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THE DEBT SETTLEMENT INDUSTRY: THE CONSUMER'S EXPERIENCE

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

APRIL 22, 2010

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ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

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THE DEBT SETTLEMENT INDUSTRY: THE CONSUMER'S EXPERIENCE

THURSDAY, APRIL 22, 2010

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 2:37 p.m. in room SR–253, Russell Senate Office Building, Hon. John D. Rockefeller IV, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

The CHAIRMAN. We will begin this hearing.

And others are coming. I've been there, you know. I was late a lot.

All right. This is important. This is very important. Millions of American families have suffered serious financial setbacks during the economic turndown, which promises to go on for a while. Sometimes it's because somebody in the family has lost a job. Sometimes it's because a family member has gotten sick and medical bills are piling up. As we all know, even people who think they have good health insurance end up owing thousands of dollars out of their own pockets, and that's another hearing and another subject.

For thousands of Americans and West Virginia families, our economic downturn has meant falling farther and farther behind. It also means struggling every month to pay bills. And it means thinking seriously about what happens if they can't make even their minimum monthly payments to their creditors.

One person who found himself in this situation was Mark Spaulding, who lives in South Charleston, West Virginia. And between the credit card bills and the hospital bills, he and his wife owed more than $23,000. That is not unique. He wasn't behind on these bills, yet he was worried. He had a job, and he believed in paying what he owed. But, he wasn't sure how he was going to pay it all off. So, he looked for help. And he found a California company called U.S. Debt Settlement that looked reputable. That's—it's hard to see from South Charleston to California, so he was doing this off the Internet, and had to make that judgment.

He called a toll-free number. He talked to a sales representative named Holly Slater. She told him that U.S. Debt Settlement could act as his financial representative and could negotiate with his creditors to cut his debt by as much as 50 percent.

William and Holly Haas, of Concord, New Hampshire, had a similar experience with a debt settlement company called Con-

sumer Credit Counseling of America. Notice the—sort of the integrity of these names. And I'm very pleased that they're here with us. And they're going to have something to say.

What Mr. Spaulding and the Haas family has—and thousands of other Americans have learned the hard way, is that these debt settlement companies are not what they claim to be. And that is what we are talking about today. They promise to reduce debts by 40, 50, or even 60 percent, and then collect thousands of dollars in fees up front. They promise to settle the debts, but collect up front. When you go into a candy store, you buy a Baby Ruth candy bar, you get the candy bar, and then you pay the fee. But, it's sort of reversed here.

Today, we will learn that these companies keep the fees, but don't keep their promises. In reality, signing up to work with these families and these companies usually makes struggling consumers financially worse. And that's where that is. They fall farther behind on their debts, they see their credit scores plunge. And they get sued by their creditors.

In written testimony, Mr. Spaulding says he followed U.S. Debt Settlement's advice for 14 months and paid them more than $2,400 in fees—up front. Today he owes, in fact, 40 percent more than he did when he began on his debts, and his credit score is ruined. He has two court judgments against him, and he has been advised he should think about declaring bankruptcy. This is outrageous. It is appalling beyond words.

So, these debt settlement companies are kicking people when they are down. That's the way I look at it. I come from West Virginia. We see that a lot. And even though they take patriotic names, like U.S. Debt Settlement or Consumer Credit Counseling of America, and have all kinds of emblems, which I will show you in a bit, their actions are, in fact, profoundly un-American. This is serious, and it is a growing problem, and I'm pleased to report that our States' attorneys general and the Federal Trade Commission are fighting these fraudulent companies.

We're going to hear testimony about these companies from newly sworn-in FTC Commissioner Julie Brill and from Phil Lehman—Have I got that right?—who is Assistant Attorney General from North Carolina. And we thank you for coming.

Much of this committee's work, and my attention as chairman over this last year, has focused on consumer protection. It's what everybody else gets angry about, but doesn't do anything about. So, I've decided that we're going to do something about it in this committee, and we are. And the terrible part is that it's not really very hard to ferret out and that it's so rampant. And that's so wrong.

We have the authority to conduct independent investigations in this committee. And last October, I used this authority to ask the GAO Special Investigations Office to conduct, in fact, a covert investigation on this problem and the matter of debt settlement as an industry. I told them I wanted to know what really happens to a consumer who calls one of these 800-numbers. We will hear the results of that investigation right here, today. And I think members of the Committee, should they show up, and the American public will find them pretty disturbing, alarming, and depressing.

So, I want to thank today's witnesses. I look forward to your testimony as much as I look forward to some of our members showing up.

And we will start with you, sir.

STATEMENT OF GREGORY D. KUTZ, MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KUTZ. Mr. Chairman, thank you for the opportunity to discuss the debt settlement industry.

Today's testimony highlights the results of our investigation into fraudulent and deceptive marketing and business practices.

My testimony has two parts. First, I will discuss the results of our investigation, and then I will discuss the results of other investigations.

First, as you mentioned, posing as fictitious consumers with significant credit card debt, we contacted 20 debt settlement companies. We attempted to pick companies that, on the surface, ranged from credible to egregious in their marketing. We did not enter into any agreements with these companies. The vast majority of companies that we've contacted provided fraudulent, deceptive, and otherwise questionable information to our fictitious consumers.

The monitor shows key themes that we found, including advance fees, exaggerated claims of success, telling consumers to stop paying their bills, and linking debt settlement to Federal programs.

The basic program setup was for consumers to make a monthly payment into a bank account. Once that account had accumulated enough funds, the companies promised to settle debt with creditors for pennies on the dollar. For 17 companies, advance fees were collected from consumers before any debt was actually settled. Companies told us that their service fees ranged from 10 to 18 percent of the outstanding debt. These fees were usually taken directly from the bank account during the first 12 months of what were typically multiyear programs. In the most egregious cases, 100 percent of the consumer's first 3 or 4 monthly payments were used for fees.

Other fees charged by these companies included monthly maintenance, trust, and bank fees. Exaggerated claims——

The CHAIRMAN. If I could interrupt, for a moment.

Mr. KUTZ. Yes, sir.

The CHAIRMAN. I failed to identify you.

Mr. KUTZ. That's fine.

The CHAIRMAN. No, it isn't.

[Laughter.]

Mr. KUTZ. I'm undercover at this hearing, so—just kidding.

[Laughter.]

The CHAIRMAN. I know. I know. But, the folks listening in, et cetera, or the folks behind you, don't know. And that's my fault, and I apologize.

You are, in fact, the Managing Director, Forensic Audits and Special Investigations, U.S. Government Accountability Office, GAO.

Please proceed.

Mr. KUTZ. Thank you. Now everyone knows who I am.

The CHAIRMAN. I've blown your cover, yes.

[Laughter.]

Mr. KUTZ. You've blown my cover. All right, I can't use that one again.

Exaggerated claims of success provided our fictitious consumers with false hope of program completion. Examples included claims that 85 percent, 93 percent, and even 100 percent of clients successfully completed these programs. The reality, according to Federal and State investigations is a success rate of less than 10 percent.

One industry association represented that their members have a 34 percent success rate. Whether single digits or 34 percent, this low success rate shows the negative impact of advance fees on financially distressed consumers.

We also found that 17 of these 20 companies advised our fictitious consumers to stop paying their creditors. Although industry associations say their members don't do this, 9 of the 17 were, in fact, their members. I have no doubt that for these programs to work, consumers must stop paying their bills. However, our fictitious consumers were told to stop paying their bills even when they were current, which would have a significant negative impact on their credit scores.

Several companies advertised that their debt settlement programs were part of a Federal Government program. My favorite is the company that advertised that its program was, and I quote, "a national debt-relief stimulus plan," end of quote. These companies made it appear as if government agencies and stimulus dollars were linked to their programs. Although I find this to be ridiculous, and I'm sure you do, too, many consumers likely fall prey to these fraudulent marketing tactics. At the end of my presentation, I will play excerpts from several of these undercover calls.

Although the vast majority of companies provided fraudulent and deceptive information, several did provide sound advice. For example, one company told us to take care of our late mortgage payments before worrying about our delinquent credit cards. In another case, our fictitious consumer was told that if we could make our monthly payments, then perhaps debt settlement was not a good solution.

Moving on to my second point, the experience of our fake consumers is similar to many real consumers, like the ones sitting to my left. Cases from 12 Federal and State agencies reveal allegations of fraudulent and deceptive practices involving over 200,000 consumers across the country. This information is taken from Federal and State, open and closed, civil and criminal cases.

In addition—and you'll hear from FTC—they are taking actions to enhance consumer protection, including a proposed ban on the type of advanced fees that I just described.

The Better Business Bureau recently designated debt settlement as an inherently problematic type of business. Other businesses with this designation include payday loan centers and wealth-building seminars. I'm sure you understand, that's not good company.

In conclusion, I can't tell you that all companies in this industry are bad actors. However, it wasn't very hard for us to find the rot-

ten apples of this basket. My advice to consumers, Senator, is, buyer beware.

As I mentioned, I'm now going to play for you some of the undercover calls we made to debt settlement companies. You will see the transcription of the conversations on the monitors as you listen.

[Video presentation.]

TRANSCRIPT OF UNDERCOVER GAO CALLS TO DEBT SETTLEMENT COMPANIES

Telling consumers to stop paving their creditors. (Industry trade groups say their members do not do this.):

Clip 1: Call from GAO to *A New Beginning Financial (TASC Member)*

Debt Settlement Company: You don't actually have to be delinquent to be in our, into our program, but once you do enter the program you don't make credit, you don't make your payments to the creditors.

Clip 2: Call from GAO to *Freedomdebt.com (USOBA)*

Debt Settlement Company: Once you enroll in the program, you will no longer make any of your credit card payments.

Fictitious Consumer: OK, so . . .

Debt Settlement Company: That's correct.

Fictitious Consumer: So then, what's, what's gonna happen with my, uh, creditors? I mean . . .

Debt Settlement Company: They're, they, they're, uh, they're . . . you're not gonna pay 'em!

Fictitious Consumer: I shouldn't, I shouldn't pay a few of these cards at all?

Debt Settlement Company: You're not. . .when you are in our program you will not pay any of your creditors anymore . . .

Fictitious Consumer: [cross-chatter]

Debt Settlement Company: . . . throughout the whole program.

Clip 3: Call from GAO to Credit Solutions of America

Debt Settlement Company: I'm, I'm saying I don't, don't tell anybody not to pay their bills. I say 100 percent of the clients who have been successful have stopped paying their bills.

Fictitious Consumer: OK. Alright . . . right . . . so now, so . . . so now I'm caught between a rock and a hard place. Do I put money away in my savings account or do I use that money to pay my bills, if I'm in your program?

Debt Settlement Company: If you're in our program, umm, put that money into your savings account.

Fictitious Consumer: OK.

Claims of high success rates: (Federal and state investigators have generally found single-digit success rates.)

Clip 4: Call from GAO to Web Credit Advisors via Free Debt Settlement Now (USOBA Member)

Debt Settlement Company: OK, great. So, it's important for you to know we have thousands of clients. We're also an accredited business with the Better Business Bureau with an A rating. Umm, and, uh, we have zero unresolved customer complaints. And that's because we do exactly what we say. And we help 100 percent of the people who enter this program eliminate their debt, uh, in less than 3 years.

Clip 5: Call from GAO to ProCorp Debt Solutions (TASC Member) via Free Debt Settlement Now

Debt Settlement Company: Now, our fallout ratio in the program is probably the lowest in the country. Fallout ratio meaning people that sign up and then don't complete the program.

(cross-chatter)

Fictitious Consumer: Do you know what it is, roughly? Debt Settlement Company: Yes, it's less than 7 percent. Fictitious Consumer: Wow, that's tremendous.

Debt Settlement Company: It's my job to know those numbers. It's my job to know those numbers.

Fraudulent claims of links to government programs:

Clip 6: Call from GAO to *Freedom Fidelity Management (CA) via The Bailout Group*

Fictitious Consumer: With the government the way it is, does this government approved thing, does that have anything to do with the stimulus package?

Debt Settlement Company: No, no. It's just, it's just government approved. They allow for us to do this.

Fictitious Consumer: OK.

Debt Settlement Company: Um, you know the banks received, you know, bailout money last year—I'm sure you saw it on the news. There has to be some type of assistance for people on a consumer level also.

Other Fraudulent, Deceptive or Questionable Representations:

Clip 7: Call from GAO to ProCorp Debt Solutions (TASC Member) via Free Debt Settlement Now

Debt Settlement Company: And there are actually 12,000 companies in the U.S. that do what we do. Only 200 of them are licensed and regulated. Uh, they're regulated by TASC, which is The Association of Settlement Companies. . . . They are the regulating body for this industry.

Fictitious Consumer: So TASC . . .

Debt Settlement Company: They're like the SEC for stock traders. T–A–S–C.

Fictitious Consumer: So, for you all, that would be kind of like, in your industry, the Good Housekeeping Seal of Approval?

Debt Settlement Company: Correct. That's exactly what the story is.

Clip 8: Call from GAO to ProCorp Debt Solutions (TASC Member) via Free Debt Settlement Now

Debt Settlement Company: The companies that operate like ours are the ones that are safe, stay around forever. We've never been inquired on by the Attorney General, ever. You find me a debt settlement company that can say that, and I'll move over there and work for them. Every debt settlement company that I've ever come across has had investigations or inquiries by an attorney, the Attorney General for their state. The Attorney General doesn't even, doesn't even look our way.

Mr. KUTZ. Mr. Chairman, I applaud your efforts today to protect consumers from the kinds of fraud and abuse we're talking about here.

That ends my statement, and I look forward to your questions.

[The prepared statement of Mr. Kutz follows:]

PREPARED STATEMENT OF GREGORY D. KUTZ, MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. Chairman and members of the Committee:

Thank you for the opportunity to discuss our investigation into fraudulent, abusive, and deceptive practices in the debt settlement industry. As historic levels of consumer debt have dramatically increased the demand for debt relief services, a growing number of for-profit companies have appeared, offering to settle consumers' credit card and other unsecured debt for a fee as an alternative to bankruptcy.[1] The companies say they will negotiate with creditors to accept a lump sum settlement less than the amount owed—purported to be as low as pennies on the dollar in many cases. In addition, these companies often say their programs can result in lower monthly payments for consumers than what they had been paying their creditors, and that their programs will help consumers get out of debt sooner than going through bankruptcy or making only minimum payments on their credit cards. They commonly use radio, television, and Internet advertising to solicit consumers. The marketing claims appeal to consumers who may be vulnerable, given the stress of their financial situations.

Some consumers who have hired these companies have complained that they did not obtain relief from their debts and ended up in worse financial circumstances. For example, according to a sworn statement given to state attorneys, a 75-year-old New York woman ended up paying more than $5,100 to a company to settle only $3,900 of debt on one account. The company failed to settle a second one, which she ultimately paid off for about $1,000 more than what she originally owed. At the time she signed up for the debt settlement program, she had been a widow for several years and was working as a pharmacy clerk to help pay her bills and mortgage. She stated that she often neglected her own needs and accrued more debt trying to help her adult daughter care for two children and a sick spouse. She also stated that she was desperate for help and was easily sold on entering a debt settlement program

[1] Unsecured debts are those debts for which there is no collateral, such as most consumer credit card debt.

through an unsolicited telephone call and an offer to reduce her debts by 24 to 40 percent. Even though the debt settlement company cost her more than she originally owed, it still counted her as a success story.

Federal and state agencies have made allegations that some debt settlement companies engage in fraudulent, abusive, and deceptive practices. You asked us to conduct an investigation of these issues. As a result, we attempted to: (1) determine through covert testing whether these allegations are accurate; and, if so, (2) determine whether these allegations are widespread, citing specific closed cases. To achieve these objectives, we conducted covert testing by calling 20 companies while posing as fictitious consumers with large amounts of debt; made overt, unannounced site visits to several companies called; conducted interviews with industry stakeholders, such as industry trade associations and the Better Business Bureau (BBB); and reviewed information on Federal and state legal actions against debt settlement companies and consumer complaints. We did not actually use the services of any of the companies we called.

For our first objective, we identified debt settlement companies by searching online using search terms likely to be used by actual consumers, and by observing television, radio, and newspaper advertisements. We selected companies from across the Nation to call as part of our covert testing by using several criteria, such as: (1) types of marketing claims or pitches, such as refund offers, service guarantees, or targeting of specific groups of consumers; (2) presence, if any, of consumer complaints through BBB and other resources; (3) represented size of businesses, to include both small and large companies; (4) availability of consumer-friendly information on companies' websites, such as financial education resources, comparisons to other types of debt relief, or advice on handling credit card debt; (5) membership in various industry trade organizations, which requires adherence to specified standards of conduct; and (6) claims of advertising presence on television or radio. In one case, we identified a company through a spam e-mail message received by one of our staff members, which provided a link to the company's website.[2] The 20 cases that we selected incorporated a range of debt settlement companies, including some that appeared to make egregious claims and others that appeared more reputable. We found that some of the 20 companies we called are marketing companies that refer potential clients to other—sometimes multiple—affiliated companies. In most cases, we were unable to determine the exact business relationship between these entities. For the purposes of this testimony, our 20 cases represent the original company we called, plus any related marketers and any other affiliated companies with which we spoke. In addition, we called some companies more than once, depending on the circumstances. The findings for these 20 cases cannot be projected to all debt settlement companies. For our second objective, we identified allegations against debt settlement companies from review of closed and open civil and criminal investigations pursued by Federal and state enforcement agencies over the last decade. We did not attempt to verify the facts regarding all of the allegations and complaints we reviewed. We also identified five closed civil and criminal cases where courts found the debt settlement companies liable for their actions and interviewed affected consumers.

