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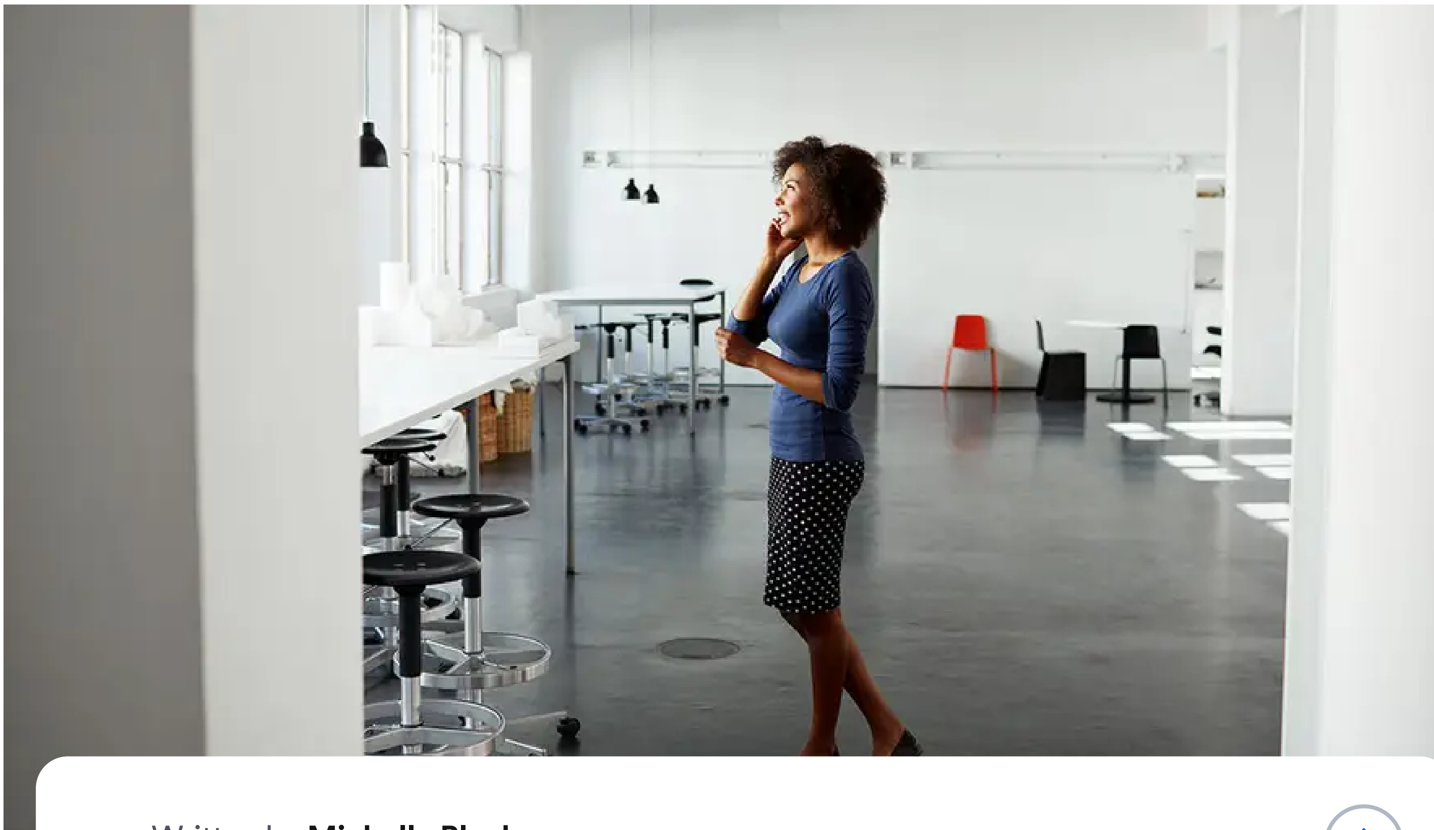
How to negotiate student loan settlement



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Nov. 19, 2021 / 6 min read

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With mortgage or rent payments, utility bills, auto loans and living expenses demanding your attention, student loan payments might not be high up on your priority list. However, not paying your student loans can hurt your finances in more ways than one. If you're having trouble making payments, you may want to consider an alternative approach, such as negotiating a student loan payoff with your lender and trying to settle for less than you owe.

You might want to consider a student loan settlement if:

- Your loans are in default (or near it).
- You have a lump-sum payment to settle your outstanding debt.
- The alternative is bankruptcy or a court judgment.

Key takeaway

If you're behind on your student loan payments but have a lump sum of cash saved up, it might be worth talking to your lender to see if settling your loan balance for less is an option.

What is a student loan settlement?

Student loan settlement is when you settle your student loans for less than the amount you currently owe. If your loans are in default and you have a chunk of cash saved up, your lender might be willing to negotiate a settlement agreement with you. It's a good idea if you're behind on your debt and can pay off a good portion of it right away.

The amount of money you may be able to save will vary according to your lender. Some might be willing to settle for 50 percent of your loan, although this is extremely rare. Most will require you to pay more — often upward of 90 of your loan balance.

Not all student loan lenders are willing to entertain settlement offers. But some might accept a settlement if it's the only way they expect you to pay off your outstanding debt.

When can I settle my student loans?

You typically can't settle if your student loans are in good standing and you make timely payments every month. Even if you're a little late on your last payment, you're usually not considered eligible until your loan is in default. However, it's not a good idea to intentionally default in order to reach a settlement — lenders typically won't agree to settle until they've exhausted all of their tools for collecting the debt.

