Credit Repair Options

When you're ready to tackle repairing your credit, there are a range of options for getting caught up on current debt and starting to pay back past debt. While doing nothing is always an option, there are consequences to not acting to repair your credit. And the sooner you start to address debt, the faster your credit rating will start to go back up.

Start by looking at your monthly spending plan to help find the best solution for your specific situation. If you find yourself burdened by debt, however, and you want to get back on track towards healthy credit, you have several options to address the situation:

1. ***Talk with your creditor*.** As a consumer, you always have the option to contact your creditors and negotiate with them directly. Depending on your financial situation, you could request a lower monthly payment amount, a reduction in interest rate or late fees, or the option to skip a few months of payments without being reported as late to the credit bureaus. Not all creditors will be willing to work with you, but if you've been a good customer and call before you miss a payment, you'll be in a better position to bargain.

Pitfalls and Traps

- **Talk to the right person**: When you call your creditor about your bill, you usually speak with a customer service representative who may be more interested in getting your monthly payment than in problem-solving with you. Ask to speak with supervisor or "loss mitigation" specialist who has the authority to adjust your account.
- **Get it in writing**: Before you send in your new agreed upon payment amount, ask your creditor to send you the agreement in writing. You'll then have a written record in case there's any question about the arrangement in the future.
- **Don't give up**: It could take an hour or longer on hold and you might get "no's" from several creditors before you find one who's willing to work with you. But if you don't even ask, the answer is already "no."

2. ***Transferring balances*.** Transferring balances from one credit card to a lower interest credit card can save money on interest or lower the monthly minimum payment due, but be careful.

Pitfalls and Traps

- **Recycling debt.** When people who are having trouble managing their money consolidate their debt, they often recycle their debt by continuing to create new debt. That's because they haven't changed any spending behaviors. People may intend to change, but once the pressure and stress of the debt is reduced through the consolidation, the motivation to change is gone.
- **Increase risk or cost of credit.** Often people want to use equity on their home to repay debt. They do this because they have no other collateral for a consolidation loan. They have increased their risk of losing their home by converting unsecured debt (credit card debt not secured by any property) into a secured debt. They also have increased the amount of interest they will be paying and perhaps the length of time it will take to pay off their debt.

3. ***Consolidation loans*.** These loans take several debts and roll them into one loan. Ideally, a consolidation loan offers a lower interest rate, but this isn't always the case. An acceptable loan can lower your monthly payment and often reduce the overall amount of interest you are paying. A consolidation loan can be a good idea for people who already can pay their monthly bills and just want to be more efficient with debt repayment. However, you need to have good credit and collateral in order to get a consolidation loan without paying excessive interest.

Pitfalls and Traps

- **Cost to transfer debt:** Some creditors are charging balance transfers at the same rate high rate as cash advances.
- **Read the fine print:** Read the contract. It often is the case that if you slip up, such as being one day late on a payment, the interest rate goes way up and you're back where you started.
- **Fees:** Be aware of the cost of extra charges on "low interest" credit cards: late fees, over limit fees, cash advance fees, yearly fees.
- **More interest:** If you switch balances, you may be stretching out the time it will take to pay off your debt and end up paying more in interest in the long run.

4. ***Use a credit counselor to negotiate debt*.** A non-profit consumer credit counseling agency may be able to negotiate a debt management plan **(DMP)** with your creditors. **DMP**s are voluntary agreements between borrower and lenders that are designed to help organize debts. This often includes reduced interest rates, lower monthly payments, and consolidates them into one monthly payment. Costs are usually based on your ability to pay. For more information on DMPs:
   - *Knee Deep in Debt:* www.ftc.gov/bcp/edu/pubs/consumer/credit/cre19.shtm
   - *For People on Debt Management Plans - A Must-do List*: www.ftc.gov/bcp/edu/pubs/consumer/credit/cre38.shtm

Pitfalls and Traps

- **Type of Debt:** While DMPs might be a good fit for some consumers, this type of plan may or may not be right for you. A DMP is most helpful if your debt is unsecured and you have money to put towards debt repayment every month.
- **Timeline:** If a repayment plan cannot be accomplished in three to five years, usually this is not an option.
- **Credit Report:** Debt repayment plans that decrease interest or monthly payments will show up on credit reports as late or reduced payments.
- **Total Cost:** It can be expensive, especially if you have several creditors and the fee is based on the number of accounts in your debt management plan.
- **Check out the agency:** There are dishonest companies claiming to do credit counseling, so choose carefully. They could overcharge for their services. Others may take your money and not pay your creditors, or they may not even have called your creditors. Many states, including Wisconsin, require licensure of credit counseling agencies that do business in the state.