We briefed Federal Trade Commission (FTC) officials on the results of our investigation. In addition, we referred cases of fraudulent, deceptive, abusive or questionable information provided by the 20 debt settlement companies we called to FTC as appropriate. We conducted our investigation from November 2009 through April 2010 in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

Background

For-profit debt settlement emerged as a business model as other, decades-old forms of consumer debt relief came under increased regulation. Traditionally, consumers with large amounts of debt turned to nonprofit credit counseling agencies (CCA) for debt relief. CCAs work with consumers and creditors to negotiate debt management plans (DMP), which enable consumers to pay back unsecured debts to their creditors in full, but under terms that make it easier for them to pay off the debts—such as reduced interest rates or elimination of late payment fees. In addition, CCAs often provide consumers with financial education and assist them in developing budgets. In order to qualify for a DMP, consumers must prove they have sufficient income to pay back the full balances owed to creditors under the terms of the potential DMP. As part of a DMP, CCAs contact each of a consumer's creditors to obtain information about what repayment options the creditors may be willing to offer to the consumer. The CCA then creates the final DMP and a repayment

[2] Spam is unsolicited "junk" e-mail that usually includes advertising for some product.

schedule, with payments typically spread over 3 to 5 years. Throughout the length of the DMP, the CCA distributes funds to each of a consumer's creditors after the consumer makes each monthly payment to the CCA. Nonprofit CCAs typically receive funding from consumers and from creditors.

Many for-profit CCAs emerged as the level of consumer debt rose over the last decade, leading to new consumer protection concerns. FTC and state attorneys general took legal action against unscrupulous CCAs that engaged in deceptive, abusive, and unfair practices. For example, some CCAs charged excessive fees, abused their nonprofit status, misrepresented the benefits and likelihood of success of their programs, and committed other deceptive and unfair acts. The Internal Revenue Service (IRS) also undertook a broad examination effort of CCAs for compliance with the Internal Revenue Code and revoked or terminated the Federal tax-exempt status of some agencies. As Federal and state actions cracked down on these consumer protection abuses, a growing number of consumers became unable to afford traditional DMPs. As a result, many companies began offering for-profit debt settlement services for consumers.

Debt settlement companies offer to negotiate with consumers' creditors to accept lump sum settlements for less than the full balance on the consumers' accounts. The process typically requires consumers to make monthly payments to a bank account from which a debt settlement company will withdraw funds to cover its fees. Some companies require consumers to set up accounts at specific banks, while others allow consumers to use their existing bank accounts. These monthly payments must accumulate until the consumer has saved enough money for the debt settlement company to attempt to negotiate with the consumer's creditors for a reduced balance settlement.[3]

Debt settlement companies typically charge a fee for their services and require payments either at the beginning of the program as an advance fee or after settlement as a contingent fee. Some companies structure the payment of advance fees so that they collect a large portion of them—as high as 40 percent—within the first few months regardless of whether any settlements have been obtained or any contact has been made with the consumer's creditors. Others collect fees throughout the first half of the enrollment period in advance of a settlement. Companies that charge a contingent, or "back-end," fee generally base it on a certain percentage of any settlement they obtain for consumers. They sometimes charge a small, additional fee every month while consumers are attempting to save funds for settlements. In addition, some debt settlement companies handle only one part of the overall settlement process, such as the front-end marketing or the negotiation with creditors, while other debt settlement companies conduct every part of the process themselves.

Currently, there has been only limited Federal action taken against debt settlement companies. Since 2001, FTC has brought at least seven lawsuits against debt settlement companies for engaging in unfair or deceptive marketing.[4] In August 2009, FTC issued a Notice of Proposed Rulemaking to amend the Telemarketing Sales Rule (TSR) to enhance consumer protections related to the sale of debt relief services,[5] including debt settlement services.[6] In its notice, FTC offers multiple criticisms of the debt settlement industry and states that its "concerns begin with the marketing and advertising of the services, but also extend to whether such plans are fundamentally sound for consumers." The proposed rule would amend the TSR to do the following, among other things:

- prohibit companies from charging fees until they have provided debt relief services to consumers;[7]

---

[3] Some creditors may sell a consumer's debt to a collection agency after the consumer misses payments for a given period of time—typically 6 to 12 months. The collection agency will then attempt to collect payments from the consumer. In such cases, debt settlement companies will generally negotiate with the collection agency seeking the consumer's money.

[4] FTC's regulatory authority related to false advertising is contained in section 5(a) of the Federal Trade Commission Act (15 U.S.C. § 45(a)), which makes unlawful both "unfair" and "deceptive" acts or practices that affect interstate commerce.

[5] The notice primarily discusses three categories of debt relief services—credit counseling, debt settlement, and debt negotiation. While some consider debt negotiation to be another term for debt settlement, FTC refers to debt negotiation as a separate type of debt relief service. In this context, debt negotiation companies are those that offer to obtain interest rate reductions and other concessions from creditors on behalf of consumers, but do not claim to obtain full balance payment plans or lump sum settlements for less than the full balance. See 74 Fed. Reg. 41988, 41997 (Aug. 19, 2009).

[6] 74 Fed. Reg. 41988 (Aug. 19, 2009).

[7] Under the TSR, advance fees are currently banned for several other industries, including credit repair services and advance fee loans.

- require companies to disclose certain information about the debt relief services they offer, including how long it will take for consumers to obtain debt relief and how much the services will cost; and,
- prohibit specific misrepresentations about material aspects of debt relief services, including success rates and whether a debt relief company is a nonprofit.

In its notice, FTC demonstrates that the requesting or receiving payment of advance fees before debts are settled meets its criteria for unfairness, and therefore designates advance fees for debt settlement services as an abusive practice. FTC considers advance fees an abusive practice due to the following:

- the substantial injury to consumers caused by advance fees, based on the low likelihood of success for debt settlement programs and the significant burden on consumers paying advance fees—especially fees charged at the front end of a debt settlement program, which FTC states ultimately impede the goal of relieving consumers' debts;
- the injury to consumers caused by advance fees outweighing any countervailing benefits; and,
- the business practices prevalent among debt settlement companies making the injury to consumers reasonably unavoidable, such as representations in advertisements obscuring the generally low success rates of debt settlement. FTC also states in its notice that many consumers entering debt settlement programs are counseled to stop making payments to their creditors in order to facilitate settlements, which has a harmful effect on these consumers' credit scores.

Given the absence of specific Federal law, some states have taken the initiative and enacted their own legislation regulating the debt settlement industry. The regulations vary widely from state to state, however. For example, Virginia's detailed legal framework requires debt settlement companies to apply and pay for an operating license, to enter into written agreements with potential customers that describe all services to be performed and provide the customer a right to cancel at any time, and to charge only a maximum $75 set-up fee and $60 monthly fee, among other restrictions.[8] Other states, such as Arkansas[9] and Wyoming,[10] have chosen to simply ban most types of for-profit debt settlement companies from operating in their states at all. Individuals who violate those states' bans are guilty of a misdemeanor and could face up to 1 year imprisonment in Arkansas and up to 6 months imprisonment in Wyoming. On the other hand, New York and Oklahoma, among others, have not yet enacted any laws specifically targeting this industry, thus leaving the public to rely on generally applicable consumer protection laws.

Covert Testing Shows That Some Debt Settlement Companies Engage in Fraudulent, Abusive, and Deceptive Practices

Our investigation found that some debt settlement companies engage in fraudulent, deceptive, and abusive practices that pose a risk to consumers already in difficult financial situations. The debt settlement companies and affiliates we called while posing as fictitious consumers with large amounts of debt generally follow a business model that calls for advance fees and stopping payments to creditors—practices that have been identified as abusive and harmful. While we determined that some companies gave consumers sound advice, most of those we contacted provided information that was deceptive, abusive, or, in some cases, fraudulent. Representatives of several companies claimed that their programs had unusually high success rates, made guarantees about the extent to which they could reduce our debts, or offered other information that we found to be fraudulent, deceptive, or otherwise questionable. We did not actually use the services of any of the companies we called. A link to selected audio clips from these calls is available at: *http://www.gao.gov/products/GAO–10–593T*.

Advance Fees

The debt settlement companies we called generally represented that they would collect fees before settling our debts—a practice FTC has proposed banning due to the harm caused to consumers. We were able to obtain information about fee structures from 18 of the 20 companies we called while posing as fictitious consumers

[8] Va. Code Ann. §§ 6.1–363.2–.26.
[9] Ark. Code Ann. §§ 5–63–301 to –305.
[10] Wyo. Stat. Ann. § 33–14–101 to –103.

with large amounts of debt,[11] and found that their fee structures generally recall the concerns expressed by FTC. Specifically, we found that 17 of the 20 companies represented that they collected advance fees before debts were settled. Company representatives told us that the advance fees are calculated based on a percentage of the consumer's debts to be settled, citing figures that ranged from 10 to 18 percent. Moreover, representatives from several companies told us that our monthly payments would go entirely to fees for up to 4 months before any money would be reserved for settlements with our creditors. Only 1 of the 20 companies we called represented that it followed a contingent fee model based on a percentage of the reduction of debt it says it obtains for consumers. Representatives from this company said a fee equal to 35 percent of each client's reduced debt was charged. Some companies also represented that they assessed monthly maintenance and other additional fees. One of the 17 advance-fee companies also revealed that it charged a contingent fee after each debt is settled based on a percentage of the debt reduction.

FTC has banned advance fees in several industries, such as credit repair, based on analyses that determined these practices to be unfair because sellers often do not provide the services for which they charge. The agency has proposed a similar ban for debt settlement, stating that the advance fees cause substantial injury to consumers. FTC justified this stance toward debt settlement, in part, based on the following findings: advance fees induce financially strapped consumers to stop making payments to their creditors; and consumers are unlikely to succeed in debt settlement programs, given evidence from Federal and state agencies that generally shows single-digit success rates.[12] Moreover, FTC stated concerns in its notice that advance fees for debt settlement may actually impede the process of saving money to settle debts, especially substantial fees collected at the beginning of a program. This business model may be especially risky for consumers who are already in financially stressed conditions, given that interest, late fees, and penalties often continue to accrue on the consumers' accounts as they work to save money toward settlements. In addition, consumers with already limited financial resources may be unable to direct adequate funds toward saving for settlements if their resources are being devoted to paying fees.

We asked representatives of some companies what services we would receive as we paid advance fees while saving money for settlements. These representatives generally stated that our advance fees would pay for financial education, updates from attorneys, and communications with our creditors—such as cease and desist letters, to attempt to prevent harassing telephone calls. One representative, however, was unable to provide an explanation of what services we would receive for our advance fees beyond the fact that her company's attorneys would "look at" our accounts every month. Several companies we called had basic financial education resources on their websites or provided links to such resources by e-mail. Industry representatives have stated that advance fees are needed to cover essential operating costs, such as overhead and providing the types of services mentioned above for their existing clients. However, FTC found that marketing and acquiring new customers make up a large portion of the operating costs for debt settlement companies. We were unable to verify whether any companies we called provide ongoing services for clients they enroll in their programs, given that we did not enter into business relationships with them.

Directing Consumers to Stop Paying Creditors

We also found that the companies we called generally follow a business model that poses a risk to consumers by encouraging them to stop making payments to their creditors, a practice that harms consumers because of the damage it typically causes to their credit scores. Representatives of nearly all the companies we called—17 out of 20—advised us to stop paying our creditors, by either telling us that we would have to stop making payments upon entering their programs or by informing us that stopping payments was necessary for their programs to work, even for accounts on which we said we were still current. The following quotes demonstrate some of the statements made by representatives of the companies we called regarding our payments to creditors:

- "You stop paying, uh, those payments out to those creditors. The only thing you're going to have to worry about is this payment here [to company]."

[11] Of the two companies for which we were unable to obtain fee information, one company presented an audio recording of general information about its program, and one company's representative told us we did not have enough debt to qualify for its program.

[12] Federal and state agencies have defined success as consumers being able to obtain the results that the debt settlement companies promised them.

- "One-hundred percent of our clients stop making their monthly payments as soon as they enroll into the program."
- "I won't tell anybody not to pay their bills; I said one-hundred percent of the clients who have been successful have stopped paying their bills."
- "Say you enrolled in the program. At that point you would no longer make any of your credit card payments. All of them would go late."

Among the 17 companies encouraging us to stop paying our creditors or representing that stopping payments is a condition of their program,[13] 5 were members of an industry trade group called The Association of Settlement Companies (TASC) at the time we made our calls. TASC's written standards, adherence to which is required of all member companies, explicitly state "No Member shall direct a potential or current client to stop making monthly payments to their creditors." A representative of 1 of these 5 TASC member companies told us that she could not direct us to stop paying our creditors, but later stated that if we could afford to make our payments then her program was not "the best solution" for us. In addition, a representative of 1 of these 5 TASC member companies appropriately screened us out by telling us that we had too low of income to afford that company's program under the scenario we presented; he later described his company's program as requiring clients to stop making their payments. In addition to these 5 TASC member companies, we spoke to a representative from another TASC member company who told us that we did not have enough debt to qualify for that company's program. In addition, 4 of the companies that told us to stop paying our creditors or represented that stopping payments was a condition of their program were members of a different industry trade group called the United States Organizations for Bankruptcy Alternatives (USOBA) at the time of our calls. According to USOBA representatives whom we interviewed, its member companies do not tell potential clients to stop paying their creditors. We received particularly good advice from a representative of 1 additional USOBA member company—not among the 4 listed above—whose representative told us that we should worry about taking care of our late mortgage payments before we worried about settling our credit card debts.

Stopping payments to creditors results in damage to consumers' credit scores. According to FICO (formerly the Fair Isaac Corporation), the developer of the statistically based scoring system used to generate most consumer credit scores, payment history makes up about 35 percent of a consumer's credit score. Moreover, the damage to credit scores resulting from stopping payments is generally worse for consumers who have better credit histories—such as consumers who maintained good payment histories prior to entering a debt settlement program that required them to stop making payments. In its notice, FTC also discussed the harmful effect that stopping payments has on consumers' credit scores.

Success Rates

In several cases, representatives of companies we called claimed success rates for their programs that we found to be suspiciously high—85 percent, 93 percent, even 100 percent. In its notice, FTC cites claims of high likelihood of success as a frequent representation in the debt settlement industry. The success rates we heard are significantly higher than is suggested by evidence obtained by Federal and state agencies. When these agencies have obtained documentation on debt settlement success rates, the figures have often been in the single digits. For example, as part of an annual registration process in Colorado, the state's Attorney General compiled data on success rates for all debt settlement companies statewide. The data show that, from 2006 to 2008, less than 10 percent of Colorado consumers successfully completed their debt settlement programs. Our case studies discussed below provide additional evidence of similarly low success rates.

Industry-reported data have claimed a higher success rate for debt settlement programs. According to TASC, data gathered from a survey of some of its largest member companies in 2009 shows that 34.4 percent of consumers participating in a debt settlement program offered by a TASC member company completed their debt settlement programs by settling at least 75 percent of their enrolled debts.[14] A previous study released by TASC in 2008 claimed overall completion rates between 35 and 60 percent. However, Federal and state agencies have raised concerns with the

[13] As stated above, some companies we called referred us to one or more affiliates. We were unable to determine the relationship between these companies and their affiliates.

[14] While TASC requires its member companies to make a series of disclosures in its discussions with potential clients, the individual completion rate for each company's program or the 34.4 percent overall completion rate mentioned in TASC's study are not among the required disclosures.

methodology behind TASC's data. For example, these agencies have argued that: (1) TASC's data were self-reported by its member companies, and may not reflect all member companies; (2) not every TASC member company that submitted data defined completion in the same way; and (3) the fact that consumers complete a debt settlement program does not necessarily imply that these consumers successfully obtained the debt relief services for which they paid. We did not attempt to validate success or completion data from TASC or Federal or state agencies.

TASC and USOBA have cited several factors that might contribute to consumers' success rates in debt settlement programs, such as that most consumers entering debt settlement programs are in extreme financial hardship and may choose to quit their program after settling some debts and improving their financial situations. However, FTC stated in its notice that the prevalent fee structure in the debt settlement industry—substantial up-front fees—may be a major factor in the generally low consumer success rates as well. TASC and USOBA have both offered suggestions for ways to boost consumer success rates, such as improved processes for determining consumers' suitability for debt settlement programs.

Debt settlement success rates also play a key role in the BBB rating system for companies in the industry. Due to the volume and nature of consumer complaints,[15] among other factors, BBB recently designated debt settlement as an "inherently problematic" type of business and, in September 2009, implemented new rating criteria for debt settlement companies to reflect this designation. Under this designation, no debt settlement company may earn a BBB rating higher than a C−.[16] While BBB has designated other types of businesses as inherently problematic—such as pay-day loan centers, businesses that charge fees for publicly available information on government jobs, scientifically unproven medical devices and products, advance fee modeling agencies, and wealth-building or real estate seminars—debt settlement companies are the only type of business currently allowed by BBB to escape the inherently problematic designation if they provide evidence to BBB that they meet a series of criteria. These criteria require a debt settlement company to prove, among other things, that:

- It has substantiated all advertising claims, including claims relating to the benefits or efficacy of debt settlement;
- It makes certain disclosures to consumers, including clear and conspicuous disclosure of program fees and the risks of debt settlement;
- It has adequate procedures for screening out consumers who are not appropriate candidates for debt settlement; and
- A majority (at least 50 percent) of its clients successfully complete its program and obtain a reduction in debt that is significant and exceeds the fees charged by the company.

