How debt negotiators can crush your credit

By Lucy Lazarony, Bankrate.com

Stressed out and looking for relief from high credit card bills?

Beware of companies that promise to cut your bills in half by negotiating lower payoff amounts from creditors.

Sign on with a debt negotiator or debt-settlement company and your credit rating and your wallet could take some serious hits. If high fees and trashed credit aren't bad enough, you may also owe taxes on any debt that gets wiped away.

It's easy to wind up in worse financial shape than when you started.

"Be very, very careful. Because there can be substantially more harm than good," says Paul Richard, executive director of the Institute of Consumer Financial Education in San Diego.

"It's the fees, the possible liability to the IRS after you get this negotiated and they're not doing anything for you that you can't do yourself.

"These slick debt negotiators, they smooth talk people around all these issues. They're really taking advantage of people."

Fees, fees, fees

Let's start by taking a closer look at the fees. Some debt negotiators charge hefty upfront fees. Others charge fees based on the amount of debt you owe or the number of credit accounts you have. Many also charge fees based on the amount of debt a creditor agrees to wipe away.

"There are all these hidden charges going on," says Daniel Benson, a senior consumer attorney at the Legal Aid Society of San Diego.

Let's say a creditor agrees to settle for $4,000 of the $5,000 you owe. You've saved $1,000, but a debt negotiator will want a big cut, often 20 to 35 percent, for themselves. That's not much of a deal, especially when you toss in the other fees that you have to pay.

One of Benson's clients learned that lesson the hard way. She's 82, single and had $2,128.81 of debt she wanted to settle with the help of a debt negotiator. The company charged her an initial application fee of $250 and an initial legal processing charge of $1,345. That's $1,595 in fees right off the bat for help with just over $2,100 in debt.

Talk about a lousy deal.

The hit to your credit rating

Sky-high fees are only part of the problem when you do business with a debt negotiator. Your credit takes just as much of a hit as your wallet.

Here's why. Often, a debt-negotiating company will tell you to stop making payments to creditors and to send money to them instead. The money gets placed in an account until the debt negotiator decides to make an offer to a credit card company.

And that could take awhile, especially if you pay a negotiator through monthly payments rather than forking over a large sum upfront.

It could be several months before a debt negotiator has collected enough money from you to make a settlement offer to a creditor.

And after several months of not paying your creditors, your credit will be trashed.

"They tell you to stop talking to creditors, which is a bad idea," says Dianne Wilkman, president of Springboard, a nonprofit, consumer credit management company in Riverside, Calif.

"Your creditor will charge off your account and that will ruin your credit."

Creditors typically write off or charge off a debt if there has been no payment on the account for more than 180 days or six months. A charge off will remain on your credit report for seven years plus 180 days from the date of the first nonpayment, according to the Fair Credit Reporting Act.

"A charge off is the biggest negative red flag on your credit report," Richard says. "It means a lender lost money doing business with you."

So even if a debt negotiator is able to lower a credit card balance as promised, you could be stuck with a dismal credit record for more than seven years.

Here's another thing to worry about. If a creditor refuses the settlement amount offered by a debt negotiator, you could be sued.

Just ask Raquel Avila, of Millbrae, Calif. She signed on with Debtco in August 2001 for help with $10,000 of debt spread over five credit cards. The card debt was left over from her university days.

"I was just making the minimums. I foresaw myself paying this debt forever, paying the minimum. That's why I went to them," says Avila, 28.

She paid Debtco a $1,000 upfront fee and agreed to $250 monthly payments. Debtco would also take a 25 percent cut of any forgiven debt.

She stopped paying her creditors and sent payments to Debtco instead. She was told she would be debt-free in three years.

Last July, one of her creditors sued her for nonpayment.

"I ended up getting summoned in July and I got scared," Avila says.

"I was never told this could happen. They said there are some creditors that want their money right away and that I should talk to a lawyer."

She ended up settling the disputed debt in November.

"At the beginning I didn't feel it would hurt my credit this much," Avila says. "I feel like it's hurting me more now."

After 19 months with Debtco, she still owes several thousand dollars on three credit cards.