5. ***Discharge debt (file bankruptcy).*** Bankruptcy is a specialized branch of the law. It is not your responsibility to understand bankruptcy and all the laws that apply to it. It is your responsibility to become an informed consumer and know the consequences of filing bankruptcy and the long-term effect it will have on your credit.

Pitfalls and Traps

- **Consequences of filing bankruptcy:** It can be difficult to rent or obtain employment if a credit check is required. It can be difficult to borrow money from a financial institution. Loans that are approved will have a higher rate of interest.
- **Recycling:** Behavior must change or debt will reoccur. Sometimes people file bankruptcy and then turn around and start to incur more debt.
- **Determining if it's the best option:** A bankruptcy attorney will almost always recommend bankruptcy if a person is eligible without determining if this is the best option for a client. They also don't address spending issues that might put them at risk after the debt is discharged.
- **Embarrassment:** Often people who file bankruptcy feel ashamed and it is kept a secret. This can be a heavy burden to carry.

Credit repair options to approach with caution

1. ***Debt Settlement*****:** Debt settlement agencies are different than debt management plans. Usually debt settlement agencies collect your payments for many months instead of paying off creditors each month. When the agency has saved up a sizeable amount from your payments, then they will attempt to negotiate a lump sum settlement with your creditor for less than the full amount owed.

Pitfalls and Traps

- **No legal protection:** Debt settlement agencies typically take a percentage of what you save for their fee. While the agency saves up your monthly payments, your creditors can continue to come after you for payments and could pursue legal action.
- **Scams:** Any debt elimination or debt termination company that claims to be able to wipe out all your debt is most likely a scam. Some companies use fraudulent documents that claim your debt is invalid or challenge your creditors to arbitration over legitimate debt.

2. ***Selling Assets:*** You might consider selling something you own to help come up with some cash to put toward your debts. While selling items online or at a rummage sale can be a good one-time source of cash to pay down debt, it doesn't add to your monthly income to cover future debt payments.

Pitfalls and Traps

- **Lose Money**: When selling, you typically won't get as much money as you paid for an item. If you plan to replace the item when you get back on solid financial ground, this option could cost you more money in the long run.
- **Willing to sell**: You might own some family heirlooms or items with sentimental value that would be too hard to part with.
- **Do you own it:** You might not be able to sell an item that is being used as collateral for a loan. Sometimes the creditor will give you permission to sell the item, such as an auto, in order to use the money to pay off the loan.

3. ***Withdrawing Retirement Savings***: The Internal Revenue Service allows "hardship withdrawals" from certain retirement plans under circumstances which present an immediate and heavy financial need, including preventing foreclosure or eviction. Your withdrawal is limited to the amount of money you paid in and does not include any employer match or interest income. A withdrawal is not considered necessary if you still have other options available to you, such as securing a bank loan or selling assets.

   A hardship withdrawal is different from taking a loan out of your retirement account. Unless you're purchasing a home, a loan must be repaid within 5 years with payments beginning immediately. On the other hand, a hardship withdrawal doesn't need to be paid back. If you take out a loan and then leave the company before the loan is paid back, you must repay the loan right away or else pay taxes and penalties.

Pitfalls and Traps

- **Taxes:** Withdrawals are taxed as income, plus there's a 10% penalty added on, so you need to figure this amount into how much savings you plan to withdraw. It's extremely important to check with a tax professional about penalties and taxes due if you are considering cashing in a retirement policy. Find out more on the IRS website at: www.irs.gov.
- **Exceptions:** A retirement plan is not required to offer hardship withdrawals. Your options for withdrawing savings also depend on the type of plan you have, such as a 401(k), 403(b), 457(b) or IRA.
- **Long-term impact**: A hardship withdrawal permanently lowers your retirement savings since the money can't be paid back once it's taken out. Also, you won't be able to contribute to any retirement account for at least 6 months following a withdrawal.
- **Bankruptcy:** Retirement savings is exempt from seizure by your creditors during a bankruptcy. Once you've spent the hardship withdrawal from your retirement savings, what other options do you have for keeping up with your bills? Borrowing from retirement savings may not be the best option if you end up filing for bankruptcy a few months later.

Created by: Peggy Olive, Family Living Agent, Richland County UW-Extension, March 2010.
Sources: Building Bucks "Credit Management, Credit Counseling, and Bankruptcy," UW-Extension, 7/09; Wisconsin Homeownership Preservation Education (WHPE) Credit Management and Counseling, UW-Extension, 1/10.