According to a BBB official, he was unaware of any debt settlement company that had yet successfully demonstrated that it met these criteria, as of March 2010. Officials from TASC and USOBA told us they strongly disagree with BBB's new rating system for debt settlement companies. According to these officials, the new rating system minimizes the importance of resolved consumer complaints, requires an unrealistic measure of programs' success rate—50 percent—and inhibits consumers' ability to differentiate between reputable and disreputable debt settlement companies.

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[15] According to data it provided to us, BBB has received thousands of complaints about debt settlement companies in recent years, with the number of complaints rising from 8 in 2004 to nearly 1,800 in 2009. This figure may underestimate the total number of complaints related to debt settlement, as not all companies providing debt settlement services are classified as debt settlement companies by BBB. According to BBB, these complaints are related primarily to debt settlement companies: (1) charging advance fees without providing services as promised to consumers and sometimes without providing any services at all; (2) failing to disclose important information to consumers, such as unannounced fees; and (3) failing or refusing to provide refunds to consumers.

[16] According to BBB, its rating system uses grades based on a proprietary formula that incorporates information known to BBB and its experience with the business under assessment. The ratings are intended to represent BBB's degree of confidence the business is operating in a trustworthy manner and will make a good faith effort to resolve any customer concerns. The rating system uses grades from A to F, with plusses and minuses, so that A+ is the highest grade and F is the lowest. Some debt settlement companies may currently have a BBB rating higher than a C− because they were misclassified (*e.g.,* characterized by BBB as something other than a debt settlement company) or because debt settlement does not represent a substantial portion of its services.

Guaranteed Reductions in Debt

Representatives from some companies also guaranteed or promised that they could obtain minimum reductions in our debts if we signed up for their services. For example, some representatives stated that they would save us 40 to 50 cents on the dollar once they negotiated settlements with our creditors. In its notice, FTC cites claims of specific reductions in debt as an example of a consumer protection abuse in the debt settlement industry.

Fraudulent or Other Deceptive Representations

We found examples of companies offering fraudulent or other deceptive information, such as using names and imagery for their services that indicates that their program is linked to the government. Table 1 below shows examples of fraudulent or deceptive information from companies we called.

Table 1: Examples of Fraudulent or Deceptive Information Provided by Debt Settlement Companies We Called

No.	Representation	Comments
1	Debt settlement companies are "licensed and regulated" by TASC, which is "like the SEC [United States Securities and Exchange Commission] for stock traders."	TASC is a nonprofit trade association that lobbies lawmakers on behalf of the debt settlement industry. It is not a licensing or regulatory authority.
2	Stopping payments will "knock [credit score] down a couple of points . . . However, unlike bankruptcy or any other credit counseling program, this only affects your credit while you're in the program."	According to FICO, stopping payments to creditors as part of a debt settlement can drop credit scores anywhere between 65 to 125 points. In addition, missed payments leading up to a debt settlement can remain on a consumer's credit report for 7 years even after a debt is settled.
3	Debt settlements will be noted on consumers' credit reports as "paid in full" or "paid as agreed."	According to FICO, settlements are typically listed on consumers' credit reports as "settlement accepted on the account" or "settled for less than full balance."
4	Company advertises a "National Debt Relief Stimulus Plan."	The company's services are not affiliated with a government program or part of the American Recovery and Reinvestment Act of 2009 (the "stimulus").
5	Company promised that calls from creditors seeking money will "slow down and eventually stop" if we just told our creditors we had hired the company.	Debt settlement companies cannot prevent creditors from contacting consumers. Companies often advise consumers to terminate all communication with their creditors, ask consumers to assign power of attorney to them, and send cease and desist letters to creditors in an attempt to cutoff further communications.

Source: GAO.

Five of our cases are highlighted below. The companies in these cases made multiple fraudulent or deceptive representations either to our fictitious consumers by telephone, on their websites and through company documents or to our staff during unannounced, overt site visits. Table 2 below shows basic information represented by these companies, including the location, fees, and industry trade association membership of each of these companies and their affiliates, if any. (Table 4 in appendix I provides summary information on all 20 companies we called.)

Table 2: Representations Made by Select Debt Settlement Companies We Called

No.	Location of company and affiliates	Fees [a]	Association membership [b]
1	Florida; affiliates in Florida, Massachusetts, California, and New Jersey [b]	• Advance fees based on 15 percent of enrolled debt, with monthly payments required throughout program.	TASC; [c] affiliates in TASC and USOBA
2	Unknown; affiliates in Arizona, Texas, and California [b]	• Advance fees based on 12 percent of enrolled debt • First 3 monthly payments go to fees. • $25 monthly maintenance fee. • Additional contingent fee based on 4 percent of reduction in debt company obtains for clients.	Affiliate in USOBA

Table 2: Representations Made by Select Debt Settlement Companies We Called—Continued

No.	Location of company and affiliates	Fees [a]	Association membership [b]
3	California	• Advance fees based on 16 percent of enrolled debt, with monthly payments required throughout program. • First 3 monthly payments go to fees. • $100 fee for out-of-state clients.	TASC (at the time of our call)
4	California	• Advance fees based on 17 percent of enrolled debt, with monthly payments required throughout program. • First 3 monthly payments go to fees. • $840 maintenance fee (total throughout program) • $623.50 trust account fee (total throughout program).	TASC
5	California	• Advance fees based on 15 percent of enrolled debt	TASC (at the time of our call)

Source: GAO analysis of information obtained from debt settlement companies.

[a] Fee information reflects fees disclosed to us; some companies may charge additional fees that were not disclosed. Debt settlement companies typically charge fees requiring payments either at the beginning of the program as an advance fee or after each settlement as a contingent fee. Some companies structure the payment of advance fees so that they collect a large portion of them—as high as 40 percent—within the first few months regardless of whether any settlements have been obtained or any contact has been made with the consumer's creditors. Others collect fees throughout the first half of the enrollment period in advance of a settlement. Companies that charge a contingent fee generally base it on a certain percentage of any settlement they actually obtain for consumers. They sometimes charge a small, additional fee every month while consumers are attempting to save funds for settlements.

[b] Some companies we called referred us to one or more affiliates. It was not always clear to us exactly with which company or affiliate we were speaking, where the companies or affiliates were located, or what the relationships were between the companies and affiliates. In some cases, separate affiliates of the same company claimed to be members of different industry trade associations.

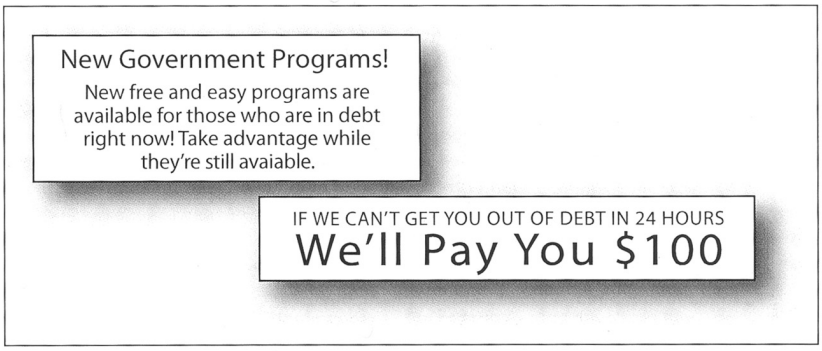
[c] While Company 1 claimed to be a member of TASC, it appears this was a false representation.

Company 1

Company 1 made several fraudulent and deceptive representations. We identified Company 1 when one of our investigators received an unsolicited spam message through his private e-mail account advertising debt settlement services, with a mailing address in the country of Lebanon listed at the bottom. A link in the message brought us to a website advertising "New Government Programs! New free and easy programs are available for those who are in debt right now! Take advantage while they're still available

[sic]." (See figure 1 below.) The website also featured logos for TASC and BBB, along with other insignias declaring "Satisfaction Guaranteed" and "Privacy 100 percent Guaranteed." When we called the number listed on the website, a representative answered using the name of an affiliate different than the company name listed on the website. He explained that the website was a "generic advertisement" to spread information about his company. Throughout our conversation, he made multiple statements that we found to be deceptive or questionable. According to the representative, the "worst case scenario" for settlement of our debts would be "40 cents on the dollar." He stated that his company has helped 100 percent of its clients get out of debt in 3 years or less, and that "every single creditor settles. There's not one creditor we haven't been able to reach a settlement with." When asked about the government programs advertised on the website, he replied "What we're offering is not part of any government program whatsoever. . . . It's just that the government is allowing this to take place at this time. . . . The government is putting pressure on banks to allow things like this so that, you know, there are no more bankruptcies or things along those lines." Even though the website displayed a TASC logo, we were unable to find either Company 1 or this affiliate on TASC's member directory. The Executive Director of TASC confirmed to us later that neither Company 1—as it listed itself on its website—nor this affiliate is a member of the organization. The affiliate's website displays a logo for USOBA, and we confirmed its membership with that organization.

Figure 1: Fraudulent or Deceptive Advertising Claims Featured on Company 1's Web Site



Source: Debt settlement company Web site. Images enhanced by GAO.

Shortly after we called Company 1 the first time, we noticed that the website contained some changes—when we attempted to leave the website on later visits, a pop-up message appeared declaring "If we can't get you out of debt in 24 hours we'll pay you $100!" (See figure 1 above.) We called Company 1 again and a representative said that he was with Company 1. He later stated that he was actually with an affiliate of Company 1—a different affiliate than the first representative with whom we spoke. He described the website for Company 1 as a "landing page" used to attract business to his company. This second representative also offered deceptive or questionable information, such as a 93 percent success rate for his program. When asked about the government programs advertised on Company 1's website, he replied that the government program was related to creditors' ability to obtain tax credits from the IRS for the debts they sell to collection agencies. Regarding the offer to get consumers out of debt within 24 hours, he said that this was for clients who have the financial resources to make a large lump sum payment at the very beginning of the program. However, he added that "ninety-nine point 9 percent of the people that come to us do not have the ability to do that." When we asked about the risk of being sued by our creditors, he told us that "a judgment is nothing more than a fancy I.O.U." We were able to find this second affiliate on TASC's member directory, and the Executive Director of TASC later confirmed that this affiliate is a member of TASC.[17]

We made a site visit to Company 1 in Florida. The owner of Company 1 admitted that the company does not really exist and is really just a marketing website, and told us he actually owns a different company that offers both debt settlement and mortgage modification services. He claimed that he did not know that Company 1's website contained information about an alleged government program, and logos for TASC and BBB. However, he acknowledged that neither Company 1 nor his real company is a member of TASC despite the logo featured on the website.[18] When asked about the offer to get consumers out of debt within 24 hours, he replied that this was a "typo" and that the offer should say 24 months rather than 24 hours.[19] Our investigators observed employees at the location listed for Company 1 representing on the telephone that they were employees of the second affiliate mentioned above. Moreover, when the owner of Company 1 gave our investigators a copy of the script his employees use when speaking with potential clients, the text of the script implied that they were representatives of the second affiliate. We were unable to determine the actual relationship, if any, between Company 1, its affiliates, or the other company the owner claimed he runs.

[17] We also identified an additional website at a different address that was nearly identical to the one that referred us to the two representatives discussed above, with the same phone number and logos for TASC and BBB, but listing what appeared to be a different company name entirely.

[18] TASC's executive director confirmed that Company 1 is not a member.

[19] Prior to our site visit, we found a testimonial from an alleged client on Company 1's website claiming that Company 1 helped her to cut her monthly bills in half in 24 hours.

Company 2

Company 2's online and radio advertisements feature multiple fraudulent or deceptive claims. The company's website advertises that its services will "Reduce balances to 40 percent—60 percent," "Eliminate excessive Credit Card Debt interest immediately," and "End late payment fee's [sic]." When we called Company 2, it referred us to at least 3 different affiliates. It was not always clear exactly with which company's representatives we were speaking.[20] Representatives from these affiliates described Company 2 as a marketing group that referred potential clients to them. We also identified radio advertisements placed in several major cities purporting to be from Company 2, in which it claimed to offer a "government authorized" and "government approved" debt settlement program. When we called the telephone number listed in one of the radio advertisements, a representative answered from one of the affiliates of Company 2 that we had spoken to earlier. When asked about the government-approved debt settlement program, the representative acknowledged the radio advertisement and replied "it is government approved. . . . They allow for us to do this. You know, the banks received, you know, bailout money last year. I'm sure you saw it on the news. There has to be some type of assistance for people on a consumer level also." According to this representative, Company 2 runs similar advertisements on television and radio stations nationwide.

We were unable to visit Company 2 because we could not determine its physical location. However, we visited the affiliate whose representative discussed the radio advertisement with us, which is located in California. Officials from this affiliate told us that their company is "the most legitimate debt settlement company," and that their employees receive commission based on the number of clients they enroll in the company's program. They also claimed that their company was not associated with Company 2, and refused to disclose to us the number of clients in their program or the total amount of consumer debt their company is currently handling. On two separate covert telephone calls we made to Company 2, representatives of this affiliate stated they were with Company 2 at the beginning of each call but later informed us that they actually were with the affiliate and that Company 2 handled their marketing. When asked during our site visit if we could see their call center, officials refused.

Company 3

Company 3 targets Christians for its debt settlement services by employing a Biblical marketing theme, both on its website and over the phone. Representatives of Company 3 told our fictitious consumers that they run a nonprofit ministry affiliated with their for-profit debt settlement company, with funds from debt settlement feeding into the ministry and missionary trips overseas. In addition, representatives told us that their program has an 85 percent success rate and that they would negotiate our debt down to 40 or 60 percent of what we currently owed. About the risk of being sued by our creditors, a representative remarked to us that "It's just a computer thing. I mean, sometimes there's a handful of them that they'll have reserved to go after and it's just random. But even if they were to do that in your case, it's just a small percentage; we'd be able to advise you at that time, too. You don't need an attorney in the matter or anything like that. It's just a civil thing."

We visited Company 3 in California, where we found it located in a strip mall near a grocery store. The owner of Company 3 told us that he owned a mortgage company and sold cars prior to entering the debt settlement industry. Company 3 handles the front end of the debt settlement process by signing up clients, and uses a third-party company and law firm for the rest of the process. Most of the employees of Company 3 are contractors who earn $200 commission for each client enrolled, with bonuses for employees who enroll a high number of clients. According to Company 3 officials, they enrolled approximately 1,200 to 1,300 new clients in the first 2½ months of 2010. When asked if we could see a copy of their IRS Form 990 for the nonprofit side of their operation, the owner replied, "The Bible says you should never let the left hand know what the right hand is doing."[21] Company officials provided us with a sample of its contract, which states that "In the event Client comes into a lump sum of money and wishes to settle an account before original

[20] A recent report by the Maryland Consumer Rights Coalition stated that debt settlement companies "often seem a many-headed Hydra" with parent companies split from other divisions that handle the marketing and solicitation. The report further states that this division of services causes confusion for consumers trying to track the progress of their debt settlement, and for agencies attempting to enforce compliance.

[21] IRS Form 990 is a Federal information return filed annually by tax-exempt public charities. Information reported on this return includes assets held, contributions received, and grants paid.

designated completion date, Client must first pay [Company 3] Fee. The remainder of the lump sum will be utilized in settling Client's unresolved program debt." The contract also states that Company 3 does not provide legal representation or any legal advice to its clients.

Company 4

We became interested in calling Company 4 when we noticed on its website that it advertised a "U.S. National Debt Relief Plan," with a logo depicting a shield filled with a U.S. flag. When asked about this plan, a representative stated that it was "a consumer advocacy program entitled [sic] to help consumers get out of debt" but that "it's not a government agency. We just take advantage of the fact that the government are [sic] giving money to the banks to get out of debt and we just show you and go through the route of settling out your accounts." The representative also told us that our first 3 monthly payments would go entirely to paying fees with no money set aside for savings. He said that Company 4 uses this advance fee structure because, during the first few months of the program, the company would be setting up our account and mailing cease and desist letters to our creditors, and "to show that you have the commitment to be in the program."

When we visited Company 4 in California, officials told us that the company only handles the front-end marketing of the debt settlement process, and that it had enrolled approximately 1,000 clients in the first 2½ months of 2010. In early March 2010, TASC issued a statement on its website noting a recent increase in companies practicing deceptive marketing, including companies sending letters to potential clients resembling government documents and using terms like "U.S. National Debt Relief Plan." Company 4 marketed the "U.S. National Debt Relief Plan," and is a member of TASC.

Company 5

A representative of Company 5 advised us that we could not afford its debt settlement program because our fictitious consumer's income was too low and his expenses were too high. He suggested that we consider credit counseling or bankruptcy as options if we were unable to make substantial improvements in our budget. However, when we indicated that we may obtain a new job soon that would boost our income, he provided details on how Company 5's debt settlement program works. He told us that it generally takes about 7 to 8 months to save up enough money to begin negotiating settlements. When we asked what services we would be paying for during those first 7 to 8 months, he replied that our fees would pay for the ability to get out of debt within 36 months, and monthly education and updates from the company's attorneys. Company 5's website advertised that it can help consumers who are experiencing stress, anxiety, and depression associated with being in debt. When we asked about these services, the representative laughed and said these services are arranged through debt negotiators who will hold monthly strategy calls with us.

