

# **FACTS YOU SHOULD KNOW ABOUT NEGOTIATED DEBT SETTLEMENTS**

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## Introduction

Negotiating debt settlements is the present rage in the credit counseling industry and thousands of consumers are finding their way to consulting agencies that specialize in this form of debt reduction. It's an especially appealing approach because it gives the illusion that creditors are being beaten at their own game and consumers are getting something for nothing. But, when things seem too good to be true, they usually are!

This article has been published by *Cornerstone Financial Counselors*, a non-profit credit-counseling ministry in Miami, Florida. Its purpose is to provide helpful information to people who are considering negotiated debt settlements so they can make an informed decision as to whether or not it's an appropriate strategy for their particular situation and family.

Unfortunately, many consumers are trying such settlements without benefit of the full story with increasingly tragic results. In truth, negotiated debt settlements are not for everyone and it is better to find that out before you ruin your credit rating by carrying out an inappropriate financial strategy.

Since it was founded in 1987, the ministry of *Cornerstone Financial Counselors* has focused on providing biblically based information and service to the American family to help in the pursuit of financial freedom and victory over indebtedness. For further information visit our website at [www.creditcounseling.net](http://www.creditcounseling.net) or call the main office toll free at 1-800-357-4223. You can also write us at 10621 North Kendall Drive - Suite 113, Miami, Florida 33176.

## How Credit Problems Progress

The world of consumer credit is based on a very basic principle: as long as you make all your payments on time, creditors are happy. They "love" you so much they periodically tell you what a wonderful person you are

and raise your credit limits to recognize your good payment history. And they love to send you friendly advertisements with suggestions for taking advantage of your growing “purchasing power.”

But as soon as you start to have a few payment problems, watch out! The budding friendship quickly becomes strained. When one of your credit card payments fails to arrive on time, you will discover in the next statement that your account has been charged a “late fee” of \$29.00 or \$35.00. When you call the creditor to discuss it, you will find a little less friendliness but if it’s your first time, they may agree to waive the late charge and you experience the temporary euphoria of believing you have defeated a creditor. After you’re late two or three times, it will be increasingly impossible to remove the related late charges and if you become “chronically” late the credit card company will eventually send a notice that your interest rate has been increased. If your payments are late on a regular basis and at the same time your outstanding balance is growing, the creditor will eventually lower your credit limit. If your outstanding balance exceeds your revised credit limit, there will be another charge of \$29.00 or \$35.00 each month until the excess has been paid in full and the outstanding balance is back under your revised credit limit.

As this situation continues, your creditor will be faithfully reporting all of their actions to the three national credit bureaus. By law, your other creditors, insurance companies, landlords and employers, among others, have the right to review your credit reports. You’ll find that creditors have no sympathy for the personal problems you might have had, even temporary ones that caused you to have made a few late payments. The friendship is now over and the reality is that the credit bureaus are legally authorized to publish whatever they know about you for up to 7 years (up to 10 years for bankruptcies).

But let’s say that your financial problems become worse than just a few late payments. Let’s suppose that you’re temporarily laid off from work or you have an illness or injury and are unable to work for a period of time. As your payments are extended to 30, 60 and 90 days late, you will start to receive letters and telephone calls from your creditors. They

won't care about why your payments are late; they want to know how you're going to catch up and when. They have many ways to intimidate and threaten which will destroy your peace and make you feel insecure. If you're still unable to pay them, they'll send your account to "Collections," first to a Collection Department in the same company and later to an outside professional Collection Agency or Collection Attorney. By this time your credit rating for all practical purposes will have been destroyed.

But the system still provides further action the creditor can take. He can "charge off" your account meaning further collection action has been suspended but giving you the most damaging credit rating you can have outside of legal action. And, if the creditor believes there is potential benefit, he can bring legal action against you, obtain a Summary Judgment and force you into garnishment, the loss of your non-residential and non-essential property or bankruptcy. This is the full progression of credit problems from late payment to bankruptcy that can cause years of heartache for consumers who experience financial problems they may or may not have had control over.

### **Dealing With Credit Problems**

Most people wait too long after a problem has emerged to seek a solution. Some are hoping for some financial breakthrough while others believe creditors will be willing to work with them because of "past friendship." Sorry: neither one of these is likely to happen in time to avoid damage to your credit rating. Here are some of the things you should consider:

1. At the very beginning of the problem, you can visit a non-profit credit-counseling agency for assistance. At the very least they will prepare a Family Budget for you to help discover what actions you need to take to avoid late payments. If you find the right agency or ministry, budget counseling is a public service and there will be no charge.
2. If after the budgeting exercise you find that you cannot catch up with your credit card payments, many non-profit credit counseling

agencies offer a ***debt consolidation*** service. In debt consolidation, the agency works out a payment plan with your creditors that can significantly reduce your interest payments and make it possible for you to afford the monthly payments until you get back on your feet financially. You need a non-profit agency instead of for-profit because many creditors will only work with a non-profit. Some creditors will report your debt consolidation program to the credit bureaus but many creditors don't. And while you're in debt consolidation you'll not be able to find new credit cards or finance a home at normal rates. But having debt consolidation in your credit history is much better than having collections, charge offs, judgments or bankruptcy. The references to a debt consolidation program may appear on your credit reports for up to 7 years but your credit privileges will be restored when you successfully complete the program, which should be much sooner.

