



Credit Reputation Ransoming: Held Hostage to Zombie Debt

Recently, a practice employed by a debt collector has been brought to my attention. I don't know whether it's new, or how widespread it is, but even one significant debt collection agency using this horrible tool is one too many. In speaking with several industry experts, none of whom claim any prior knowledge of this practice, I suspect this is an emerging tactic that has only recently reared its' ugly head.

The practice in question involves a refusal to delete a collection from a consumer's credit report—even if the consumer agrees to pay it in full—unless the borrower repays in full all of their other debt owned by that specific collection agency, regardless of the age of the debt.

No Good Deed Goes Unpunished

Here is a use case. Janet Jones has saved enough money to put a down payment on her first home. She applies for a residential mortgage loan with Acme Mortgage Lender. Acme pulls her tri-merge credit report and sees that she has a collection on one or more of her credit files for a relatively small amount that is four years old.

In her state, Janet's debt is past the statute of limitations and she can no longer be sued by her debtor or the current owner of the debt. However, Acme Mortgage tells Janet that they'd prefer her to negotiate with the collection agency in order to have the collection paid in full and removed. They represent that in so doing, she may be able to qualify for better loan terms that could save her thousands of dollars over the life of the loan. Acme also knows that a clean borrower credit history makes the loan worth more on the secondary market—where they will resell it immediately after closing.

Janet calls the debt collection company—Grub Collection—that owns the debt on her credit report. She is informed that it is Grub's policy not to remove from a credit report any collection until all that person's additional and unrelated debt owned by Grub is also paid in full.

The Curse of the Zombies

It turns out that Grub owns several uncollectable or “zombie” debts from when Janet had just graduated from college and struggled to secure her first permanent job. Zombie debts are time-barred (beyond the statute of limitations so that neither the debt owner nor the original creditor can sue the debtor and force them to pay), and are also over 7 years old so that they are no longer included in credit files shared with lenders or credit reports shared with consumers (though some debt collection agencies “re-age” the debt and report it to credit bureaus as new debt—an illegal practice). In some cases, the



zombie debt may not even belong to the person being assigned the debt. It may have been generated from ID theft, or, it may belong to another person with the same name.

It is called “zombie debt” because it is debt that can be resurrected if you are not careful. If you agree to pay any amount against “zombie debt,” you risk restarting the statute of limitations. The debt is brought back to life and is just as valid as any other active credit obligations you may have—such as student or mortgage loans, credit card debt, and auto financing. Then the amount of the old zombie debt that you’ve agreed to pay becomes legally collectible for whatever period of time your state defines as the statute of limitations on credit collections.

A collection agency also now has a far greater incentive to aggressively pursue you, through court (perfectly legal) or through constant harassment (not so much). If they secure a judgment against you, this will be included on your credit report and could do serious damage to your credit standing for a long time.

Currently, the only way to avoid this nightmare scenario is to have the debt collection agency agree in writing to a formal “offer-in-compromise” that clearly states they will not report anything to nationwide CRAs and they indemnify you from liability for the agreed upon amount. This is unlikely. You are far better off not agreeing to anything. That is unless the zombie debt is tied to a collections account on your credit report.

Credit Reputation Ransoming

Returning now to Janet’s use case. Her zombie debts owned by Grub were all between 8 to 10 years of age and are thus so old that they are no longer on Janet’s credit reports and she is no longer liable for them under her state’s laws. In order to have the Grub collection information that is 4 years old removed from her credit report, Grub are demanding that Janet pay them the full amount for the credit reported debt they own, plus all the zombie debt they own.

This odious practice—call it “ransoming”—is achieved by tying or bundling stale, old, and even phantom debt owned by a debt collection agency that does not appear on a consumer’s credit file, with a collection that does appear, regardless of the age of the collection. The debt collection agency leverages their ability to potentially improve a debtor’s credit standing—in some cases, removal of a collection may have little to no impact on a borrower’s credit score and no material impact at all on their credit standing (which risk tier they are grouped in that determines whether they receive credit and the terms)—in order to secure payment from the desperate debtor many times the amount the collection agency paid to buy the debt.