We attempted to visit Company 5 in California, but found that it was no longer at the location listed on its website. Employees of several other companies in neighboring office suites told us that Company 5 had moved to another office down the hall, which was listed under a different company name. An official from this company denied knowing anything about Company 5, and claimed that his company did not provide debt settlement services. However, records we obtained indicate that the name of Company 5's owner is the same as the name on this official's driver's license. In addition, the website for this other company indicates that it does, in fact, provide debt settlement services. After we returned from our site visit, the website for Company 5 was down for maintenance.

Allegations of Fraud, Abuse, and Deception in the Debt Settlement Industry Are Widespread

We found the experience of our fictitious consumers to be consistent with the widespread complaints and charges made by Federal and state investigators on behalf of real consumers against debt settlement companies. We identified allegations of fraud, deception and other questionable activities that involve hundreds of thousands of consumers.[22] We drew this figure from closed and open civil and criminal cases governments have pursued against these companies over the last decade. Our calculation likely underestimates the total number of consumers affected, since we obtained information from only 12 Federal and state agencies about the clients with-

[22] We did not attempt to verify the facts regarding all of the allegations pursued by Federal and state agencies that we identified.

in their jurisdiction that they identified in some of the cases they pursued.[23] Federal and state agencies have reported taking a growing number of legal actions against companies that offer these services in recent years. As mentioned above, since 2001, FTC has brought at least seven lawsuits against debt settlement companies for engaging in unfair or deceptive marketing. The National Association of Attorneys General (NAAG) said in an October 2009 letter to FTC that 21 states brought at least 128 enforcement actions against 84 debt relief companies, including debt settlement companies, over the previous 5 years.[24] The group stated that the number of complaints received by the states about debt relief companies—especially debt settlement companies—had more than doubled since 2007. Last, the group noted that any business model requiring "cash-strapped consumers to pay substantial up-front fees" raised significant consumer protection concerns and agreed with a consumer group that called it "inherently harmful."

Attorneys general from 40 states and 1 territory submitted the letter, saying they supported FTC's proposed rule changes to combat unfair and deceptive practices in the industry. They cited similar debt settlement activities that prompted their own enforcement actions, including the following:

- collecting advance fees in many instances without providing services;
- misleading consumers about the likelihood of a settlement;
- misleading consumers about the settlement process and its adverse effect on their credit ratings;
- making unsubstantiated claims of consumer savings;
- deceptively representing the length of time necessary to complete the program;
- misleading or failing to adequately inform consumers that they will be subject to continued collection efforts, including lawsuits;
- misleading or failing to adequately inform consumers that their account balances will increase due to extended nonpayment under the program; and
- deceptive disparagement of bankruptcy as an alternative for debtors.

The state attorneys general expressed concern the industry would grow exponentially given the current economic climate and a regulatory environment that allows substantial advance fees to be collected. They criticized the advance fees as providing minimal incentive for companies to perform services because they get paid whether or not they take any action on behalf of the consumer. They also noted that low set-up costs help in the promotion of debt settlement as a cheap business opportunity. They stated that they would continue to take enforcement actions against unscrupulous operators in the industry, but that they also believed the proposed FTC rule changes would substantially aid law enforcement agencies in addressing harms caused to consumers.

We developed case studies from five closed civil or criminal actions in which state or Federal courts found debt settlement companies liable for fraudulent, unfair or deceptive actions that left clients in worse financial condition—bankrupt, owing more debt, and with lower credit scores and more judgments against them. We also examined the experiences of a consumer from each of these cases. Table 3 below shows key information from each of these five cases. Further details are discussed below.

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[23] We obtained information from the following agencies: Federal Trade Commission, U.S. Department of Justice, and state law enforcement agencies in Alabama, Colorado, Delaware, Florida, Illinois, North Carolina, New York, Texas, Vermont, and West Virginia. They identified clients through company records, individual complaints, and restitution paid. We focused on select states with enforcement actions listed in a National Association of Attorneys General letter. We did not attempt to query all 50 states.

[24] According to the letter, the 128 enforcement actions listed in its attachment do not represent a comprehensive list of all cases filed or regulatory actions taken against debt relief companies. We did not attempt to verify the facts regarding all of the actions listed in the letter. Details regarding 3 of these enforcement actions are provided below, as case studies 1, 3, and 4.

Table 3: Select Cases of Debt Settlement Companies Engaged in Fraudulent, Abusive, or Deceptive Practices

No.	Company location	Federal/state agency	Case details
1	Arizona; affiliates in Arizona and Florida	New York Attorney General	• More than 500 New Yorkers withdrew from the debt settlement program after paying over $1 million in fees only to receive more debt, tarnished credit ratings, and increased collection calls and creditor lawsuits. • Nearly half of the New York clients that completed the program during the Attorney General's investigation, or 27 out of 64, ultimately paid more than they originally owed. • Only 0.3 percent of the New York clients realized the promised savings. • A New York court found the company and its affiliates liable for statutory fraud and ordered restitution for clients who paid more than they owed.
2	New York and Vermont	U.S. Attorney General	• An attorney and his law firm associates misappropriated and embezzled millions of dollars from 15,000 clients seeking debt reduction help over a 6-year period, forcing some customers into bankruptcy. • The group lured consumers through television and radio advertisements by falsely claiming a 50 to 70 percent savings off unsecured debt, an improvement in credit scores and bankruptcy avoidance. • Only 8 percent of the group's clients completed the program. • Clients paid advance fees for these services and funded escrow accounts from which their creditors were supposed to be paid. The fees were not considered "earned" until consumer debts were settled. • The fees collected were used in part to fund huge payments to the attorney and two of his associates before they provided any services to clients. • The client escrow accounts were drawn upon, in part, to cover overdrafts from the law firm's operating account and to make payments to the attorney's wife, among other things. • The law firm filed for bankruptcy in 2003. • A Federal jury found the attorney guilty in 2005 on multiple felony counts, including fraud. His six associates pled guilty to Federal charges.
3	Florida	North Carolina Attorney General	• Two companies and their owners ran an illegal debt settlement business using unfair and deceptive practices, collecting over $500,000 from about 220 North Carolinians who rarely obtained the services they purchased. • North Carolina law prohibits anyone from acting as a for-profit intermediary between residents and their creditors for the purpose of reducing, settling, or altering debt payments, except in limited circumstances. It specifically bans advance fees for these services. • The companies and their owners, one of whom was an attorney, marketed their services in part using third-party "referral agents" who received compensation for directing consumers to the group. • Many clients dropped out of the program dissatisfied. Few received refunds or obtained settlements with their creditors. Many filed for bankruptcy. • A North Carolina court found that the group's actions violated state law and banned the parties from doing any debt-related business with state residents. In a separate action in January 2009, the attorney was disbarred for a period of 5 years.

Table 3: Select Cases of Debt Settlement Companies Engaged in Fraudulent, Abusive, or Deceptive Practices—Continued

No.	Company location	Federal/state agency	Case details
4	Maryland	Maryland Attorney General	• A Maryland attorney, his law firm and their marketers used unfair and deceptive trade practices to collect $3.4 million from about 6,200 clients over a 2 year period to settle debt but provided little or no services in return, causing harm to consumer credit histories and credit scores. • The group told clients that its employees were qualified credit counselors capable of recommending the most appropriate action, but instead it provided virtually the same advice to everyone—enter debt settlement plans profitable for the group. • The group reached an agreement in 2007 with the Attorney General, agreeing to immediately cease and desist selling unlicensed debt settlement services, pay restitution to customers, and pay investigatory costs and a fine to the state consumer protection office. • The Attorney General filed a lawsuit in 2008 against the group for violating the terms of their agreement and the state's consumer protection act. The court ordered the group to fulfill the terms of its previous agreement, pay a fine and costs of $180,000, and pay restitution of almost $2.6 million.
5	California	Federal Trade Commission	• Four related California companies lured more than 1,000 consumers into a debt settlement program through false promises of reducing debt, halting collection calls, removing negative credit report information, and holding payments in trust to settle accounts—from which, the FTC alleged, more than $2 million later went "missing." • FTC filed a complaint against the companies in August 2002, alleging that numerous consumers who enrolled in the program saw their indebtedness increase after incurring late fees, finance charges, and overdraft charges. Many ultimately filed for bankruptcy. • The Federal court entered default judgments against all four companies, banning them from engaging in any debt settlement services and ordering them to collectively pay $1.7 million in restitution to consumers, among other actions.

Source: GAO analysis of case studies discussed below.

Case Study 1

An Arizona company and its affiliates used false advertising and deceptive marketing to fraudulently induce more than 500 New Yorkers into paying over $1 million in fees for a debt settlement program that left them with more debt, tarnished credit ratings, and increased collection calls and creditor lawsuits. The group told clients that consumers typically saved between 25 percent and 40 percent, including all fees and charges. It also promised to substantially reduce credit card debt in as little as 24 months. However, according to the New York Attorney General, only 0.3 percent of the company's clients realized these savings and few ever completed the program. Only 64 of the group's New York clients finished the program during the time period of the Attorney General's investigation (between January 2005 and September 2008); another 537 withdrew from the program after paying fees. Those who finished the program complained of being deceived and harmed by the group. Nearly half of them actually paid more than they owed. For example, one said, "I actually paid 87 percent more than what was originally due." Another said that the company "did not settle any of my accounts until I was actually sued by my creditors." A state court found the group liable for statutory fraud, ordered it to pay restitution to clients who completed the program but paid more than they owed, and prohibited it from doing business with consumers in New York unless it posted a $500,000 performance bond.

The group required clients to authorize electronic debits from their personal bank accounts in an amount that typically ranged between $300 and $1,000 each month, depending on the consumers' cash-flow and expected settlements. The group told clients that once the funds accrued to a sufficient amount, it would negotiate with creditors for a settlement. Clients were instructed to stop making credit card payments during this time and to cease all communication with their creditors. The group did not include most of the program fees it charged in its calculation of the "savings" clients would achieve. The fees included the following: $399 for "set up"; an amount equal to three times the clients monthly payment for "enrollment"; $49

per month for administrative and bank fees; and an amount equal to 29 percent of the difference between the amount originally due and the settlement amount for a "final fee." The set-up and enrollment fees had to be paid in full before the group would allow money to accrue for a settlement.

The experience of one New York family exemplifies the harm suffered by the group's clients. According to a sworn statement the wife gave to state attorneys, the couple owed about $21,700 in credit card debt accumulated after the husband was laid off. In 2006, the wife received a call from a telemarketer saying that the Arizona company had looked into her family's credit history and found that it could cut their credit card debt in half. She and her husband joined the program and began making $325 in monthly payments to settle five accounts, even though they were current on their bills. "Who wouldn't want to save 50 percent on her credit cards?" the wife told state attorneys. The couple was advised to stop paying their creditors, which they did after being told by the company that no penalties and interest would accrue as a result. The couple was soon being harassed by their creditors, who called at all times of day, including evenings and weekends. Four of the couple's small accounts were settled during this time. However, the creditor with the largest balance, which totaled about $19,000, took the couple to court. The pair withdrew from the program and settled the lawsuit for $28,000, including $9,000 in penalties and interest. They subsequently had to pay this creditor $300 per month. The wife called this outcome "disastrous for us." Nevertheless, the couple received a "congratulations" letter from the company, saying the pair had paid only 79.3 percent of what was originally owed on the four settled accounts.

Documents that the couple gave state attorneys, however, show otherwise: after adding the $2,506 in fees they were charged, the pair actually paid more than 140 percent of what was originally owed on the four accounts. The wife told state attorneys that the Arizona company "failed our family in every respect, and we are counted as one of its success stories!"

Case Study 2

An attorney and his law firm associates defrauded about 15,000 clients seeking debt reduction help, causing them to lose millions of dollars and forcing legions of them to file for bankruptcy. The group lured consumers through television and radio advertisements, falsely claiming a 50 to 70 percent savings off unsecured debt, an improvement in credit scores and bankruptcy avoidance. The group, with offices initially in New York and later in Vermont, further promised that if clients did not receive a settlement, they would be entitled to a full refund. Clients paid fees for these services and funded escrow accounts from which their creditors were supposed to be paid. Under the terms of the contract that clients signed, the fees were not considered "earned" until consumer debts were settled. The group, however, did not reduce debt for most of its clients (only 8 percent completed the program, according to a witness cited by the U.S. Department of Justice) and failed to pay refunds to many of those who withdrew from the program or were forced into bankruptcy. Instead, the fees collected were used in part to fund huge payments to the attorney and two of his associates before they provided any services to clients. The client escrow accounts, meanwhile, were drawn upon to cover overdrafts from the law firm's operating account and make payments to the attorney's wife, among other things. The law firm filed for bankruptcy in 2003. A Federal jury found the attorney guilty in 2005 on multiple felony counts, including fraud. His six associates pled guilty to Federal charges.

To enter the law firm's debt settlement program, clients signed an agreement that authorized monthly automatic deductions from their bank accounts. The first four payments often went into a retainer account to collect advance fees owed to the firm, despite the fact that the clients had pressing debt problems. The advance fees equaled about 25 to 28 percent of the total projected savings from the client's debt settlement plan. Thereafter, about half of payments also were deposited into an escrow account to settle client debts held by creditors until the retainer account was fully funded. Subsequent monthly deductions went into escrow account until enough money accrued to make a settlement offer on behalf of the client. Although not formalized in written contract, many clients were instructed to stop making their minimum monthly payments to creditors. They were told that continuing to pay creditors would inhibit the firm's ability to reach a settlement.

One of the firm's New York clients who Federal authorities interviewed enrolled in the debt settlement program after hearing an advertisement on the radio. The woman, who owed $60,000, was experiencing marital problems and feared becoming a single mother with small children and a large amount of debt. She called the toll-free number and arranged for a meeting at a New York office. One of the firm's associates, who later pleaded guilty to interstate transmittal of stolen money and pre-

paring a false tax return, told her that the advance fees she paid would be held in trust until all of her debt was settled. She paid about $7,000 to $8,000 to the firm to settle her debts until one of her creditors obtained a judgment against her, causing her bank account to be frozen. When she contacted the firm to withdraw and ask for a refund, her calls were not returned. She ultimately filed for bankruptcy. The firm never secured a settlement on her behalf. She filed a civil lawsuit and won a default judgment against the firm for $10,000 including attorney fees, but told us she never recovered any money from the court decision. In relating her experiences with the debt settlement company, she described the attorney as "a ghoul and a vulture . . . preying on vulnerable consumers."

Case Study 3

Two Florida companies and their owners ran an illegal debt settlement business using unfair and deceptive practices, collecting over $500,000 from about 220 North Carolinians who rarely obtained the services they purchased and found themselves in far worse financial positions. North Carolina law prohibits anyone from acting as a for-profit intermediary between residents and their creditors for the purpose of reducing, settling or altering debt payments, except in limited circumstances. The state ban specifically includes situations where an individual is receiving advance fees to provide these services. To enforce these laws, the North Carolina Attorney General filed a complaint in February 2008 accusing the group of operating a "classic advance-fee scam, designed to extract up-front fees from financially strapped consumers whether or not any useful services are performed." The companies and their owners, one of whom was an attorney, marketed their services in part using numerous third-party "referral agents" who received compensation for directing consumers to the group. One such referral agent listed a local telephone number which, when dialed, actually rang a telemarketing "boiler room" in Massachusetts or Florida. The group and its agents told consumers that their unsecured debts could be reduced by up to 60 percent in as little as 1 to 3 years and thus avoid bankruptcy. The group typically charged clients an advance fee of 15 to 25 percent of their total debt, paid through monthly debits from their bank accounts. It also advised them to cease all communication and payments to creditors, stating that it could stop any harassment and provide "legal protection." When consumers were sued, however, the group gave them no legal assistance. They also experienced difficulty in contacting the group and were often put on hold, disconnected, or "given the runaround," state prosecutors said. Many clients dropped out of the program dissatisfied. Few received refunds or obtained settlements with their creditors. Many filed for bankruptcy. A North Carolina court found that the group's actions violated state law and banned the parties from doing any debt-related business with state residents. State prosecutors ultimately secured refunds for some of the group's clients. In a separate action in January 2009, the attorney also was disbarred for a period of 5 years.

An example of the service the group's clients received can be found in the experience of a rural North Carolina couple. According to the wife's sworn statement, the pair found it increasingly difficult to meet their monthly financial obligations after the husband became ill and temporarily lost his income. They searched for ways to reduce their unsecured debt on the Internet and found what turned out to be one of the group's referral agents. They were told that the initial monthly payment of about $1,700 would be deducted from their bank account for the first 3 months of the program to cover attorney fees. Subsequent monthly payments of about $1,200 were to go toward settlements with creditors. The couple joined the program in hopes of avoiding bankruptcy and made their first installment in February 2007. Seven months later, the wife called the group for a status on her account and was told the couple had only accrued about $3,000 in savings, despite paying the group over $11,000 to date. She also learned that none of their credit accounts had been settled and they had been charged additional attorney fees of $499 each month. They withdrew from the program and demanded a full refund, since the group had done nothing "other than take our money with no accountability." The couple started receiving collection notices and threats of lawsuits. Their debts had now increased since they were no longer making payments to creditors. In an attempt to save their home from foreclosure, the couple filed for Chapter 13 bankruptcy. They also took second jobs as janitors to help pay off their debts. The wife told us that during the day she works as a bank teller and her husband is employed as an electrical engineer. One of their creditors suggested they call their state Attorney General. "My husband and I are worse off than before we entered into an agreement with (the group) for debt settlement services," the wife said in her sworn statement. The state Attorney General ultimately secured a full refund for the couple.