3. Once you have acquired negative credit history, it's possible to hire a ***credit repair*** professional to try to reduce the number of detrimental items on your credit reports. You need to be very careful to choose a reputable firm that charges a reasonable fee. And you should know that ***no credit repair firm should "guarantee" they are able to eliminate all your negative items.*** They may be able to ***reduce*** the number and increase your Beacon Score but they can't predict with accuracy how creditors are going to respond to their credit repair efforts. This is a big problem in the credit counseling industry: agencies may make claims to the contrary but there's no way to legally remove negative information from your credit reports as long as the information is accurate, as long as the creditors are determined that it continue to be published and as long as they have followed the law (Fair Credit Reporting Act) in requesting the credit bureaus to publish their information. Credit repair may be helpful but is by no means automatic and it's not a way to get out of paying a debt. If you owe a debt, the legal status of that debt is in no way connected to whether or not related information is published on your credit reports by the bureaus.

4. The fourth remedy is to consider a *negotiated debt settlement* once your accounts have reached the status of “Collection” or worse such as “Charged Off.” A negotiated debt settlement is where you make an agreement with a creditor to pay off your delinquent balance in a short time, usually not more than two payments a few weeks apart, in exchange for a significant discount or forgiveness often 50% or more. This would be possible if you came into some funds after a time of credit payment problems. This type of remedy is only possible after one or more of your accounts has gotten to at least a collection status or worse, such as charge off or a pending judgment, because creditors will not consider a negotiated debt settlement until your accounts have been delinquent for a period of time and they have been unsuccessful in “motivating” you to pay by other means. Typically it’s better to hire a professional negotiator to handle this for you because they already know what particular creditors are likely to accept in settlement of your debts. A professional will charge you from 15 to 30 percent of the amount they are able to have forgiven.

We emphasize: your credit status must be in “collection” or “charge off” or worse before creditors, which are usually professional collection agencies or attorneys, will accept a negotiated debt settlement.

### **Problems With Negotiated Debt Settlements**

When many consumers hear that they can have half or more of their indebtedness forgiven, they become excited thinking they have come upon a way to get something for nothing. To be sure, there are many credit counseling agencies these days that will advise consumers who don’t even have a delinquent payment problem yet to stop paying on their accounts and allow them to go into collection so they can become eligible for negotiated debt settlements. These agencies however are giving counsel that is usually not in the best interests of their clients and they’re failing to tell them the complete story. Following is the truth that everyone should consider before deciding on this form of debt relief:

1. When a settlement is negotiated, the client's credit reports will carry a notation that the account was paid off for less than the original amount. This is better than having a collection or charge off on the report but it is not better than just having a few late payment notations. Your Beacon Score will be slower to recover from a negotiated debt settlement than from a limited number of late payments.
2. If you are only in the early stages of a payment problem and your Beacon Score is still high, you'll have to stop paying your creditors for several months in order to qualify for a negotiated debt settlement. This will cause a significant deterioration of your credit rating to a lower level than would have been the case had you sought temporary relief from budget counseling or debt consolidation by a non-profit agency.
3. You must also be aware of the fact that creditors are not bound by any convention or law to enter into a debt settlement negotiation. If they suspect it's to their benefit, they may prefer to force you into bankruptcy instead of accepting your settlement offer. By that time it will be too late to go a different route and you could have to go through with the bankruptcy to protect your family. The statute of limitations for the publishing of bankruptcy information on credit reports is 10 years.
4. It is also possible that a creditor will go ahead and obtain a Summary Judgment against you before entering into a debt settlement agreement. While your record will show that the Judgment was satisfied, it's a matter of Public Record just as a bankruptcy is and may be nearly impossible to remove from your credit report prior to the 7-year statute of limitations.
5. The counseling agency offering negotiated debt settlements may tell their clients that they will remove all the negative information in the aftermath of a debt settlement negotiation but the truth is there's no way to force the creditors to stop reporting all the negative information your strategy has generated. In fact, it's unlikely. They will

report that the accounts have been settled but they very well may continue to report related information about it which will serve to depress your Beacon Scores for years to come.

