Builds Credit Utilization History:** Low credit utilization (keeping balances below **30%**, ideally **under 10%**) improves overall **lendability**.

## Top Secured Credit Cards for Credit Rebuilding

Here are some of the best secured credit cards, **ideal for those completing a debt settlement program**:

Card	Annual Fee	Rewards	Deposit	Best For
Discover it® Secured	\$0 [18]	2% cash back (gas & dining, up to \$1,000/qtr), 1% all purchases	Starts at \$200	Earning rewards while rebuilding credit
Capital One Quicksilver Secured	\$0 [19]	1.5% cash back on all purchases	\$49, \$99, or \$200	Flat-rate cash back
OpenSky® Secured Visa®	\$35 [20]	None	Starts at \$200	No credit check required
Secured Sable ONE Credit Card	\$0 [21]	2% cash back on groceries, streaming, & transportation	Refundable deposit	Easy transition to unsecured credit
Bank of America® Customized Cash Rewards Secured	\$0 [22]	3% cash back (category of choice), 2% groceries/wholesale, 1% other	Starts at \$200	Customizable rewards categories
Chime Credit Builder Secured Visa®	\$0 [23]	None	No minimum deposit	Fee-free, flexible deposit rebuilding

## Key Features to Look For in a Secured Credit Card

- **Reports to All Three Credit Bureaus:** Ensures your responsible use reflects on your credit report.
- **Low or No Fees:** Avoid unnecessary costs; cards with **no annual fees** are preferable.
- **Refundable Deposit:** Choose a card that **returns your deposit** when you upgrade or close the account.
- **Graduation to Unsecured Credit:** Some cards transition to an unsecured line with consistent responsible use.
- **Credit Limit Growth:** Cards that allow **limit increases** without additional deposits help with utilization ratios.

## Tips for Using Secured Credit Cards While in Debt Settlement

1. **Keep Balances Low – Use less than 30%** of your credit limit; ideally, keep it **below 10%**.
2. **Pay in Full Each Month** – Avoid carrying a balance to **sidestep interest charges**.
3. **Make On-Time Payments** – Payment history is **35% of a credit score**; never miss a due date.
4. **Avoid Additional Debt** – **Do not** use secured cards for unnecessary purchases; they are a **credit-building tool, not a spending tool**.

By responsibly using a secured credit card during and after **debt settlement**, individuals can **restore their financial health** while improving their **lendability**—ensuring stronger financial opportunities in the future.

## Lendability and Credit Utilization Strategies

Beyond improving credit scores, individuals must enhance their **lendability**—a broader measure of financial health that lenders use when evaluating loan applications. Debt settlement can play a significant role in this process by **reducing overall debt obligations, lowering credit utilization, and improving the debt-to-income ratio (DTI)**—all critical factors in determining financial stability.

### Debt-to-Income (DTI) Ratio Improvement

The DTI ratio measures the percentage of your gross monthly income that goes toward debt payments. Lenders typically **prefer a DTI below 36%, with no more than 28%** allocated to housing expenses. A lower DTI indicates better financial health and increases the likelihood of loan approval.

- **How Debt Settlement Helps:** By **negotiating a reduction in total outstanding debt**, debt settlement directly **lowers the DTI ratio**, making individuals more attractive borrowers in the future.
- **Example:** If a person has \$40,000 in debt and earns \$60,000 annually, their **DTI is 66%**—a red flag to lenders. If they settle for \$20,000, their **DTI drops to 33%**, significantly improving their lendability.

### Credit Utilization Impact

Credit utilization refers to the ratio of your current credit card balances to your credit limits. It's a significant component of credit scoring models, accounting for about 30% of your FICO score. Maintaining a utilization rate below **30%, and ideally under 10%**, is advisable to positively influence your credit score.[25]

- **How Debt Settlement Helps:** By eliminating delinquent debt, **the borrower can gradually restore available credit** and work towards a healthy utilization ratio.
- **Future Strategy:** Post-settlement, using a **secured credit card responsibly** and paying off balances in full each month can help establish **positive credit usage patterns**.

By effectively managing these factors, individuals can improve their financial profiles, making them more attractive to lenders.