Case Study 4

A Maryland attorney, his law firm, and their marketers used unfair and deceptive trade practices to collect $3.4 million from about 6,200 clients over a 2-year period to settle debt but provided little or no services in return, causing harm to consumer credit histories and credit scores. The group told its clients that they could settle debts with creditors for half of the total amount owed, but either did not do so or negotiated agreements that saved significantly less than promised. Only $811,136—less than a quarter of the money the group collected—was either paid to creditors or refunded to clients. Moreover, about $240,000 was taken from client trust accounts to pay for the law firm's debt and expenses. The group told clients that its employees were qualified credit counselors capable of recommending the most appropriate action, but instead it provided virtually the same advice to everyone—enter debt settlement plans profitable for the group. The Maryland Office of the Attorney General began an investigation of the group because it was not licensed to provide debt settlement services in the state. The group reached an agreement in 2007 with the Attorney General, agreeing to immediately cease and desist selling unlicensed debt settlement services, pay restitution to customers, and pay investigatory costs and a fine to the state consumer protection office. However, the Attorney General filed a lawsuit in 2008 against the attorney, his law firm, and their marketers accusing them of continuing to provide debt settlement services, thus violating the terms of their agreement and the state's consumer protection act. The court ruled in favor of the Attorney General and ordered the group to fulfill the terms of its previous agreement, pay a fine and costs of $180,000, and pay restitution of almost $2.6 million. As of March 2010, the attorney had only paid $20,000.

Clients made numerous complaints to the Maryland Office of the Attorney General, detailing the financial harm they suffered from the group. A New Hampshire couple struggling to pay their bills joined the debt settlement program in August 2007 and authorized the firm to automatically deduct about $650 from their checking account each month, according to a letter they sent to the Attorney General. Although the couple had approximately $41,000 in credit card debt when they joined the program, the wife told us that they had a good credit history and had never missed a payment. However, she said that they were told they had to stop making payments to their creditors when they entered the program. The collection letters and phone calls from creditors started "arriving constantly" by the end of September, the couple told the Attorney General. Threats of lawsuits followed 2 months later. The couple withdrew from the program in February 2008, after paying the firm $3,895 and receiving no relief from their debts. They told the Attorney General they were so far in default on their credit cards, with interest and fees added on top, that they considered bankruptcy to be the best option available to them. According to the wife, their credit score dropped from 720 down to 605 as a result of their experience with this debt settlement program. She added that they ultimately entered into a consumer credit counseling program after they learned that state law requires such counseling prior to bankruptcy. When asked to compare the two different debt relief programs, she said that credit counseling is "legit" and helps consumers to get out of debt, but that "debt settlement is a crock."

Case Study 5

Four related California companies lured more than 1,000 consumers into a debt settlement program through false promises of reducing debt, halting collection calls, removing negative credit-report information, and holding payments in trust to settle accounts—from which, FTC alleged, more than $2 million later went "missing." The companies' telemarketers told consumers that the group could cut their debt by as much as 60 percent in exchange for a nonrefundable fee, thus improving their financial status. The companies did not disclose that the fees typically amounted to hundreds or thousands of dollars. They said that the monthly payments withdrawn from consumers' bank accounts would be held in trust to settle their debt at a reduced amount. Consumers were instructed to immediately stop paying their unsecured creditors so that they would be considered a "hardship," putting them in a better position to negotiate settlement terms. The companies stated that they would contact the creditors and tell them to cease all contact with their customers, thus preventing collection calls. They also told consumers that any negative information that appeared on their credit report would be removed at the conclusion of the program.

FTC filed a complaint against the companies in August 2002, alleging that numerous consumers who enrolled in the program saw their debt increase after incurring late fees, finance charges and overdraft charges. Negative information often appeared on the consumers' credit reports—such as charge-offs, collections and wage garnishments—and will stay on their record for a period of up to 7 years. FTC de-

termined that in numerous instances, the companies did not contact consumers' creditors or collectors, nor did they return calls. FTC later determined that more than $2 million the companies collected to be held in trust for making settlements was missing. Given their worsened financial condition, many consumers ultimately filed for bankruptcy. The Federal court entered default judgments against all four companies, banning them from engaging in any debt settlement services and ordering them to collectively pay $1.7 million in restitution to consumers, among other actions. FTC brought suit against four executives of the companies, but these cases ended in settlement agreements without any liability or fault established. As part of the settlements, however, the executives agreed to be permanently banned from participating in debt settlement services and to pay between approximately $220,000 and $2.6 million, depending on the amount of consumer injury that stemmed from their activities. The monetary judgments were largely suspended, except in two instances where the executives surrendered property and other assets to help satisfy what they owed, because of their inability to repay consumers.

The experience of a secretary from Riverside, Calif., illustrates the harm that FTC determined the companies to have caused consumers. She joined the program after receiving an e-mail in August 2000 and being told by a representative from one of the companies that she could be completely out of debt in 16 months, according to a written statement she gave to FTC under penalty of perjury. At the time, she made about $27,000 a year, owed a total of $7,000 in credit card debt and was making little progress toward reducing her balances given that her salary barely covered rent, food, car payments, and insurance. The company also offered a debt management class, which she stated had appealed to her because she wanted to learn how to better manage her money. She never received the promised training, though, despite asking for it several times. Three months after she joined the program, letters from creditors started arriving threatening legal action if she did not pay. Counselors with her debt settlement company told her to ignore them, calling the move a "scare" tactic. She started to panic after she received a court summons in late 2000 stating that a lawsuit had been filed against her. A counselor again told her not to worry, that everything would be OK. After a court summons arrived from a second credit card company, a counselor told her to fax the documents to the company and that staff would deal with it. The state courts, however, entered two judgments against her in March 2001. She later received notice that her wages would be garnished by 25 percent. "I was frantic," she stated. "I was barely making ends meet on my salary." By July 2001—less than a year after the secretary entered the debt settlement program—her credit card debt had more than doubled to about $15,000, because of late charges, interest, and other fees. She filed for bankruptcy that same month. She later sued the company that enrolled her in the program and settled for what she had paid in program fees, about $1,700, plus court costs.

Mr. Chairman, this concludes our statement. We would be pleased to answer any questions that you or other members of the Committee may have at this time.

APPENDIX I: DEBT SETTLEMENT COMPANIES

Table 4 below summarizes examples of fraudulent, deceptive, abusive or questionable information provided by the 20 debt settlement companies we called. We have referred these cases, as appropriate, to the Federal Trade Commission (FTC).

Table 4: Representations Made by Debt Settlement Companies We Called

No.	Location of company and affiliates	Fees [a]	Association membership [b]	Case details
1	Florida; affiliates in Florida, Massachusetts, California, and New Jersey [b]	• Advance fees based on 15 percent of enrolled debt, with monthly payments required throughout program.	The Association of Settlement Companies (TASC);[c] affiliates in TASC and United States Organizations for Bankruptcy Alternatives (USOBA)	• Marketing website that referred us to two affiliates • Representative from one affiliate (a member of USOBA) stated "everyone who enters the program makes the independent decision to stop paying their creditors" • Identified through spam e-mail message received by one of our investigators • website advertised "New Government Programs!" and "If we can't get you out of debt in 24 hours we'll pay you $100" • Representatives claimed high success rates—93 percent and 100 percent • Representative from USOBA-member affiliate claimed that "worst case scenario" for our settlements would be "40 cents on the dollar," and that "every single creditor settles." He also promised that hiring his company would ensure that calls from creditors would "slow down and eventually stop" • Representative from TASC-member affiliate claimed that TASC was "like the SEC for stock traders" and serves as the regulating body for the industry • Owner of company acknowledged TASC logo featured on website despite company not being a member of TASC • For further details, see section on "Company 1" in this testimony
2	Unknown; affiliates in Arizona, Texas, and California[b]	• Advance fees based on 12 percent of enrolled debt. • First 3 monthly payments go to fees. • $25 monthly maintenance fee. • Additional contingent fee based on 4 percent of reduction in debt company obtains for clients.	Affiliate in USOBA	• Marketing website that referred us to at least three affiliates • Representatives from two affiliates told us we would not make our monthly payments to creditors while in the program • Representative from one affiliate told us we could not afford debt settlement and suggested that we consider bankruptcy as an alternative • website advertised "Reduce balances to 40 percent—60 percent," "Eliminate excessive Credit Card Debt interest immediately," and "End late payment fee's [sic]" • Company's radio advertisements claimed "government approved" and "government authorized" debt settlement • Representative from one affiliate stated creditors would send letters to us indicating that our settled accounts are considered "paid in full" • For further details, see section on "Company 2" in this testimony
3	California	• Advance fees based on 16 percent of enrolled debt, with monthly payments required throughout program. • First 3 monthly payments go to fees. • $100 fee for out-of-state clients.	TASC (at the time of our call)	• website targeted at Christian consumers • Multiple representatives told us we would not make payments to our creditors once we entered company's program • Representative told us that stopping payments to our creditors would "knock [our credit score] down a couple of points," and that our credit would only be affected while we were in the program • Representatives claimed that program has 85 percent success rate, that lawsuits from creditors were "just random" and did not require an attorney, and that they would negotiate our debt down to 40 to 60 percent of what we owed • Representative told us that creditors would report our accounts settled for less than the full balance as "paid in full" or "paid as agreed" • Owner told us during our site visit that the company recently dropped its TASC membership due to rising costs • For further details, see section on "Company 3" in this testimony

Table 4: Representations Made by Debt Settlement Companies We Called—Continued

No.	Location of company and affiliates	Fees [a]	Association membership [b]	Case details
4	California	• Advance fees based on 17 percent of enrolled debt, with monthly payments required throughout program. • First 3 monthly payments go to fees. • $840 maintenance fee (total throughout program). • $623.50 trust account fee (total throughout program).	TASC	• Company advertised "U.S. National Debt Relief Plan," with a logo depicting a shield filled with a U.S. flag • Representative stated that, upon entering the program, we would "no longer be making payments to your creditors on a monthly basis" • Representative justified first 3 monthly payments going only to fees as necessary because it covered initial set-up costs and "to show that you have the commitment to be in the program" • For further details, see section on "Company 4" in this testimony
5	California	• Advance fees based on 15 percent of enrolled debt.	TASC (at the time of our call)	• Representative told us we were too poor for debt settlement and advised us to consider bankruptcy as an alternative; later described company's debt settlement program • Representative stated that we could not continue paying our creditors while in company's program • After our undercover call but prior to release of this testimony, company appears to have gone out of business • For further details, see section on "Company 5" in this testimony
6	Texas	• Advance fees based on 15 percent of enrolled debt, with monthly payments required during first 24 months (program length unknown).	Unknown	• Representative stated that "One-hundred percent of our clients stop making those [credit card] payments" in order for program to work; later directed us to divert money from paying creditors to account from which company withdraws fees • Representative advised us to give company's telephone number to creditors as our telephone number, to avoid calls from creditors • Representative stated "basically what we do is . . . we negotiate with your creditors to basically cut your bills in half. So when we go to negotiate, we go to negotiate at 50 cents on the dollar. That's what we guarantee. Now, we can also get less," and added as an example one major bank that he claimed "normally settles" for only 30 cents on the dollar. • Represented their program could prevent creditors from suing us or garnishing our wages
7	California	• Advance fees based on 10 percent of enrolled debt, with monthly payments required during first 12 months (of estimated 38-month program).	Unknown	• Advertises "National Debt Relief Stimulus Plan" • Representative told us we would stop paying our creditors, and that "the only thing you're going to have to worry about is this payment here [company's fees]" • Representative stated that lawsuits were a "scare tactic" • website states it can "Prevent Creditor Harassment" • Representative claimed company could reduce our balances so that we would pay "anywhere from 30 to 60 percent on what you owe"
8	Texas	• Advance fees based on 12 percent of enrolled debt, with monthly payments required during first 15 months (of estimated 48-month program). • First 4 monthly payments go to fees.	TASC	• Regarding payments to our creditors, representative stated "you're gonna have to cut them off so that they haven't received anything" • Representative claimed "every account that we work on will be at least 40 cents on the dollar"
9	Texas	• Advance fees based on 15 percent of enrolled debt, with monthly payments required during first 12 months (of estimated 24-month program).	Unknown	• Representative stated that "one-hundred percent of our clients stop making their monthly payments as soon as they enroll into the program" • Representative encouraged us to explore other debt relief options as well as debt settlement • Name of company changed during our investigation

Table 4: Representations Made by Debt Settlement Companies We Called—Continued

No.	Location of company and affiliates	Fees [a]	Association membership [b]	Case details
10	Texas	• Advance fees based on 17 percent of debt, with monthly payments required during first 19 months (of estimated 48-month maximum program).	USOBA	• Representative stated that upon enrolling in company's program "you would no longer make any of your credit card payments. All of them would go late" • Representative claimed to "negotiate your debt down to 50 percent or less of what you owe" • Representative said advance fees paid for attorneys who would "look at" our account monthly • Representative was unable to explain refund policy by telephone • Representative suggested we change our address on billing statements to address for company's attorneys
11	Florida	• Unknown—only received recorded information.	Unknown	• Telephone number listed on website went to a 7-minute recording • Recording stated that we would stop paying our creditors upon entering program • Recording claimed to send letters to credit bureaus that would "remove any late marks that you may have received on the account"
12	California	• Advance fees based on 15 percent of enrolled debt.	Unknown	• Front-end marketing company, with 28 different websites used to solicit customers for referral to one debt settlement company • Representative stated that affiliate handling actual settlement process would call us back; we did not receive a return call
13	Texas	• Advance fees based on 10 percent of enrolled debt, with monthly payments required throughout program.	USOBA	• Representative stated that program does not work for everyone, but does work for everyone who has a hardship • Representative stated company's services are helpful to consumers "because we allow [consumers'] accounts to go delinquent and past due and into collections" • An e-mail sent after our call stated that upon enrolling in the program, "we will inform your creditors that you will no longer be making payments on the accounts"
14	Arizona	• Advance fees based on 12.9 percent of enrolled debt, with monthly payments required during first 10 to 12 months (of estimated 30-month program).	Unknown	• Representative stated that "9 out of 10 of our clients are current," but stop making payments when entering program • When asked whether to stop paying accounts that are current, representative replied "Absolutely"
15	California	• Advance fees based on 15 percent of enrolled debt. • First 3 monthly payments go to fees. • $30 monthly maintenance fee. • $14.50 monthly trust account fee.	TASC	• Representative stated that she could not interfere with our obligation to pay our creditors, and encouraged us to continue making payments if we could afford to do so at the same time as saving for settling debts • Representative later stated that if we could continue making our minimum payments "maybe this [debt settlement] isn't the best solution for you"
16	Florida	• Contingent fees based on 35 percent of reduction in debt company obtains for clients. • First monthly payment goes to enrollment fee. • $53 monthly maintenance fee.	USOBA	• website targeted at Christian consumers • Representative stated that "you stop paying everybody. That's what makes you qualify. You fall behind." • Company's contract states there is a $1,000 termination fee for dropping out of the program • Representative suggested that we could pay our initial fee with a credit card • Representative offered to also provide us information on debt consolidation loans, to determine which option would be best
17	California	• Advance fees based on 18 percent of enrolled debt, with monthly payments required during first 18 to 24 months (of estimated 36-month program).	USOBA	• Representative encouraged us to take care of our late mortgage payments before worrying about paying off or settling our credit card debts

Table 4: Representations Made by Debt Settlement Companies We Called—Continued

No.	Location of company and affiliates	Fees [a]	Association membership [b]	Case details
18	Unknown	• Advance fees based on 15 percent of enrolled debt, with monthly payments required throughout program. • First 3 monthly payments go to fees.	Unknown	• website targeted at Christian consumers • website describes one of the "blessings" of its program as "Immediate increase of spendable cash-flow [sic]" • Representative told us the program is based on our stopping payments to creditors
19	Maryland	• Advance fees based on 15 percent of enrolled debt. • $9.85 monthly bank fee.	Unknown	• Representative stated that it "wouldn't make sense" to continue making payments while in a debt settlement program • Representative said that program "works for some" but is "not great for others," and that company discourages consumers from debt settlement if they plan to buy a house soon, due to credit score damage
20	California	• Unknown—representative said we did not have enough debt to qualify for program.	TASC	• Representative stated that we did not have enough debt to qualify for the company's debt settlement program

Source: GAO analysis of information obtained from debt settlement companies.

[a] Fee information reflects fees disclosed to us; some companies may charge additional fees that were not disclosed. Debt settlement companies typically charge fees requiring payments either at the beginning of the program as an advance fee or after each settlement as a contingent fee. Some companies structure the payment of advance fees so that they collect a large portion of them—as high as 40 percent—within the first few months regardless of whether any settlements have been obtained or any contact has been made with the consumer's creditors. Others collect fees throughout the first half of the enrollment period in advance of a settlement. Companies that charge a contingent fee generally base it on a certain percentage of any settlement they actually obtain for consumers. They sometimes charge a small, additional fee every month while consumers are busy attempting to save funds for settlements. FTC has criticized advance fees, stating that consumers often suffer irreparable injury as a result of paying them in advance of receiving services. The agency maintains that the practice of taking fees before a settlement is obtained results in a number of adverse consequences for consumers: late fees or other penalty charges, interest charges, delinquencies reported to credit bureaus that decrease the consumer's credit score, and sometimes legal action to collect the debt.