"They're basically telling me I need to send them more money," Avila says. "I don't really foresee myself getting out of this, this year."

Steve Dahl, a senior vice president of sales and marketing at Debtco, says only a small percentage of Debtco clients get sued and most settle the suits out of court.

"Probably less than 9 percent of our consumers ever get sued," Dahl says. "That's a reality. We put that in our contract. We always let people know that's a possibility."

Getting angry calls from collection agencies is another unpleasant reality associated with debt-negotiation programs.

"This is boot camp to avoid bankruptcy," Dahl says. "It's tough and it can be nasty."

A long and expensive road

Resolving debt through a debt negotiator is a long and expensive road. Even if all goes well, you'll be left with a banged-up credit record and you may owe taxes on any debt that is wiped away. This article from Bankrate.com explains the tax consequences of forgiven debt.

Not all debt negotiators are on the up and up. Some consumers pay high fees and never get any of their debts settled through a debt negotiator or debt-settlement company.

"There are nonprofits and for-profits in this business with various degrees of credibility," Wilkman says.

The latest debt negotiator in the hot seat for allegedly shoddy business practices is Briggs & Baker, based in Santa Clarita, Calif. The California Attorney General filed a lawsuit against Briggs & Baker on Feb. 19.

"This firm and its ads preyed on consumers, who paid thousands of dollars to rid themselves of crushing debt," says California Attorney General Bill Lockyer. "Instead, Briggs & Baker left its customers with more debt, ruined credit histories and sometimes no choice but to file for bankruptcy."

People with just a few thousand dollars of debt would do well to steer clear of debt negotiators altogether. A debt-management program may be a better option.

When you enroll in a debt-management program, you write a monthly check to the credit-counseling agency and the agency pays your creditors. In a typical debt-management program, a card issuer will charge lower interest rates, stop charging late fees and contribute money to the debt-counseling agency. A debt-management plan usually lasts three to four years.

A visit to a reputable credit-counseling agency may help you determine if a debt-management plan might be right for you.

Be sure to choose your counseling help carefully. There are some pretty shady operators running so-called counseling agencies these days. For tips on finding the right kind of credit counseling help, check out this article from Bankrate.com.

Do-it-yourself debt help

There are plenty of things you can do to get a handle on your debts all on your own. These pay-down strategies from Bankrate.com are a great place to start.

And you may be able to get lower interest rates on your credit card accounts by picking up the phone, calling your creditors and asking.

You don't need perfect credit to get a rate reduction from your card company but you do need to ask. Not sure what to say? This Bankrate.com article is full of tips.

You may be able to negotiate a lower payoff amount from a credit card company on your own as well. You'll never know if you don't call and ask.

"Most creditors are willing to work with consumers," says Edward J. Johnson III, president of the Better Business Bureau in Washington, D.C. "Their interest is in getting the money back."

So give your creditors a call and ask for a lower payoff amount.

Richard has worked with consumers who were able to settle card accounts by paying 60 percent of the balance. All they did was call and ask.

"They can do this themselves. The creditors are willing," Richard says. "You don't need to hire someone and pay a lot of fees."

But you do need to have plenty of cash available to make a settlement offer. If you don't have the cash, try asking for a break on your monthly payment amount or a lower interest rate.

If you're still game to try a debt-negotiation program, be sure to choose the company carefully.

Contact the Better Business Bureau to see if the firm has had any consumer complaints. Check with your state attorney general's office or other state consumer agencies to find out if there are any pending legal investigations.

"Look into these places," says Deanne Loonin, staff attorney with the National Consumer Law Center in Boston. "What are they doing for you first of all? What kind of track record do they have?"

What kind of fees do they charge? Are there upfront fees? How much do they charge for negotiating a lower payoff amount with a creditor?

Don't forget to check for debt negotiation programs run by credit-counseling agencies. These programs tend to charge lower fees.

Be sure to run a background check on a credit-counseling agency before your first visit. Not every nonprofit counseling agency has your best interest at heart.

Conclusion

Are you one of the many that suffer from insurmountable debt and wonder if bankruptcy is an option? Give Amicus Curia a call at **(360)427-3599.**