## Avoiding the Debt Trap

To maintain long-term financial stability post-settlement:

- **Avoid Opening Too Many New Credit Accounts:** Multiple hard inquiries can lower your credit score and signal risk to lenders.
- **Prevent the Cycle of Consolidation:** Be cautious of consolidating debt only to accumulate more, leading to a cycle of financial strain.
- **Reduce Reliance on Credit for Basic Expenses:** Develop a budget that allows you to manage daily expenses without over-reliance on credit.

By following these strategies, you can work towards restoring your financial health and improving your creditworthiness after debt settlement.

## Conclusion

Debt settlement is more than just a financial tool—it is a **transformative process** that provides individuals with the opportunity to regain control of their financial future while alleviating the mental and emotional burdens of overwhelming debt. By negotiating reductions in total outstanding debt, debt settlement offers **substantial financial relief**, enabling individuals to resolve their obligations faster than alternative methods like debt consolidation, credit counseling, or bankruptcy.

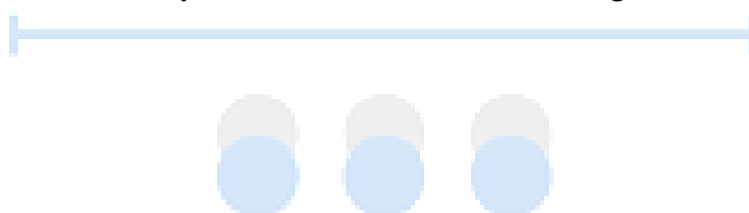
Beyond the numbers, the psychological benefits of debt settlement are equally profound. Studies show that financial distress is directly linked to **heightened anxiety, depression, and strained relationships**, and resolving debt through settlement can significantly **improve mental health, emotional well-being, and overall quality of life**.

At the same time, debt settlement **enhances long-term financial health** by helping individuals reduce their **debt-to-income (DTI) ratio, lower credit utilization, and develop responsible financial habits**. While the process may have an initial impact on credit scores, **strategic credit rebuilding efforts**—such as using secured credit cards, managing credit utilization, and maintaining on-time payments—can **accelerate recovery and improve lendability**, positioning individuals for **better borrowing opportunities in the future**.

For those considering debt settlement, **choosing a reputable firm** is crucial to ensuring a successful outcome. Certified professionals who operate transparently, hold funds in **third-party FDIC-insured accounts**, and comply with **Consumer Financial Protection Bureau (CFPB) regulations** provide clients with **both security and confidence** in the process.

While **debt settlement is not the right solution for everyone**, it remains a **powerful and viable alternative** for individuals struggling with unmanageable unsecured debt. By understanding its benefits, legal protections, and post-settlement financial strategies, consumers can leverage debt settlement as a **springboard toward financial stability, improved mental health, and long-term economic success**.

Ultimately, the path to financial freedom begins with **taking decisive action**—and debt settlement offers a structured, strategic, and effective way for individuals to achieve **lasting financial relief and a fresh start**.



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## Ready to Take Control of Your Credit?

To learn more about debt relief solutions and take the first steps toward financial freedom, consider scheduling a consultation with Relief Strategies.

Contact Relief Strategies today for a free consultation and take the first step toward financial freedom. Call [1-888-870-7922](tel:1-888-870-7922) or [schedule your free consultation](#) today!

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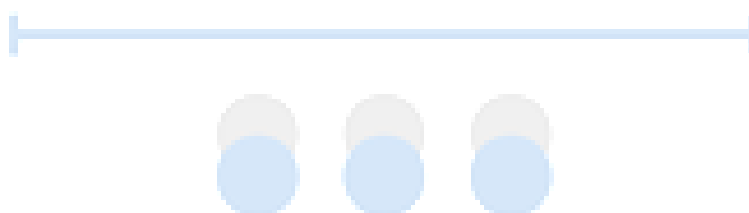
## About the Author

*James Farias is the CEO of Relief Strategies, LLC, a leading firm dedicated to helping individuals achieve financial freedom through effective debt relief solutions. With over 30 years of business management experience and a passion for empowering others, James has guided countless clients through their journey to reduce debt and regain control of their finances.*

*Recognizing how quickly debt can overwhelm even the most financially disciplined individuals, James focuses on strategies that reduce monthly payments, minimize financial stress, and unlock new opportunities. His mission is to help clients move past financial challenges and embrace a brighter future.*

*Connect with James on [LinkedIn](#) or visit [Relief Strategies](#) to learn more about how he and his team can assist you on your journey to financial freedom.*

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