

Settling Collections: A Complete Guide to When (and When Not) to Settle Collections and Charge-offs on Your Credit Report

by Edward Jamison, Esq.

In most circumstances it is important to pay or settle unpaid collections because not doing so can lead to a lawsuit or a collection agency selling the collection to other agencies when the debt REMAINS unpaid, which adds additional negative collections to your credit report. But knowing how much to pay or not pay can be confusing. More times than not give the creditor or collection agency has the upper hand because they know the rules and have made it their business to use the rules in their favor at the consumer's expense.

Although they usually will not tell you, in most cases the collection agencies and creditors will settle for much less than the full balance due on your debts. Notable exceptions are student loans and unpaid child support. Due to government regulations, child support must be paid in full. Government guaranteed student loans require that 100% of the original principal be paid, at least 50% of the interest needs paid, while the penalties and fees have no restrictions and can be settled for the best possible deal.

In many cases, depending on the creditor and its policies, the right negotiator can obtain a settlement at 35 to 65% of the balance owed. But remember, any collection or charge-off that is paid or settled WILL NOT get deleted from the credit report simply because it is paid. Rather, the account will only be updated as paid or settled and will remain as a paid or settled negative account on the credit report for seven years from the date of last activity with the original creditor (*not* seven years from the time the account is settled, as many people falsely assume).

So now the question is: **HOW MUCH SHOULD YOU PAY TO SETTLE THE ACCOUNT?**

I always answer this question by saying that clients should be willing to pay as much as 100 cents on the dollar if the collection agency agrees to delete the account with payment in full. Although this is very hard to accomplish, it is possible. If you can afford to pay a particular account in full with a deletion, this is optimal because every deletion counts when the credit score is calculated, and the higher the score, the better. I think that gaining a few points is worth the extra money spent, since a few points can mean thousands in future interest savings on a loan. (On a side note, I do not suggest paying a collection in full even with an agreement to delete if the collection is older than four years (the negative effect on the credit score decreases as the account gets older) or if the amount is over \$2000 (since the benefit received as a result of the deletion does not out weigh the cost of paying it in full). Unless someone has tons of money, which is usually not the case if they have unpaid collections, the score increase usually does not justify the cost of paying the collection in full.

Since the ability to settle a collection at any amount depends on how much money you have, following this advice cannot always be adhered to if you don't have the money to settle. You can only pay what you can afford to pay. Keep in mind this "deletion-with-payment theory" only works with collection agencies; it doesn't apply to charge-offs with credit card companies. Deletion-with-payment is almost impossible with credit card companies or any other big bank because they never agree to delete with payment unless there is a very good reason, which is usually not the case for the person that owes the money.

Here is my synopsis of when you should or should not settle these debts:

CREDIT CARD CHARGE-OFFS IN GENERAL: Because deletion is nearly impossible even with payment in full, always try to settle for pennies on the dollar. For credit scoring purposes, a settled account with a zero balance is not much worse than a paid-in-full charge-off, which is why it is never a good idea to pay extra and settle in full.

COLLECTION ACCOUNT UNDER \$2,000 IN GENERAL: Try to offer payment in full if the collection agency agrees to delete the account with payment. If the collection agency says no, switch gears and try to get the best settlement possible, because a paid-in-full collection and a settled collection have pretty much the same negative effect on the credit score.

COLLECTION ACCOUNTS OVER \$2,000 IN GENERAL: Try to settle for pennies on the dollar, because the benefit of deletion may not be worth paying the extra money (UNLESS, of course, you have lots of money to spare).

Now let's add the age factor to the principles above:

UNPAID COLLECTIONS AND CHARGE-OFFS OF ANY AMOUNT THAT HAVE BEEN OUTSTANDING FOR LONGER THAN FOUR YEARS (sometimes five or more depending on your State's statute of limitations on written contracts) SHOULD NOT BE PAID OR SETTLED EXCEPT IN CERTAIN CIRCUMSTANCES: First, because these accounts are at least four years old, they do not have a big effect on the credit score. Second, when you pay a collection or charge-off, your credit score may go down 10 to 20 points because the credit bureaus change the date of last activity from four years ago to the present. The credit scoring software interprets this as recent collection or charge-off activity, even though all you did was pay it.

YOU MAY BE THINKING, "IF THAT'S THE CASE, WHY SHOULD I PAY ANY COLLECTION, EVER?"

Here's the answer: Assuming that your state has a four year statute of limitations on written contracts, collections with a date of last activity **less than** four years should be treated differently than accounts older than four years. The statute of limitations in most states is four years on a written contract. If you don't pay a collection that is less than four years since the date of last activity, you run the risk of being sued. You also have a higher risk that the collection will be sold several times to other collection agencies, which pollutes your credit report with negative collection accounts on a continual basis. I advise that you attempt to settle collections and charge offs that are less than four years when possible to avoid these pitfalls.