6. During the time that your credit rating is in decline, don't forget that other interested parties have access to your credit reports. These interested parties include landlords, employers, insurance companies and other creditors including your mortgage company if you own a house. Prior to allowing their credit ratings to be destroyed, consumers should review their Mortgage Agreements and other creditor documents to find out what the penalties are if those other creditors should decide that the economic status of their customers has undergone a material deterioration since credit was originally granted. In such cases, creditors may have the right in an older mortgage agreement to cancel further credit privileges and call in the outstanding balances for immediate pay off.
7. Credit counseling agencies also often fail to advise their clients that the amounts forgiven by creditors through negotiated debt settlements in excess of \$600.00 will be reported as income by those creditors to the Internal Revenue Service. Accordingly, consumers will be surprised when they receive IRS Form 1099 from their creditors that show additional taxable income must be accounted for when their next tax returns are filed. Under the law the amount forgiven is considered to be ordinary income and is therefore taxed at the appropriate marginal rate for your revised income bracket. If the additional tax cannot be paid by the established due date, the taxpayer will be subject to interest and possible penalties eventually amounting to a substantial portion of the savings from the negotiated debt settlement.

If a consumer is delinquent in the payment of those taxes, IRS becomes the new collection agency but this collection agency has absolute legal power and authority. Delinquent taxpayers can have liens filed against them by IRS, which will stay on the record long past the settlement date, and they can be garnished directly by IRS without going through the Court system that applies to all other kinds of

indebtedness. They can also have their bank accounts levied overnight without court action and future tax refunds, if any, will automatically be confiscated and applied to the delinquent tax. In short, it's unadvisable to get into a delinquency problem with IRS. Avoid it at all costs!

8. During the waiting period as settlements are being negotiated or have to be driven into further delinquent status before a favorable settlement can be reached, creditor balances may increase due to the possible continuance of finance charges and late penalties. So it must be remembered that the eventual balance from which the creditor will offer the discount in exchange for a lump sum payoff could be significantly higher than the amount at the beginning of the process. Where it may seem like a 50% discount for example, it may in effect be more like 20% when you consider the original balance.

Because of these considerations, we recommend negotiated debt settlements to only those clients whose accounts have **already** gone to collection or charge off. Prior to that having occurred there is usually a better strategy for the long-term interests of the family.

### **Special Comments for Christian Consumers**

As a base case for life, Christians should do everything they can to avoid indebtedness. The Bible says that we should "owe no man anything (Romans 13:8). It also says that indebtedness is a curse (Deuteronomy 28:44) and that debt freedom is a blessing from God (Deuteronomy 28:12). Also, using credit cards is a way of telling God you are not happy with the way He is providing so you feel you need to help. Therefore, voluntary indebtedness and a life of faith are incompatible.

Nevertheless emergencies sometimes happen or it takes a while for us to embrace the revelation of God's desire for us to be debt free. So, we go into debt believing God will provide and we have hope of getting out of debt as soon as possible. When this happens we must not lose sight of the fact that when we went into debt we signed a contract, a covenant, with another person and we gave our promise, our word that we would

pay the debt according to certain terms and conditions. When a Christian gives his or her word to do something, he should do everything possible to fulfill what he has promised. This means that a Christian deciding to stop making payments for the purpose of coming into collection so debt settlements can be negotiated is destroying his testimony and is on shaky scriptural ground. That Christian is now demonstrating that he cannot be trusted; he's announcing that his word doesn't mean anything. And, he's saying that he doesn't have enough faith to believe that God is able to provide the full amount.

On the other hand, what about the case where a Christian's debts have already gone into collection because the family didn't have the funds for a period of time to make the monthly payments? What the Christian family must do is get before God and find out what He wants to do in such a situation. It's not automatic that you reach for a negotiated debt settlement. On the one hand you could pay a lower amount and retain the difference for the Kingdom of God; on the other you'll be breaking your word to that creditor and tarnishing your testimony. If you seek Him in faith, He'll provide the peace and direction you need to make the right decision for your family.

In some cases there's a choice to be made between a negotiated debt settlement and bankruptcy. In other words, the creditor would force you into bankruptcy if you refuse to enter into debt settlement. In such cases, we would lean toward a preference for debt settlement because it protects the family from the Courts and in the world system it's usually better to have a negotiated debt settlement in your credit history than a bankruptcy. Nevertheless, the family must get before God and seek His direction because there's no obvious way in these matters that's always right for everyone. Just be sure to seek the will of the Lord and whatever happens will eventually turn out right.

## Conclusion

In conclusion, we don't want to be excessively negative about negotiated debt settlements. They are a legal, valid means of debt reduction and they can be a preferred strategy in certain situations. In fact, *Cornerstone*

*Financial Counselors* can refer you to a secure Christian agency that offers this service to those families who'll best benefit from it.

However, consumers need to be informed so they can make informed decisions. If your accounts aren't yet in collection or charged off, there's likely a better strategy for you to consider. Know what you're getting into. Don't just blindly charge ahead without investigating what you're hearing at some credit-counseling agency. Consider the consequences of your actions and you'll make the right decision. God bless you!