In other words, Janet's current and future credit standing is being held hostage by a debt collection agency regarding debt that is past the statute of limitations and no longer reported on her credit report. Improving her current credit reputation requires that she pay to Grub what amounts to a ransom. By agreeing to this, her zombie debt is now resurrected, and the amount she agrees to pay (in full or some percentage of the total) becomes a new and active debt for which the Grub Agency can sue her for repayment if she does not fulfill the agreed upon terms. And while they legally cannot credit report the new agreement, they will not remove the reported collection until she fully pays the ransom.

It's All About Leverage

Because Janet needs to clear up her credit quickly (to secure a mortgage loan), she is put in an asymmetric position vis-à-vis Grub. Grub's leverage is so great that it may compel Janet to pay for debt so old that she may no longer remember the details or have any records of the initial transactions. For all she knows, this debt may not even be hers. In all likelihood, given its age and status as "uncollectable," Grub purchased the old debt for pennies on the dollar (usually 3% or less, even far less).

This approach to debt collecting could be a massively profitable emerging business model for a collections agencies that purposefully buy zombie debt over a person's lifetime for those for whom they own newer debt that is still credit reported. Credit collections agencies currently receive "trigger reports" from nationwide credit bureaus that alert them of new credit activity on such people—a way to prioritize collections efforts on those who have a capacity to repay. The very same trigger reports could be used to prioritize zombie debt acquisition efforts by collections agencies.

In fact, assuming it does not already exist, debt collection agencies and debt buyers (often times one and the same firm) could creative a viable debt swapping market to enable zombie debt to acquired by whichever firm owns fresher debt on any person.

Owning uncollectible zombie debt without newer debt (debt still reported to credit bureaus, regardless of whether it is time-barred) is practically worthless—hence the steeply discounted price. But zombie debt that can be tied to newer debt takes on much greater value, especially zombie debt owned by credit active persons who are motivated and who possess the means to pay. Tying would also increase the resale value of fresher and middle-aged debt (debt that is a few years old but still credit reported) meaning that the original creditors could charge more to debt buyers. Here is the only possible upside. In competitive markets, reduced losses through higher resale could be passed along to borrowers in the form of lower prices for credit. Spread across a few hundred million borrowers, this would likely be a negligible amount. Still, anything helps.



Let me offer the disclaimer that I do not hate debt collectors, nor do I see them as uniformly as vampires preying upon the weak and powerless as they are often portrayed. Most debt collectors are hard working people who are trying to earn a living. They have a largely thankless and high-stress job. The good ones are not intimidators (that lot doe exist though) but instead are negotiators, mediators, and even counselors. Debt collection is useful and necessary.

Having said all of that, debt collection practices approved by senior management at some debt collection agencies have a long and sordid history. Tactics including intimidation, the use of mis- and dis-information (borrowers are dis-informed about the need to make a large bulk payment on an aggressive time schedule, and are misinformed about their rights under the Fair Debt Collection Practices Act), and harassment have resulted in a bevy of consumer protections having been enacted including the FDCPA and the Fair Credit Billing Act that are both part of the Consumer Credit Protection Act.

Policymakers Should Ban Ransoming

While “ransoming” may currently be legal—after all, in a voluntary credit reporting system, creditors (and by extension debt owners) are not obligated to report payment data at all, let alone remove account information if they elect to report—it is a practice screaming for attention from regulators, especially the CFPB. If collection agencies are going to report account information to one or more nationwide consumer reporting agencies (credit bureaus), then they should be required to report updated payment information—including payment in full, paid as agreed or removal—on a per tradeline basis, not tied to any other account owned by that collection agency.

In reality, when a debtor repays an old debt it is not going to the original lender or service provider (e.g. a hospital or cable company). All such firms anticipate a charge off rate and include that in the risk premium and fees charged to all customers. Instead, the money goes directly to the debt buyer/debt collector with a huge return for little more than engaging in sustained haranguing of consumers.

PERC urges Congress, the CFPB, and the FTC to examine this practice and take measures to protect consumers from having their credit reputation held hostage for ransom payments to debt collection agencies. The FDCPA should be amended to prohibit the tying of debt obligations, and to prohibit the statue of limitations on debt from being extended. Further, the Fair Credit Reporting Act should be amended to require data furnishers to delete collections either paid in full or for a mutually agreed amount. These simple steps will go a long way toward protecting consumers from zombie debt and preventing them from having their credit reputations ransomed.