[b] Some companies we called referred us to one or more affiliates. It was not always clear to us exactly with which company or affiliate we were speaking, where the companies or affiliates were located, or what the relationships were between the companies and affiliates. In some cases, separate affiliates of the same company claimed to be members of different industry trade associations.

[c] While Company 1 claimed to be a member of TASC, it appears this was a false representation.

The CHAIRMAN. Do you have, incidentally—there are several of those comments which I couldn't understand. Do you have text which is available?

Mr. KUTZ. Yes, we do.

The CHAIRMAN. We have text.

Mr. KUTZ. Yes.

The CHAIRMAN. OK. I just—I want to have that.

Mr. KUTZ. OK.

The CHAIRMAN. I thank you very much.

And now, we will turn to The Honorable Julie Brill.

Well, I—I'm just doing it in order of what I see here. I'm not going to be stage-managed, OK?

[Laughter.]

The CHAIRMAN. I will be stage-managed.

[Laughter.]

The CHAIRMAN. Mrs. Haas—Mr. and Mrs. Haas. You're of Concord, New Hampshire.

Mrs. HAAS. Yes, I am.

The CHAIRMAN. And please proceed.

STATEMENT OF HOLLY A. HAAS, CONSUMER

Mrs. HAAS. Thank you, Chairman Rockefeller and Ranking Member Hutchison, for inviting me to speak with you today about my experience with debt settlement.

I live in New Hampshire with my husband of 17 years. I have three sons and one grandson. My son served proudly with the U.S. Navy until 2009.

In June 2007, our credit card interest rates were increased. The credit card company told us our debt-to-income ratio was too high, and that justified an increase, even though we were current. These increases made it difficult to meet our monthly budget, due to dramatic increases of our monthly payments. We were never late on our payments, but we needed help to reduce them.

In July 2007, after watching TV commercials on credit counseling, we started researching credit counseling companies on the Internet. We found one, in particular, that was close to home in Massachusetts: Consumer Credit Counseling of America; and because it had "America" in it, we thought we couldn't go wrong.

We called CCCA and spoke with a man named Tom Roy, who talked to us about credit counseling, but, because of our credit card balances, he persuaded us to do a debt settlement. For a fee, they could get us an attorney, that they selected, who would work to settle our debts. In the end, we would pay 46 percent of our debt and a retainer of $7,500. This would cut our credit card payments in half. Forty-eight payments would go into an account and would be used to pay the attorney and the settlements. After trying to work with our creditors, to no avail, this sounded like a better option for us.

On August 4, 2007, we received the contract and sent it back, signed, along with the checking info for the installments. We were instructed by the CCCA not to pay our credit card bills, because the credit card companies would not negotiate settlements with current accounts. By September, the collection letters and calls started. Money was going into our holding account, and the attorney that Consumer Credit Counseling of America put us in touch with started taking his fees.

The attorney's name was Richard A. Brennan. We heard nothing from him, so we researched our attorney on the Internet. To our dismay, we found numerous serious complaints about him.

Afraid that we were being scammed, we called Brennan's client services number, as instructed on the contract, for questions, which we thought was Brennan's office staff. But, it turned out to be a totally separate entity in Boca Raton, Florida. The person assured us that our case was being handled properly, so we continued with Brennan to help us with our debt.

In November 2007, we called client services, due to collection threats. They no longer handled Brennan's cases, and referred us to a number in Maryland that no one answered; the voice-mails were always full. We called client services again, who said the creditors agreed to settle our credit card debt at 80 percent. In reality, nothing was being done on our case and the attorney was still taking our money from our account.

In February 2008, we got a call from Howard Lee Schiff, a law office hired by Sears credit. They were going to sue us. We told them that we had a lawyer and that they needed to contact him. We again called client services, and the woman told us they no longer instructed clients of Richard A. Brennan, again giving us the contact number that gets you nowhere.

We decided to Google his name. The complaints were worse. The Better Business Bureau rated him an "F," and the AG of Maryland had reached a settlement with him to discontinue debt settlement practices, but the attorney was still practicing debt settlements. After learning this, we realized we had to stop working with him immediately. We then faxed a letter to the bank that had the holding account, and told them to stop all payments to Brennan, and to stop all transfers. We immediately closed our checking account, for fear that they would still take the money out anyway. The next day, we sent a letter to the attorney's office, terminating his services.

On February 25, 2008, we consulted with an attorney in New Hampshire, to see if we could undo the damage that Brennan caused. We were now so far in default that we thought our only option was bankruptcy. At our consultation, we found that neither Consumer Credit Counseling of America nor Brennan was licensed for debt adjustment in New Hampshire, making our contracts with them illegal. He said we should formally complain to the AGs' offices in New Hampshire and in Maryland, and the New Hampshire Banking Commission, which we did.

There is now an order to cease and desist in New Hampshire, and the AG's office in Maryland had Brennan disbarred from their State.

Our New Hampshire attorney told us about Consumer Credit Counseling Service of New Hampshire and Vermont, a licensed, nonprofit company that is affiliated with the credit card companies to help manage debt. We joined the program on March 10, 2008. In 6 months' time, we were about $13,000 behind from where we started. Our credit scores had gone from excellent to poor. All credit extended to us now is at a higher rate, if at all, and banks who once gladly financed our cars won't look at us. Insurance companies have given us a higher quote, due to their—our credit history.

Debt settlement companies are very misleading. They have no regard for State or local laws. Debt settlement is much different than debt management. As we now know, a debt settlement plan does extreme damage to your credit. And in our opinion, they don't work and shouldn't exist.

In 2 years, we have paid about $32,000 toward our credit cards, and we now owe approximately $34,000. If we started with a legitimate company first, our current debt would be about $13,000. We would have paid off our credit cards in April 2011. With our current payment plan, we will be debt-free October 2012.

Now, we don't spend beyond our means. If we want to buy something, we save up first and we do not use credit cards at all.

Thank you.

[The prepared statement of Mrs. Haas follows:]

PREPARED STATEMENT OF HOLLY A. HAAS, CONSUMER

After numerous years of unrequested credit limit increases from our credit card companies and them sending us checks with our monthly statements to use for credit, in June 2007, we noticed an increase in our interest rates on our monthly statements. After calling the credit card company, we were told that our "debt to income ratio was too high" and that justified an increase in rates. This was in spite of the fact that we were making payments on time. Increased rates made our payments higher and this is what made it difficult to pay these cards off.

My husband and I, realizing our ever increasing financial debt with credit cards, were paying more than what we could afford in credit card payments and needed some advice in how to reduce them in some way to make it easier to pay our necessary bills without struggling each month. We were *never* late on any of our credit card payments at this time.

In late July 2007, after researching debt management companies on the Internet, we called Consumer Credit Counseling of America, (CCCofA) 1060 Osgood Street, North Andover, MA to get more information on debt reduction. We chose this company because it was the closest we could find from our home in Concord, NH and we thought they were credit councilors to help manage our debt. The representative, Tom Roy, asked us about our credit card balances and assured us that there were options for us, either reduction or settlement. First he talked about "credit counseling" where they would set up a payment plan with the creditors and help reduce the interest rates. However, he thought that it would be better for us to do a debt settlement plan. For a small referral fee to fill out the paperwork they could get us an Attorney who would work for us to settle our debts with the credit card companies. For our total debt of $48,648 we would be paying forty-six percent (46 percent) or $23,821 and an attorney fee of $7,500 for a total sum of $31,321. This would reduce our monthly payments from $1,327 a month to $653 (estimate) for a period of 4 years. The monthly payments would go into a bank account which they would set up for us. The money in that account would collect over time and be used to pay the attorney and the settlements for each of the creditors we had. They told us that their attorney (unknown at the time) would pay them off as he got word that the credit card companies agreed to settlement with the money accrued in the account. After trying to work with all of our creditors beforehand about reducing the interest rate and being denied, this sounded like a better option for us at the time.

Once we agreed to go with the debt settlement and Consumer Credit Counseling of America sent out our contract in the mail, this was the last time we ever could get a hold of Tom Roy. They gladly took $400 electronically from our checking account for their referral fee. It took about 2 weeks to get the contract.

Finally, on August 4, 2007, we received the contract in the mail, read and signed it and sent it by fax back to Consumer Credit Counseling of America, along with our checking account information for the monthly installments and a hardship letter to our creditors, as instructed. During that time, we were verbally instructed not to pay our credit card bills—which were not overdue at that time, because the credit card companies would not negotiate settlements with current accounts. If the credit card companies or collection companies called, we were told to say "We are not neglecting our debts, we have hired an attorney. Please call (the number) for more information." We were instructed to fax all collection letters to our attorney, which we did. (Exhibit A)

Exhibit A

BRENNAN, SMITH & ASSOCIATES
ATTORNEYS AT LAW

For Mail:

Consumer Credit Counseling of America
1060 Osgood Street
North Andover MA 01845
cccainfo@consumercounselingofamerica.com

For payment changes or questions please call us: 800.336.9811

Please fax forms to: 800.688.1571

From: William Haas # 603-835-5592 10 pages

Instructions for completing the forms are as follow:

Checklist

☒ Sign forms in highlighted areas.

☑ Attach voided check or savings deposit slip where indicated.

☑ Please complete the attached "Creditor Information Form", and attach copies of your most recent statements. This will ensure accuracy of your information and timely payment of your creditors. If you do not have your statements, do not wait until they come in to fax back the rest of your forms. Fax your forms initially and then just fax your statements one at a time as they come in.

☐ Fax all forms to 800.688.1571

☐ If there is no way to get to a fax machine today then please mail them back with the envelope that is enclosed with these forms.

☐ We will be giving you a confirmation call within 1 business day of receiving your forms. Sit back and become debt free!

BRENNAN, SMITH & ASSOCIATES

ATTORNEYS AT LAW

LIMITED POWER OF ATTORNEY

Holly Haas mt

I/We, WILLIAM N. HAAS located CONCORD, NH hereby appoint The Law Offices of Brennan, Smith & Associates, as my attorney-in-fact, with full power to represent me in negotiating the validity, reduction, settlement, and payment as may be required, of accounts owed to my creditors. This power of attorney only grants authorization for attorneys to negotiate on my behalf with existing creditors that have been included in the creditor worksheet. This limited power of attorney can be cancelled at any time.

I/We also authorize The Law Offices of Brennan, Smith & Associates to request and receive confidential credit and account information from creditors, credit reporting agencies, and other third parties who are involved with my credit issues. I further authorize The Law Offices of Brennan, Smith & Associates to release a copy of this Limited Power of Attorney to my creditors.

Client Name: WILLIAM N. HAAS

Co-App's Name: Holly Haas mt

Client's Date of Birth: 04/23/60 Co-App's Date of Birth:

Client's SSN: Co-App's SSN:

Client's Signature: William N Haas Date: Aug 4, 2007

Co-App's Signature: Holly Haas Date: Aug 4. 2007

BRENNAN, SMITH & ASSOCIATES
ATTORNEYS AT LAW

ELECTRONIC PAYMENT AUTHORIZATION

Fill out the following form and your payment will be automatically withdrawn from your checking or savings account each month. If you have any questions or problems, please call.

Client Name: WILLIAM N. HAAS

Check One: Checking:X Savings:

ROUTING # 011900291 ACCOUNT # 1[illegible]

TD BANKNORTH 800-224-5563

Please Print Bank Name Bank Telephone Number

Electronic Payment Authorization: Client authorizes Law Firm to deduct any Service Fee or other applicable charges via Electronic Payment Authorization from Client's checking or savings account. Law Firm requires a minimum notice of seven (7) business days to change any scheduled electronic fund transfers from Client's bank account. There is a $10.00 fee for each Non Sufficient Funds (NSF). Please debit my account on or after 08/20/07 for the amount of 400, and thereafter on the 20 day of each month in accordance with our contract. This authorization is to remain in full force and effect until Company has received written notification from me of its termination in such time and in such manner as to afford Company and Depository a reasonable opportunity to act on it. If your payment is lowered we are authorized to deduct the lower amount instead.

William N. Haas Aug. 4-2007

Client Signature Date

Holly Haas

DEPOSIT TICKET

WILLIAM N. HAAS
HOLLY A. HAAS
PH. 603-731-5091
[illegible] CURTISVILLE RD.
CONCORD, NH 03303

Attachment 1
Global Client Solutions
Special Purpose Account Application

APPLICATION FOR A SPECIAL PURPOSE ACCOUNT

I hereby apply for and agree to establish a special purpose account (the "Account" with Rocky Mountain Bank & Trust of Colorado Springs, Colorado ("Bank") for the purpose of creating an effective and disciplined approach to fulfilling my obligations under a debt settlement program (the "Program") sponsored by the organization identified below (the "Sponsor"). I understand that the Account's features, terms, conditions and rules are further described in an Account Agreement and Disclosure Statement that accompanies this Application (the "Agreement"). I acknowledge that I have received a copy of the Agreement, which I understand is fully incorporated into this Application by reference, and I agree to be bound by all of its terms and conditions. I also understand that this Application is subject to Bank's customer identification program pursuant to the U.S. Patriot Act, and accordingly, I hereby represent that the following information is true and complete to the best of my knowledge and belief.

APPLICANT'S OWNERSHIP, CONTROL OVER AND USE OF THE ACCOUNT

I understand that the Account, when established pursuant to this Application, will be my sole and exclusive property, that only I may authorize deposits to and disbursements from the Account, and that I may close the Account at any time as provided for in the Agreement. I hereby authorize Bank, through its agent Global Client Solutions, LLC ("GCS"), to administer the Account on my behalf by (a) periodically depositing funds to the Account by debiting my primary bank account pursuant to the authorization provided for below, or pursuant to other instructions that I may give from time to time, and (b) periodically disbursing funds from the Account to fulfill my obligations under the Program and to pay the fees and charges provided for in this Application and the Agreement. In disbursing funds with respect to the Program, Bank and GCS may rely on my instructions to the Sponsor unless and until I give Bank and GCS a written notice to the contrary. I understand that I may revoke the foregoing authorization at any time by giving GCS a written revocation notice.

PERMISSION TO SHARE DATA

I hereby grant permission to Bank, GCS and the Sponsor to share information regarding the Program and the Account with each other to facilitate transactions involving the Account, and with any other party that is essential to the administration of the Account on my behalf. I understand that the Agreement provides additional information relating to privacy.

APPOINTMENT OF AGENT

Applicant hereby appoints GCS as his/her lawful agent with full power and authority to execute and deliver those instruments that may be necessary to establish and maintain the Account, and to keep books and records identifying the Applicant and the amount of his/her ownership interest(s) as an Account Holder on the deposit records of the Bank.

Applicant Last Name	First Name	M.I.	Social Security #	Date of Birth (mo/day/yr)
HAAS	WILLIAM	N		04/23/60

Co-Applicant Last Name	First Name	M.I.	Social Security #	Date of Birth (mo/day/yr)
HAAS	HOLLY	A		12-02-1964

Address	City	State	Zip
10 N. CURTISVILLE RD	CONCORD	NH	03301

Home Phone	E-mail address	Mother's Maiden Name (for future ID purposes)
603-715-1091		

Sponsor	Account Number with Sponsor
XXX	XXX

AUTHORIZATION TO DEBIT BANK ACCOUNT

Financial Institution Information

Name: TD BANKNORTH

Address / City / State / Zip:

Routing Number[1]	Account Number[2]
011400071	1701224713

Customer Information

Name (as it appears on check): WILLIAM HAAS & HOLLYA HAAS

Address (as it appears on check) / City / State / Zip:

Amount of Debit	Date of Debit
$ 653	On or after the ____20___ day of each month until further notice

I hereby authorize Bank, through its agent GCS, to initiate debit entries to my ☑ checking / ☐ savings account at the above financial institution, or any other account subsequently designated, in the amount(s) stated, or revised, on or after the date(s) set forth above, or as revised, and to debit the same to such account for the purpose of transferring funds to my Account. I represent that the above account exists, and that any other designated account will exist, and that I own or will own the account, and I agree to maintain sufficient funds in the above account, or any other designated account, to permit the debits to clear on the applicable dates. I understand that I will incur a charge as set forth in the Schedule of Fees and Charges if any attempted debit is not immediately honored when presented.

This authorization shall remain in full force and effect until I give a written termination notice to GCS that affords it a reasonable period of time to act on it. Any such notice, and any other notice that is provided for in this Application or the Agreement, shall be sent to the Customer Service Center at the address set forth on the "Important Information" sheet that accompanies this Application. In addition, I understand that GCS may terminate this authorization by providing me with a written notice at least ten (10) days prior to the actual termination.

[1] Routing Number is the 9-digit number that appears in bottom left-hand corner of your check.
[2] Account Number is to the right of the Routing Number and after the check number on your check.