You might qualify for federal student loan debt settlement if:

- **You can't afford the loan:** You must prove that you can't afford to repay your loan through pay stubs and bills or recent tax returns.
- **You've redefaulted:** If you've defaulted on the same loan more than once, options like rehabilitation, income-driven repayment plans, deferment or forbearance may no longer be available to you. Instead, a settlement might be one of your last options.

For private student loans, most loans will default after 120 days of nonpayment, though this depends on your lender. If you can show your lender that you don't have income or assets to pay back your loan, it might accept a settlement offer. However, you'll still need to have an offer worth accepting, which usually includes a lump-sum offer or a final amount paid over the course of a few installments.

How to settle your student loans

Before you begin negotiations, your loans will probably need to be either in default or near default. Some lenders may suggest an alternative repayment plan, but if your loans are far beyond hardship assistance, you can start trying to negotiate a student loan settlement.

1. Know your options

Your private student loan settlement options depend on your lender. Some lenders might require you to pay at least 90 percent of your loan, while others might be more lenient and accept less. The longer you go without making a payment, the less you might need to pay when you request a student loan settlement.

If you have federal loans, there are a few standard compromise options. You can pay:

- The remaining principal and interest without any collection charges.
- The principal and half of the unpaid interest that has accrued since the loan went into default.
- 90 percent of the current balance of principal and interest.

Be open if your loan servicer requests a different settlement offer, and don't be discouraged if you end up going with a backup plan.

2. Let the lender make the initial offer

Even though you should have an idea of your options, let your lender make the first offer. This gives you the chance to review the offer and either accept it or counteroffer. It's your starting point for negotiation. By knowing your options ahead of time, you'll be able to successfully negotiate a plan you're comfortable with.

If you're unsure how to get here, explain your situation to your lender and ask, "How can we go about getting this right?" or "What are my options at this point?"

3. Request a paid-in-full statement

Since this is outside of your normal payment plan, you'll need to handle a settlement carefully. Get an offer in writing and have a lawyer review the terms with you. Once you've paid your debt in full, request a "paid-in-full" statement as part of your terms. Otherwise, you may still be on the hook for some of your outstanding loan balance.

Keep your paid-in-full statement handy in case lenders or debt collectors try to request money from you later on. You might also need it to request an update on your credit report or when you file your taxes. Note that if you receive a 1099-C from the lender after you settle your debt, you might have to pay taxes on the amount of debt the lender canceled.

Alternatives to student loan settlement

In many cases, student loan settlement should be a last resort, particularly since defaulting on your loans will damage your credit score. Before settling your student loans, try getting back on track with your payments in other ways:

- **Deferment or forbearance:** Deferment and forbearance offer a temporary pause on your student loan payments. Interest may continue to accrue, but it could still be worth it if taking a break from payments helps you get back on track.
- **Income-driven repayment plans:** Available with federal student loans, income-driven repayment plans base your payments on your income and how many people are in your household. If you don't have a job, you could pay as little as $0 without facing any penalties, fees or harm to your credit. Plus, your remaining balance will be forgiven after 20 or 25 years of payments.
- **Refinancing:** If you have private student loan payments you can't afford, you might want to consider refinancing. If you have good credit, refinancing might help you secure a lower interest rate, and perhaps lower monthly payments too. It's usually best to avoid refinancing federal student loans, since you'll lose federal benefits by doing so.

FAQ about student loan settlement

Will settling student loans hurt your credit score?

Settling your student loan debt is likely to hurt your credit score. For one, lenders report loan default to the credit bureaus, and you must usually be in default to initiate a settlement agreement. With that said, you can ask the lender to remove the default from your credit history as part of the settlement agreement.

Settling for less than your full balance may also show up as a negative mark on your credit report. However, if you were already in default, the added settlement notation may not have a noticeable effect on your credit score.

A settled account can remain on your credit report for up to seven years. On a positive note, its credit score impact lessens over time.

How much money can you save with a student loan settlement?

How much money settling your student loans can save you depends on several factors, such as:

- How much you owe.
- Outstanding collection charges and late fees.
- How far behind you are on payments.

Sometimes, a settlement waives the late fees, collection costs or a portion of your interest. In some instances, you could get a small percentage of your principal balance waived as well. Depending on the circumstances, you might save 10 percent to 50 percent of your loan balance.

How much does student loan settlement cost?

When you settle your student loans, you'll have to pay the settled amount in a lump sum. This amount could be 50 percent to 90 percent of your outstanding loan balance, depending on what your lender agrees to. You may also have to continue paying collection fees and interest in the meantime.

Settlement may also cost you years of damage on your credit report and score. This credit damage could hurt your chances of borrowing in the future and could cause lenders to offer you higher interest rates when you do qualify for financing.

What is the best way to get rid of student loan debt?

With any debt, the best way to get rid of it is to pay it off according to the terms of your loan agreement. But if you're struggling to afford your payments, talk to your lender about your options.

You might qualify for deferment, forbearance or an income-driven repayment plan. If your credit is in decent shape, you could also consider refinancing your student loans to try to secure a lower interest rate, lower monthly payment or both. Student loan debt settlement is one option, but that doesn't mean it's the best option for everyone.

What happens if you never pay your student loans?

When you stop making your student loan payments, your lender will likely make moves to try to compel you to pay. On top of the loss of eligibility for future financial aid, you could face severe, long-term credit score damage.

Once you miss enough payments, your lender might opt to file a lawsuit against you. In some cases, lenders may be able to seize your tax refunds and garnish your wages to force you to pay back your student loan debt.

Learn more:

- Student loan repayment process: Everything you need to know
- What is student loan default?
- Deferment vs. forbearance: Which is best for your student loan?