Credit Card Companies Willing to Deal Over Debt

By ERIC DASH

Hard times are usually good times for debt collectors, who make their money morning and night with the incessant ring of a phone.

But in this recession, perhaps the deepest in decades, the unthinkable is happening: collectors, who usually do the squeezing, are getting squeezed a bit themselves.

After helping to foster the explosive growth of consumer debt in recent years, credit card companies are realizing that some hard-pressed Americans will not be able to pay their bills as the economy deteriorates.

So lenders and their collectors are rushing to round up what money they can before things get worse, even if that means forgiving part of some borrowers' debts. Increasingly, they are stretching out payments and accepting dimes, if not pennies, on the dollar as payment in full.

"You can't squeeze blood out of a turnip," said Don Siler, the chief marketing officer at MRS Associates, a big collection company that works with seven of the 10 largest credit card companies. "The big settlements just aren't there anymore."

Lenders are not being charitable. They are simply trying to protect themselves.

Banks and card companies are bracing for a wave of defaults on credit card debt in early 2009, and they are vying with each other to get paid first. Besides, the sooner people get their financial houses in order, the sooner they can start borrowing again.

So even as many banks cut consumers' credit lines, raise card fees and generally pull back on lending, some lenders are trying to give customers a little wiggle room. Bank of America, for instance, says it has waived late fees, lowered interest charges and, in some cases, reduced loan balances for more than 700,000 credit card holders in 2008.

American Express and Chase Card Services say they are taking similar actions as more customers fall behind on their bills. Every major credit card lender is giving its collection agents more leeway to make adjustments for consumers in financial distress.

Debt collectors, who are typically paid based on the amount of money they recover, report that the number of troubled borrowers getting payment extensions has at least doubled in the last six months. In other cases, borrowers who appear to be pushed to the brink are being offered deals that forgive 20 to 70 percent of credit card debt.

“Consumers have never been in a better position to negotiate a partial payment,” said Robert D. Manning, the author of “Credit Card Nation” and a longtime critic of the credit card industry. “It’s like that old movie ‘Rosalie Goes Shopping.’ When it’s $100,000 of debt, it’s your problem. When it’s a million dollars of debt, it’s the bank’s problem.”

The recent wave of debt concessions is a reversal from only a few years ago, when consumers usually lost battles with their credit card companies. Now, as bad debts soar, it is the lenders who are crying mercy.

Credit card lenders expect to write off an unprecedented $395 billion of soured loans over the next five years, according to projections from The Nilson Report, an industry newsletter. That compares with a total of about $275 billion in the last five years.

All that bad debt is getting harder to collect. In the past, troubled borrowers might have been able to pay down card loans by tapping the equity in their homes, drawing on retirement savings, taking out a debt consolidation loan, or even calling a relative for help. But with credit tight, consumers are maxed out.

“Knowing that the sources of funding have dried up, having someone pay the balance in full isn’t a viable strategy,” said Tim Smith, a senior executive at Firstsource, one of the biggest debt collection companies.

Lenders are reluctant to admit they will accept less than full payment, lest they encourage good customers to stop paying what they can. Industrywide data is scarce.

Unlike the huge mortgage loan modification programs that are taking place, which address thousands of mortgages at once, workouts for credit card customers are still being handled on a case-by-case basis.

In addition to debt forgiveness, debt collectors are allowing many delinquent borrowers to pay down their debt over the course of a year rather than the standard six months.

Paul Hunziker, the chairman of Capital Management Services, said that before this downturn, his firm put only about a quarter of all borrowers into longer-term repayment plans. Now, it puts about half on such plans.

Some lenders are also reaching out to borrowers shortly after they fall behind on their payments to try to avoid having to write off the account. Others are reaching out to customers who seem likely to fall behind. Just as lenders competed for years to be the first card to be taken out of the wallet, they are now competing to be the first ones paid back.

And realizing that millions more consumers are likely to default on their credit card bills in the coming months, the banking industry has started lobbying regulators to make it more advantageous to lenders to extend payment terms or forgive debt.

In an unusual alliance, the Financial Services Roundtable, one of the industry's biggest lobbyists, and the Consumer Federation of America recently proposed a credit card loan modification program, which was rejected by regulators.

Under the plan, lenders would have forgiven about 40 percent of what was owed by individual borrowers over five years. Lenders could report the loss once whatever part of the debt was repaid, instead of shortly after default, as current accounting rules require. That would allow them to write off less later. Borrowers would have been allowed to defer any tax payments owed on the forgiven debt.

Landmark changes to bankruptcy legislation passed in 2005, for which the industry aggressively lobbied, seem to have hurt card debt collections. Credit card industry data indicate the average debt discharged in Chapter 7 bankruptcy has nearly tripled since 2004. And in Chapter 13 bankruptcies, secured lenders like auto finance companies routinely elbow out unsecured lenders like card companies, trends that have contributed to the card lenders' willingness to settle.

Borrowers should not expect sweetheart deals. Card companies will offer loan modifications only to people who meet certain criteria. Most customers must be delinquent for 90 days or longer. Other considerations include the borrower's income, existing bank relationships and a credit record that suggests missing a payment is an exception rather than the rule.

While a deal may help avoid credit card cancellation or bankruptcy, it will also lead to a sharp drop in the borrower's credit score for as long as seven years, making it far more difficult and expensive to obtain new loans. The average consumer's score will fall 70 to 130 points, on a scale where the strongest borrowers register 700 or more.

For the moment, it may be easier for troubled borrowers to start negotiating a modification by contacting the card company or collection agency directly. Credit counselors can help borrowers consolidate their debts and get card companies to lower their interest payments and other fees, but they currently cannot get the loan principal reduced.

Another option is for a borrower to sign up a debt settlement company to negotiate on her behalf. But regulation of this business is loose, and consumer advocacy groups warn that some firms prey on troubled borrowers with aggressive marketing tactics and exorbitant upfront fees.