SCHEDULE OF FEES AND CHARGES

Program Fees (refer to your Sponsor Agreement)	
Account Setup (one-time fee)	$3.00
Monthly Service Charge	$8.38
Transaction and Other Fees	
Premium Deposit Services	
Wire transfer	$10.00
Dishonored/returned deposit item	$25.00
Premium Disbursement Services	
2nd Day Delivery (3pm Central Time cutoff)	$10.00
Overnight delivery (3pm Central Time cutoff)	$20.00
Wire transfer	$15.00
Account research - per hour (1 hour minimum)	$10.00

See the "Important Information" sheet that accompanies this Application for the GCS payment and correspondence addresses, the address of the GCS website to get information via the Internet and a toll-free customer service number. Monthly statements will be provide via the Internet unless this box is checked ☐, in which case they will be mailed to Applicant.

APPLICANT SIGNATURE(S)

Applicant Signature	Date
William N Haas	8-4-07

Co-Applicant Signature	Date
Holly A Haas	8-4-07

FOR OFFICE USE ONLY

ACCOUNT NUMBER

PASSCODE

Limitation of Liability: Under no circumstances shall we be liable for any special, incidental, consequential, exemplary or punitive damages.

Change in Terms: We may, at any time, and subject to applicable law, add, delete, or modify the terms, conditions, rights and responsibilities regarding your Account. You will be notified of any changes. However, if the change is made for security purposes, we can implement such change without prior notice. We reserve the right to add, delete, change, modify, or replace, from time to time, and without prior notice, any of our service providers, as we deem necessary in our sole discretion.

Governing Law: The laws of the State of Colorado govern this Agreement without giving effect to the choice of law provisions thereof. If any part of this Agreement is declared void or unenforceable, such provisions shall be deemed severed from this Agreement. The remainder of this Agreement shall remain in full force and effect, and shall be modified to any extent necessary to give such force and effect to the remaining provisions. No delay or forbearance in the strict observance or performance of any provision of this Agreement, nor any failure to exercise a right or remedy hereunder, shall be construed as a waiver of such performance, right, or remedy, as the case may be.

USA Patriot Act Compliance: In order to assist in combating terrorism and preventing the banking system from being used for money laundering purposes, you authorize us to take those steps that are reasonable and practical to identify you and any information about you, including, without limitation, securing a credit report on you and otherwise verifying your identity as we are required to do so by the USA Patriot Act.

PRIVACY POLICY

We are committed to providing the highest level of security and privacy regarding the collection and use of your personal information. Personal information may be collected from your account Application, any updated information you may provide us from time to time and the banking transactions processed through your Account. A description of our Privacy Policy is provided below. If you have additional questions regarding the privacy of your personal information, please contact GCS customer service at the address shown at the end of this Agreement.

Collection / Use of Personal Information: Our collection of your personal information is designed to protect access to your Accounts and to assist us in providing you with the products and services you want and need. All personal information collected and stored by us, or on our behalf, is used for specific business purposes to protect and administer your Account and transactions, to comply with state and federal banking regulations, and to help us better understand your financial needs in order to design or improve our products and services.

Only approved personnel will have access to your personal information. Furthermore, auditing mechanisms have been put into place to further protect your information by identifying the personnel who may have accessed and in any way modified - for example, updated or added to - your personal information.

Maintenance of Accurate Information: It is in the best interest of both you and us to maintain accurate records concerning your personal information. For this reason, we allow you to update your personal information online, at any time, by using your Password to log into the GCS website or by contacting GCS customer service.

Limited Access to Personal Information: We limit access to your personal information to only those personnel with a business reason for knowing such information. We also educate all personnel about the importance of confidentiality and customer privacy. In addition, individual user names and passwords are used by approved personnel to access your personal information, providing audit trails to further safeguard the privacy of your personal information.

Third-Party Disclosure Restrictions: We follow strict privacy procedures in regard to protecting your personal information. In addition, we require all third parties with a business need to access this information to adhere to similar and equally stringent privacy policies. Personal information may be supplied to a third party in order to process a transaction you have authorized or if the disclosure is required or allowed by law (i.e. exchange of information with reputable reporting agencies, subpoena, or the investigation of fraudulent activity, etc.).

Disclosure of Privacy Policies: We are committed to ensuring the privacy of your personal information. For more information regarding our Privacy Policy, please contact GCS customer service.

SCHEDULE OF FEES AND CHARGES

One-time account setup	5.00
Monthly service charge	8.35
Transaction and other fees:	
Incoming wire transfer	10.00
Dishonored/returned deposit item	25.00
Premium disbursement services:	
Wire transfer	15.00
2nd day check delivery	10.00
Standard next day check delivery	20.00
Stop payment order	17.50

CUSTOMER SERVICE INFORMATION

Website Address:

www.globalclientsolutions.com

Correspondence Address:

9820 E 41st Street, Suite 400
Tulsa, OK 74146
Telephone - (800) 398-7191
Fax - (866) 355-8228

Payment Address:

PO Box 562, Florence, CO 81226

Express Mail Payment Address:

101 E Main, Florence CO 81226
719-784-6316

Wire Transfer Instructions:

Rocky Mountain Bank & Trust
101 East Main, Florence, Colorado 81226
Telephone - (719) 784-6316
ABA# - 107000929
For credit to - Global Client Solutions, Custodian
Account # - 034584
For further credit to: Your name plus your 16-digit acct. number.

MoneyGram Instructions:

Agent locator - www.moneygram.com

Sending Instructions
Pay to - Global Client Solutions, Custodian
Receive Code - 4912
Account # - "DR" + last 8 digits of your 16-digit acct. # (Example: DR12345678)

BRENNAN, SMITH & ASSOCIATES

ATTORNEYS AT LAW

Applicant Name: WILLIAM N. HAAS

CREDITOR INFORMATION FORM

(PLEASE PHOTOCOPY IF ADDITIONAL SHEETS NEEDED)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
Sam's Club Credit	Holly Haas		1-800-964-1917
Address: PO Box 530942	City: Atlanta	State: GA	Zip Code: 30353-0942
Balance: 2242.99	Type of Debt: Credit Card	Monthly Payment: $ 75.00	Months Behind: 0 / Over Limit? Y (N)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
Bank of America	Holly A Haas		1-800-346-3178
Address: PO Box 15721	City: Wilmington	State: DE	Zip Code: 19886-5721
Balance: 4931.83	Type of Debt: Credit Card	Monthly Payment: $120.00	Months Behind: 0 / Over Limit? Y (N)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
Capital One	William N Haas		1-800-955-7070
Address: PO Box 70884	City: Charlotte	State: NC	Zip Code: 28272-0884
Balance: $6903.62	Type of Debt: Credit Card	Monthly Payment: $213.00	Months Behind: 0 / Over Limit? Y (N)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
PayPal	Holly Haas		1-866-892-9268
Address: WA-MU PO Box 660847	City: Dallas	State: TX	Zip Code: 75266-0487
Balance: 7,685.62	Type of Debt: Credit Card	Monthly Payment: 154.00	Months Behind: 0 not over limit

BRENNAN, SMITH & ASSOCIATES

ATTORNEYS AT LAW

Applicant Name: WILLIAM N. HAAS

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
Home Depot	William N. Haas		1-800-677-0232
Address Processing Center	City Des Moines	State IA	Zip Code 50364-0500
Balance 1,399.69	Type of Debt Credit Card	Monthly Payment $32.00	Months Behind 0 Over Limit? Y (N)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
CHASE	Holly A Haas William N Haas		800-945-2000
Address PO Box 15153	City Wilmington	State DE	Zip Code 19886-5153
Balance 18,260.27	Type of Debt Credit Card	Monthly Payment 495.00	Months Behind 0 Over Limit? Y (N)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
SEARS	Holly A Haas		800-917-7700
Address PO Box 183081	City Columbus	State OH	Zip Code 43218-3081
Balance 6997.07	Type of Debt Credit Card	Monthly Payment 218.03	Months Behind 0 Over Limit? Y (N)

Creditor's Name	Cardholder's Name	Account#	Area Code/Phone#
Address	City	State	Zip Code
Balance	Type of Debt	Monthly Payment	Months Behind_____ Over Limit? Y__ N__

BRENNAN, SMITH & ASSOCIATES
ATTORNEYS AT LAW

NOTICE TO CONSUMER

Law Offices of Brennan, Smith & Associates will be providing all the necessary legal services under the terms of this agreement. All fees and payments are included with your monthly payments, and you will not receive an invoice for any legal services. You are now a client of this firm, and any legal questions that you have will be answered in a timely manner, and with the requisite skill and professionalism necessary. This service is not limited to credit or debt, but instead covers the entire spectrum of the law. Should you have a question about a lease, deed, automobile accident, or any other legal issue, do not hesitate to contact us. We require 100% consumer satisfaction so if there is ever an issue, please contact us immediately. We can be reached via email: cccainfo@consumercounselingofamerica.com for the quickest response.

If you are receiving this notice, you have already started a working relationship with Consumer Credit Counseling of America. Consumer Credit Counseling of America provides budget counseling without charging you a fee. It is imperative that your return your paperwork as soon as it is completed.

You have taken the first step towards building wealth. Our mission is to get you out of debt so that rather then send $100-$200 per month in interest payments to creditors, you will be able to build a bank account with liquid assets you never thought possible. During the last six months of your program, please contact Consumer Credit Counseling of America. We will provide you with additional free information detailing how you can earn money through sophisticated investments.

In order to move you away from debt and into equity, we need your representation agreement completely filled in, and sent to our offices. If you cannot fax them in, please send them via priority mail. If you have legal issues that cannot wait, please contact the law firm so that an attorney or paralegal can immediately assist you.

If you have any feedback you would like to share regarding our intake process, please do not hesitate, to call or write. You input helps us better serve the community.

To Your Success,

Consumer Credit Counseling of America

1060 OSGOOD ST NORTH ANDOVER MA 01845

BRENNAN, SMITH & ASSOCIATES
ATTORNEYS AT LAW

CONSUMER EDUCATION

If you are having debt problems, you may feel overwhelmed and powerless. During periods of financial hardship, you may not have the resources to pay pressing debts, to meet family needs, and to get legal help. You may feel helpless to fight debt collectors pressing you for payment or threatening to seize your home, car, or other possessions.

We will help you make the best choices possible despite difficult financial circumstances. We will help you decide whether there are debts you can ignore and what your options are when you cannot ignore a particular debt. Most important, we will make sure that your rights as a consumer are protected. Many state and federal laws are designed to help people facing financial problems.

Most people in financial distress will first want to deal with the worst symptoms of a deteriorating financial situation. However, you should never make a decision based upon what a debt collector tells you. If you have an issue, have the debt collector call your attorney three way to confirm what they have just said. Or, tell the debt collector that you need to call your attorney first, or better yet, ask the debt collector to contact us directly.

When your financial condition is such that you cannot meet your monthly payment requirements, we are here to develop a long-term strategy to deal with your debt problems. This strategy involves figuring out those debts that you need to repay, and understanding the likely consequences if you cannot pay certain debts.

The first discipline that you need to learn is keeping a log of your income and expenses for a few months. You should have already submitted an income statement worksheet to the lawyer referral firm that referred you to our law firm. We will make sure that we have this.

The second discipline is determining the priority of your debt. Debts with collateral are top priority. These include mortgages, rent, car loans, and loans secured by household goods. Debts without collateral are low priority debts. These include credit cards, charge cards, medical bills, gasoline cards, payday loans, and loans from family or friends.

The third discipline involves identifying those debts that should be paid first. Always pay family necessities. This means food and unavoidable medical expenses. Next pay your housing related bills. Pay your mortgage or rent if at all possible. If you own a home, pay your non-deferrable real estate taxes and your insurance unless they are included in the monthly payment. Failure to pay these bills can result in the loss of your home or apartment. If you are having a serious problem that require you to move, you might stop paying the mortgage or rent. When you do so, do not spend this money. Save this money as a fund to use when you move, and to put down any required down payment. Pay the minimum required to keep your essential utility service. You should pay the minimum payment necessary to avoid disconnection. It would not make sense to work hard to keep your house or apartment only to not be able to live there because of no utility service. Pay car loans or car leases if you need to keep your car. If you need your car to get to work or for other essential transportation you should make your car payment your next priority after food, housing costs, and utilities. You may want to pay for the car first if the car is necessary to keep your job. You must pay your child support debts. A child support debt will not go away. If you need to modify a final order of child support obligation, then do it. You will have to prove that your financial condition has dramatically changed, and some states have minimum thresholds. However, if you do not make these payments, you can lose your license and go to jail. Income tax debts are a high priority. You must pay

1000 Osgood St. North Andover, MA 01845

income taxes you owe that are not automatically deducted from your wages. You must file your federal income tax returns, even if you do not have the money to pay the tax liability. The government has powerful collection rights that other creditors do not have, particularly if you do not file your returns. If your income has been reduced due to a change in circumstances, you can have your tax liability reduced. Loans without collateral are low priority. Most credit card debts, doctor and hospital bills, and other debts, such as open accounts with merchants, and similar debts are low priority. You have not secured any property with these debts, and in the short term, creditors cannot hurt you. Do not move a debt up in priority because a creditor or debt collector threatens to sue you. Many threats to sue are not carried out. Even if the creditor does sue, it will take a while before the collector can seize any property, and much of your property may be exempt from seizure. Court judgments against you move a debt up in priority, but less than you think. After a collector obtains a court judgment, that debt is often higher priority because the creditor can now ask a court to seize certain pieces of property, wages, and bank accounts. However, as to whether or not it is a serious threat will depend upon your state's law, the value of the property, and your income. Debt collection efforts should **never** move up a debt's priority. Be polite to the debt collector, but make your own choices. Debt collectors are unlikely to give you good advice. Debt collectors may be most aggressive when trying to get you to pay debts that should be paid last, if at all. You should never listen to what a debt collector says until you have had time to contact your lawyer or paralegal. Threats to ruin your credit record should never move up a debt's priority. Many collectors that threaten to report your delinquency to a credit bureau have already done so. If the creditor has not yet reported the status of your account to a credit bureau, it is unlikely that a collector hired by that creditor will do so. Refinancing is rarely the answer. You should always be careful about refinancing. It can be very expensive and it can give creditors more opportunities to seize your important assets.

If you have retained our firm to settle your debts with your creditors and avoid bankruptcy, although in our experience, creditors accept settlement offers, we must disclose that there are inherent risks with not making payments to your creditors. Some of these risks include: late fees, penalties, and interest will continue to accrue on the consumers debt until the creditors accept and receive a settlement; (2) a creditor(s) may still sue to collect on the debts and garnish your wages; (3) interest rates applicable to the debt may increase; (4) any money saved in negotiating a settlement with a creditor must be treated as income for tax purposes; and (5) a debt settled for less than the full amount owed may result in a negative notation on your credit report.

BRENNAN, SMITH & ASSOCIATES
ATTORNEYS AT LAW

Client Initials WH

5. Hold Harmless. During the representation, Law Firm will attempt to eliminate negative inaccuracies from the Client's credit profile by notifying the credit agencies of the settlement or settlements reached. Client agrees to hold Law Firm, its authorized agents, officers, directors and employees harmless from and against any liability or damage arising from Law Firm performance of its duties under this Agreement.

6. Termination. Law Firm may withdraw from representing Client if Client fails to make any payments as set forth in the Payment Schedule, if Client misrepresents or fails to disclose any material facts, fails to cooperate, or otherwise breaches Client's duties hereunder. Client has the right to terminate Law Firm services for any reason upon three (3) days written notice. If Client chooses to terminate Law Firm services during the term hereof, Client will be reimbursed all funds held in trust as of the date of such termination within 60 days. All other fees are non-refundable.

7. Venue/Jurisdiction. This agreement shall be governed by the laws of the State of Florida. Any action to enforce this agreement, or otherwise institute litigation against any party whether in law, equity, tort, or contract shall only be brought in Broward County, Florida. Any party violating this provision shall be liable for the actual costs of defending a suit in another jurisdiction irrespective of the outcome of the litigation. For purposes of clarification, "costs of bringing suit," includes, without limitation, attorneys fees, traveling costs, accommodations, filing fees, and the like. Should either party institute litigation in a jurisdiction other than Broward County, Florida, the defendant is excused from entering an appearance, and the plaintiff in the litigation waives his right to domesticate any judgment entered in the foreign jurisdiction, within Broward County, Florida. It is the intent of this provision to prohibit the parties from litigating outside of Broward County, Florida.

Acknowledged, agreed to, and accepted by:

William N Haas Holly Haas Date: Aug 4, 2007

Client Signature

WILLIAM N. HAAS Holly Haas WH
Please Print Name

Consumer Credit Counseling of America is a financial consulting firm. CCCA does not charge a fee for the services that they provide. They are responsible for collecting your information, analyzing your information and deciding, with you, what program would best benefit you. All fees are charged by The Law Offices of Brennan, Smith & Associates. Consumer Credit Counseling of America is always here throughout this process to help you with any type of advice regarding your finances. We are your friend, and on your side in these difficult times. Please do not hesitate to call us anytime on or after this program to help you stay out of debt in the future.

BRENNAN, SMITH & ASSOCIATES

ATTORNEYS AT LAW

REPRESENTATION AGREEMENT

This Agreement is entered into this 30th day of JULY , 2007 by and between WILLIAM N. HAAS (hereafter referred to as "Client"), and The Law Offices of Brennan, Smith & Associates, 23123 State Road 7 Suite 210, Boca Raton, Florida 33428 (hereafter referred to as "Law Firm"). Client and Law Firm as referred to as the "Parties".

