



The Basics

Dealing with the debt collector

Understanding how debt collection works helps you cut the best repayment deal and avoid worse trouble. Plus: A warning against do-it-yourself repos.

By Bankrate.com

Dear Bankruptcy Adviser: Can credit card debt that is sold to collection agencies still accrue 24% interest? Can I get this rate lowered? What are my options? -- Michael

Dear Michael: I have bad news, worse news and a little silver lining.

The bad news is, yes, collection agencies will almost assuredly be charging you the maximum rate allowed in your state. The worse news is that your interest rate is the least of your worries -- you need to be thinking about how to settle with the collections agency. The silver lining, however, is that once you understand the collections business, you'll be able to make the best decision possible.

Here's how the business works: Most people face financial difficulties because of divorce, loss of employment or illness. So let's assume you've gone through one of these unfortunate life events, and you could not pay your credit card bills. After a while, the credit card company will sell your debt as part of a "bad-debt portfolio" (aka "charged-off accounts," a bundle of many debtors' accounts) to a collections agency or a third-party broker. The agency that eventually tries to collect your debt will have acquired it for about four to seven cents on the dollar. From there, your debt can be sold or resold like any commodity, sometimes even after the statute of limitations has run. Often, people are not aware that a statute of limitations even exists, so they never question the debt's current validity.

Credit card interest out of control?
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Usually, if a collections agency can collect 20% of the money you owe, it comes out on top. Frequently, agencies collect much more. So they're going

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to harass you (within legal limits) and offer you settlement deals. For example, they might say, "You owe \$5,000 on your credit card, but with accrued interest, it's \$7,000 -- and we'll settle with you for half, or \$3,500." Of course, if they bought the debt for \$200, even after you factor in their costs, they're making decent profits. However, they still want to settle and usually will settle for even less than 50% of the current balance.

The absolute worst thing you can do is begin a payment plan and then not finish paying -- sometimes the collection agency will not give you credit for paying a penny! The problem is that, if you fail to pay and the statute of limitations on the debt has not run, then the debt will likely be resold to another agency at an even deeper discount. It's like going back to square one. This new agency will collect on the remaining balance, which will have grown because you failed to settle the debt in full with the previous collections agency.

Therefore, the most important thing is to have a monthly payment you can afford. First, figure out this number -- be honest with yourself and determine what you can really pay each month. Then you can either retain a negotiator or call the collections agency and negotiate yourself. You can find good books on the subject at your local library.

Your best-case scenario is to be able to negotiate and pay the collections agency a lump sum. Next best is to have a reasonable monthly payment that you can afford and that will let you pay off your debt. After that, it's time to start thinking whether bankruptcy is a viable option so you can start fresh.

No do-it-yourself repos

Dear Bankruptcy Adviser: I have co-signed for a car loan and now he is making payments late and messing up my credit. Can I repossess the car? Can he repo it back? What can I do to physically access the car? -- Caren Carless

Dear Caren: The first thing you have to understand is this: As the co-signer, you are on the hook for this debt until it is paid in full. At risk are your credit score, your available cash and the relationship you have with your delinquent co-signer. You are in a position where all three could suffer.

You also need to give up the idea of repossessing the car on your own. Making efforts to cure a default on a loan without aid of legal proceedings, aka "self-help," aka "taking matters into your own hands," is not considered a legitimate substitute to legal action in most states. The courts have this rule

because they want to discourage the kind of physical confrontation that's possible when you attempt to repossess your friend's car. So let the dealer or the bank repossess the car.

You might not come out of this squeaky clean, Caren, but you might be able to minimize the damage if you choose wisely:

- **Choice 1:** Wait and do nothing: Your delinquent friend continues to pay late or not to pay. Your credit will drop, the car will be repossessed and sold by the bank and you will likely be sued for the balance owed.
- **Choice 2:** Surrender: Assuming that your friend is delinquent, you can notify the dealer, have the dealer pick up the car and voluntarily surrender it to the bank. You will have a repossession on your credit report and you will be liable for the remaining balance.
- **Choice 3:** Make the payments yourself: Demand that he turn over ownership of the car and you make the remaining payments. When the car is paid in full, you can sell it and recover some of your money.
- **Choice 4:** Stay one payment ahead: Call the car company, find out what amount is delinquent (if any) and pay it. Then make one additional payment. Then, even if your co-signer pays late again, any late payments he makes will still count toward the balance without hurting your credit. You just need to keep in touch with the car company and always stay one month ahead.

Caren, I think choice No. 4 is the best option right now because what you want, I think, is for your co-signer to continue paying as much as he's able for as long as he's able. If he stops paying, I would go with No. 3.

It might seem like you can sue your friend to recover some damages at some point in this process, but if your friend failed to pay the car dealer, it is unlikely he would pay you. As well, even if you get a judgment against your friend, you'd have to know how to enforce it.

So my advice is to go with No. 4 and try to maintain your friendship as best you can. Friends are precious and there are always bumps in the road of life. Don't let this one derail you (if you can). Regardless, in the future, don't co-sign anything for anyone unless it's absolutely necessary and you've eliminated all other options.

Bankruptcy Adviser is attorney Justin Harelik.

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