Collections older than four years since the date of last activity are a completely different story and should only be settled if the settlement amount is less than 40% of the balance owed or more than 40% if the company agrees to delete the account with payment since the threat of a lawsuit goes away once the statute of limitations expires (check with your particular state for the exact time frame for the statute of limitations on written contracts). After 4 years, the value of the collection account significantly decreases once the ability to sue is gone, which means that the collection agency has much less of a bargaining position and will usually be much more lenient with the settlement terms. **BUT BE CAREFUL!** If you make even a \$1 payment at any time before or after the four years pass, you **re-toll** (restart) the statute of limitations and the four-year rule starts all over again. **NEVER** make a payment or agree to any new terms unless you are planning on completely following through, because it will start the four-year clock all over again. Moreover, collection agencies are less likely to sell debts that are older than four years because their chances getting a good price on the consumer debt market are slim since the chances of collecting decreases as time passes, which makes it hard for a collection agency to sell your

unpaid account at any price. Add to that the fact that the collection will get deleted from your credit report after the seven year point, and the reasons to settle are almost non-existent (unless you are buying a home or refinancing and your lender requires the unpaid debts to be settled before they will agree to lend you the money).

The magic price to pay for settling a collection is similar to buying a used car. The longer the car sits on the lot, the better the deal the consumer can get. Since collection accounts are worth less on the debt market as they increase with age, the chances of getting a great settlement offer increases as time goes on.

THE FOUR YEAR HURDLE IS NOT ENOUGH, CREDITORS NOW PLAY DIRTY POOL

One of the big credit card providers, whom I'll call [Company X](#), is famous for duping people on the statute of limitations issue. [Company X](#) buys debts that are past the four-year rule from other companies, then sends the debtors a credit card offer for \$100 more than what they owed the previous company. *For example*, John owes Providian \$8,000 and has not made a payment in over four years. [Company X](#) buys the debt from Providian for 10 cents or less on the dollar and sends John a [Company X](#) credit card offer with an \$8,100 limit, provided he agrees to include the Providian debt in the balance of the card (in small print of course). [Company X](#) effectively duped John into agreeing to "new terms" which re-tolled the four-year statute. This tactic made John focus on the big \$8,100 credit card limit without him recognizing the consequences. John signs the offer and mails it back to [Company X](#), who in turn has the right to collect and sue John for the \$8,000 from Providian if he does not pay the new credit card as the bill comes each month. Worse yet, they have four more years to sue John if he doesn't pay it. Once John realizes he can only spend \$100 on the credit card before it is maxed, it is too late. John gets mad and doesn't pay [Company X](#) as a matter of principle. [Company X](#) in turn sues him and garnishes his wages after they get a judgment.

CONSUMERS BEWARE! This may seem unfair, but is completely legal. I think [Company X](#) could be challenged legally on a theory of *Unfair Business Practices* or *False Advertising*, but it would be an uphill battle that should be avoided by the Consumer if possible.

Edward Jamison is a consumer credit attorney and an expert in the area of Credit Scoring that has helped thousands of client's dramatically increase their credit scores. His new product *Credit Savvy™* contains all of the information you need to become a credit scoring expert and dramatically increase your credit score. *Credit Savvy™* lays out the techniques needed to save thousands on your next mortgage by allowing you to gain the upper hand on the Credit Scoring System. Over the life of a \$500,000 mortgage, a person saves an average of \$10,000 for each point they increase their credit score. *Credit Savvy™* is a financial tool that will save you over 1000 times the small investment you make in purchasing this valuable tool.

As a special offer to the Mortgage Market Guide newsletter readers, you can own Credit Savvy today for 10% off the regular retail price by clicking the link below. The price will be reduced in the check-out portion of the shopping cart.

Edward Jamison can be reached by email at Edward@jamisonlawgroup.com

Disclaimer: The information in this article is designed to enable you to learn more about the subject of credit. This information does not and is not intended to constitute legal advice, nor is it intended as a source of advertising or solicitation. The result of any legal matter may vary depending upon specific facts and applicable law; no reader should act on the basis of any matter contained within, without seeking appropriate professional advice as to the particular facts and applicable law involved. The materials contained in this article do not create and are not intended to create an attorney-client relationship between you and Jamison Law Group, P.C. Jamison Law Group, P.C. accepts clients only in accordance with certain internal procedures. Please do not send us confidential information unless you have express authorization from one of our attorneys to send us such information and always retain a copy for your records because we shred all unnecessary documents for our clients' protection due to the sensitive nature of credit

reports and personal identifying information. All of the statements in this article are the opinion of the author, and no conclusions should be drawn based on that opinion.