In consideration of the mutual covenants and conditions contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties do hereby agree as follows:

1. Retention of Law Firm: Subject to the terms and conditions set forth herein, Client retains and engages the Law Firm to represent Client regarding certain contracts that Client has entered into. This representation does not cover litigation; however, upon request by Client, the Law Firm will draft pleadings for informational purposes only.

2. Fees and Determination of program entered into:

☒ Debt Settlement Clients:
This retainer shall be taken from payments made by Client for the term of the representation or until fulfilled. Your monthly payment to the Law Firm shall be $653 per month. You have retained this law firm for 48 months. Your term and payments include all legal fees. The first payment is a one time consulting fee and is non-refundable. Your payment is based on a settlement amount of 46% of your total outstanding debt plus a legal fee of $7,500 . Payment of the legal fees entitles Client to ongoing representation in negotiation with creditors, third party debt collectors, credit reporting agencies, and the like. During this time, the attorneys and paralegal's contact all of your creditors and inform them that you will not be making any payments until an agreed upon settlement amount is reached. The attorneys then negotiate back and forth with your creditors while you are making payments to the firm. The monies are placed into your trust account for settlement, and go toward legal fees. (This section does not apply to credit counseling clients)

☐ Credit Counseling Clients:
Credit counseling payments are distributed to creditors on a monthly basis and have a $49.00 monthly maintenance fee included in payment. There is also a one time consulting fee which is non- refundable. Your debt is consolidated into one monthly payment with reduced interest rates. Your monthly payment shall be $ per month. (This section does not apply to debt settlement clients)

3. Out of Pocket Expenses. Typically out of pocket expenses occur in most legal matters. These expenses may include, but be limited to; long distance charges, messenger, courier, and express delivery charges; facsimile transmission charges; computer research; printing and reproduction costs, and other legal counsel. Your legal fee covers these expenses.

4. Payments. Client authorizes the Law Firm to deduct all payments due, including all settlement funding, Fees or other applicable charges, via Electronic Payment Authorization from Client's checking or savings account. The Law Firm require a minimum notice of seven (7) business days to change any scheduled electronic fund transfers from Client's bank account.

1060 OSGOOD ST NORTH ANDOVER MA 01845

By the end of September 2007, the collection letters and phone calls started arriving, money was going into our "Global Client Solution Banking Services at Rocky Mountain Bank and Trust" (Exhibit B) account thru electronic transfer and the Attorney's office was surprisingly now taking our money out of our holding account automatically for his fees ($649.13 each month for August and September). We still had not spoken to or heard from our Attorney. After calling the "client" phone number provided to us in the beginning to no avail and finding out who he was from our contract's business heading, we decided to research about him on the Internet to get more information about him. To our dismay, we found numerous serious complaints about our attorney.

Exhibit B

Global Client Solutions LLC
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

RETURN SERVICE REQUESTED

September 5, 2007

William Haas
10 N CURTISVILLE RD
Concord NH 03301-5906

Global Client Solutions Banking Services

Rocky Mountain Bank & Trust
Account #: **********061519

Global acct #: #60363350 9061519
Called 3/3/08 acct closed Bank fee of 8.34 0.00 balance
debt2bgone

Client of Law Offices of Richard A Brennan LLC

Internet Password: q5HRy79A
IVR Password: 8856

Welcome to Global Client Solutions

We would like to welcome you to Global Client Solutions, LLC ("GCS"). We are the processor for all activity related to your account at Rocky Mountain Bank and Trust ("RMBT"). Your account setup has been completed, and the last six digits of your new account number are displayed above. You should have received the entire 16-digit account number from Law Offices of Richard A Brennan LLC along with their program paperwork. If you have not received this account number please contact them at (561) 483-7337, or call our Customer Support line at (800)-398-7191 and select option 3. You will need this number for future access to your account activity and balance information. Also, your 16-digit account number will appear on future statements in its entirety, but for security reasons we have masked all but the last 6 digits on this letter.

Your account can be accessed online at www.globalclientsolutions.com or through our Customer Support line at (800)-398-7191. Passwords for both services are included at the top of this letter. Please note that your 4-digit Passcode must be used to access account information via telephone and is also used for verification purposes should you need to contact a customer support representative. Internet access requires that you enter your 16-digit account number as your Username, and the "Internet Password" indicated above as your Password. You can change your password once you have logged into the website, or continue to use the one provided. Please take a moment to log in and review your personal information and forward changes to customersupport@globalclientsolutions.com.

In addition to online and telephone access, we will mail you a paper statement listing all account activity during each calendar month. The statement will be mailed out by the 15th of the month following the month being reported. Please take advantage of these various access methods to monitor your account on a regular basis. We strive for excellence in helping you manage your account, but ultimately this is your account and should be treated like any other asset you own.

Our duties as the processor for your account include the drafting of funds from your primary bank account into your account at RMBT as provided for in your application, as well as making payments to your creditors when we are instructed to do so. Please note, however, that we do not maintain records of your individual debts and therefore any questions regarding negotiations of debts and the status of your debt management program should be directed to Law Offices of Richard A Brennan LLC. Additionally, any questions regarding changes to your draft or deposit schedule should also be directed to Law Offices of Richard A Brennan LLC because changes to those schedules could directly impact future creditor payments or negotiations.

Included with this letter is your Account Agreement and Disclosure Statement. Any fees applicable to the maintenance of your account with RMBT are listed and should be reviewed. Instructions for contacting us, as well as instructions on how to deposit additional funds into your account are also included in that document. Please feel free to give us a call or send an email if you have any questions about your account. Our office hours are 9:00 am to 6:00 pm CST, Monday through Friday, excluding bank holidays.

Sincerely,

Global Client Solutions
Customer Support Team

Shocked to think that we were being scammed and afraid that we'd lose everything we owned, we called the "client number" at the Client Services Department. The person on the other end in Boca Raton, FL, assured us that our case was being handled properly. We had requested at that time, that we get a copy of all correspondence to and from the creditors and the attorney from the date of the agreement until now. They agreed and said they would. About a week after that, the only copies we got were the "Cease and Desist Communications" and the POA for the companies we carried credit cards with. They were dated 9–25–07. Wanting to believe in the good of people, we continued with this Attorney to help us with our ever growing financial mess.

In November 2007, we again called our Attorney's Client Services Department due to threatening collection letters, calls and threats of lawsuits. The Client Services representative told us that they no longer handle Richard A. Brennan' s cases and referred us to a number in Maryland that when called it just rang and rang. No one ever answered the call. When we tried to leave a message for the paralegal,

the voice mailbox always said it was full. We were just like the 1000 or so other people who wrote complaints about the attorney on the websites. We again called the Client Services representative in Boca Raton, FL and told them that no one was answering the phone and that we were really concerned and he asked what our questions were. We told him that we didn't think anyone was working on our debt settlement case and he said that they got information from all creditors reducing our debt to 80 percent. (We feel that he just told us that to appease us.) Relieved, we asked him to send copies of those letters as we had already requested all copies of correspondence. He said he would. To this date, we never got those letters. At this time, nothing was done on our case and they were still withdrawing money from our account each month and the attorney was still taking money from our holding account. (Exhibit C)

Exhibit C

Global Client Solutions Banking Services

Rocky Mountain Bank & Trust
Account #:

Global Client Solutions LLC
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

RETURN SERVICE REQUESTED

October 18, 2007

William Haas
10 N CURTISVILLE RD
Concord NH 03301-5906

Client of Law Offices of Richard A Brennan LLC

ACCOUNT ACTIVITY STATEMENT (THIS IS NOT A BILL)

DATE	DESCRIPTION		AMOUNT	BALANCE
09/26/07	month pmt - 09/20/07	49308	649.18	649.18
09/26/07	Setup Fee - 08/31/07	49309	-5.00	644.18
09/26/07	Bank Maintenance Fees - 08/07 (60363350949310		-8.35	635.83

Name
Add
Phone
Acc

Account Inquiries (800) 398-7191

Correspondence Address-
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

Payment Address-
PO Box 562
Florence, CO 81226

Please note that the above account balance may not be the actual balance of your account due to pending transactions not yet processed. On a different note, we will be asking you to update your account paperwork within the next 60 to 90 days. Please look for more information and instructions in next month's statement. If you have any questions or need assistance please contact us at the phone number referenced above or by email customersupport@rbglobalclientsolutions.com

Global Client Solutions Banking Services

Rocky Mountain Bank & Trust
Account #:

Global Client Solutions LLC
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

RETURN SERVICE REQUESTED

November 21, 2007

William Haas
10 N CURTISVILLE RD
Concord NH 03301-5906

Client of Law Offices of Richard A Brennan LLC

ACCOUNT ACTIVITY STATEMENT (THIS IS NOT A BILL)

DATE	DESCRIPTION		AMOUNT	BALANCE
10/01/07	Bank Maintenance Fees - 09/07		-8.35	627.48
10/22/07	month fee - 10/20/07	9336	-324.59	302.89
10/26/07	month pmt - 10/20/07	9337	649.18	952.07
10/26/07	month fee - 09/20/07	9338	-649.18	302.89

Account Inquiries (800) 398-7191

Correspondence Address-
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

Payment Address-
PO Box 562
Florence, CO 81226

Please note that the above account balance may not be the actual balance of your account due to pending transactions not yet processed. On a different note, we will be asking you to update your account paperwork within the next 60 to 90 days. Please look for more information and instructions in next month's statement. If you have any questions or need assistance please contact us at the phone number referenced above or by email customersupport@globalclientsolutions.com

Global Client Solutions Banking Services

Rocky Mountain Bank & Trust
Account #:

Global Client Solutions LLC
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

RETURN SERVICE REQUESTED

December 28, 2007

William Haas
10 N CURTISVILLE RD
Concord NH 03301-5906

Client of Law Offices of Richard A Brennan LLC

ACCOUNT ACTIVITY STATEMENT (THIS IS NOT A BILL)

DATE	DESCRIPTION		AMOUNT	BALANCE
11/01/07	Bank Maintenance Fees - 10/07		-8.35	294.54
11/27/07	month pmt - 11/20/07	8976	649.18	943.72
11/27/07	month fee - 10/20/07	8977	-324.59	619.13
11/27/07	month fee - 11/20/07	8978	-324.59	294.54

Called 3-3-08

Account Inquiries (800) 398-7191

Correspondence Address-
9820 E 41st Street, Ste 400
Tulsa, Oklahoma 74146

Payment Address-
PO Box 562
Florence, CO 81226

Please note that the above account balance may not be the actual balance of your account due to pending transactions not yet processed. On a different note, we will be asking you to update your account paperwork within the next 60 to 90 days. Please look for more information and instructions in next month's statement. If you have any questions or need assistance

In January 2008, we continued to get collection letters from creditors and we were still faxing them to the number they provided us in the contractual agreement. We continued to try to call the Frederick Law Group, LLC, now in Maryland, to get some information on our file to no avail, but continued to not pay any credit card bills as instructed. By now, our credit cards were over limit (with fees), overdue (with fees) and interest charges sky-rocketed and the Attorney was still taking our money.

On February 19, 2008, we got a call from a Law Firm representing a creditor. They were going to sue us. We told them that we had a lawyer representing us and that they needed to contact them. The lady commented that the file doesn't show that we have an attorney and took the information and hung up. Immediately, we called the number our contractual statement first provided us. The woman told us the same thing. They no longer instruct clients of Richard A. Brennan, again giving us the contact information that gets you nowhere.

Upon trying to call this Attorney, we once again decided to Google his name. The complaints were worse, the Better Business Bureau's rating of this business is an F, and we found where the Attorney General of Maryland had reached a settlement with him but the Attorney is still fraudulently scamming hundreds of debt-stricken

people. (Exhibit D) This settlement occurred unbeknownst to us, a month or so after we signed our contract with him. According to an on-line report the attorney's company we were working with in Boca Raton, was "out of business" as of October 2007. We never received any notice of this and he still took our money each month.

Exhibit D

Maryland Attorney General - News Release

Page 1 of 2

MARYLAND ATTORNEY GENERAL
Douglas F. Gansler

Home | Protecting Consumers | Safeguarding Children | Seniors | Law Enforcement | Site Map | Search

For Immediate Release

Media Contact:
Raquel Guillory, 410-576-6357
rguillory@oag.state.md.us

Attorney General Settles with Companies Selling Debt Repayment Services

BALTIMORE, MD (October 19, 2007) - Attorney General Douglas F. Gansler announced today that his Consumer Protection Division has reached a settlement with Frederick attorney Richard Brennan, the Law Offices of Richard A. Brennan, LLC, the law firm's office manager, Jeffrey Formulak, and a related company called American Telecommunications Solutions, LLC (referred to collectively as the "Brennan Law Firm"), in connection with their offer and sale of debt management and debt settlement services to consumers.

The Brennan Law Firm sold services to consumers through which they agreed to place consumers' payments into an escrow account and either forward the money to consumers' creditors each month through a "debt management plan," or hold the money until enough was saved to negotiate a lump sum settlement through a "debt settlement plan." The Division alleged that The Brennan Law Firm failed to forward consumers' payments to their creditors, including approximately $240,000 of consumers' payments that were used by the firm to pay its own debts.

The Division also alleged that the Brennan Law Firm violated the Maryland Debt Management Services Act which requires an entity providing debt management services in Maryland to be a non-profit corporation licensed by the Department of Financial Regulation. The Brennan Law Firm is a for-profit corporation and did not possess a license to offer and sell debt management services. The Division also alleged that the Brennan Law Firm misrepresented the experience of its staff and misrepresented the amounts consumers would save through its debt settlement services.

"Consumers who are struggling with debt need to receive meaningful counseling services, not unfulfilled promises," said Attorney General Gansler. The Attorney General advised consumers to be wary of any company that promises a quick fix for repaying their debt.

Under the settlement, the Brennan Law Firm can no longer offer and sell debt management services and may only sell debt settlement services if it posts a surety bond with the Division, complies with the disclosures and restrictions imposed by the agreement, and pays full refunds to consumers who purchase the services but do not realize promised savings. The Brennan Law Firm also agreed to return all payments it received from consumers in the past that were not forwarded to their creditors, as well as pay costs and a civil penalty. In making today's announcement, Attorney General Gansler thanked Assistant Attorney General Phil Ziperman for his work on the case.

On February 19, 2008, my husband faxed a letter to the company that is in charge of taking out our money and told them to terminate our account and stop all direct payments to the account. We immediately closed our checking account for fear he would still take the money out anyway. (Exhibit E)

Exhibit E

William and Holly Haas
10 North Curtisville Road
Concord, NH 03301
603-715-1091

Global Client Solutions
9820 E 41st Street – Suite 400
Tulsa, OK 74146

RE: Account #

Dear Sir or Madame:

Please consider this letter as a termination of our Agreement to take out $649.18 from my checking account for services provided from Richard A. Brennan, AKA Frederick Law Group, LLC. Due to a breach of contract and misrepresentation Attorney Brennan will no longer be representing us.

This termination is effective immediately upon receipt of this fax. The next electronic transfer is due on or about 2/20/08 and will be stopped as the bank has been notified.

Thank you,

William N. Haas

On February 20, 2008, we faxed a letter to the Attorney's new office in Frederick, MD, terminating his POA over our creditors and terminating his (lack of) services due to breach of contract. (Exhibit F) To this date, Attorney Brennan' s office has sent us two more blank contracts to fill out to continue the debt settlement with him that we started back in August 2007, even after he was fired. We still can't believe how bold this rip off artist is.

Exhibit F

William and Holly Haas
10 North Curtisville Road
Concord, NH 03301
603-715-1091

February 20, 2008

Attorney Richard A. Brennan
Frederick Law Group, LLC
201-c Broadway Street
Frederick MD 21701

Client #: 145979

RE: Revocation of Limited Power of Attorney,
Termination of your (lack of) services

Attorney Brennan,

You are hereby notified that I am revoking your Limited Power of Attorney on all our debts with our creditors immediately. You have misrepresented yourself to us and the lack of correspondence to us in regards to your case handlers (lack thereof) and to our creditors has threatened our financial situation even worse then it was before. You will no longer be collecting our $649.18 each month to do nothing on our case. You are terminated to represent us to any of our creditors from receipt of the fax of this letter. We have already canceled our Account with Global Client Solutions.

Before we spoke with Credit Counselors of America in July of 2007, and before we received your "contract", we did not have any late payments and our credit score was over 700. When they said we qualified to "settle our high debts", we were not thousands of dollars in fees and late fees and arrearages. Because of your misrepresentation, or non-representation, we feel you have breached your contract and will be hiring an attorney to collect the amount we paid you monthly for your services as stated in our contract with you along with any late fees, added interest and added penalties we have incurred since your scamming took place in August 2007, which are in the thousands of dollars. I will be sending letters of this revocation of POA to all my creditors immediately.

Had I not been contacted by a law firm representing one of my creditors, I would have not known for months that you weren't doing your job and would have never re-checked your credentials. I have researched your ability to help others with the Better Business Bureau, with the Maryland Attorney General, and other complaints filed on line. You have so many complaints against you that there are too numerous to mention. In my opinion, you are a scammer who enjoys lining your pockets with the money of unexpecting people who are so high in debt they turn to you for a last resort. I will be contacting my state's Attorney General and asking if they can bar you from ever representing people from my State again.

Sincerely I am,

William N. Haas

cc: file

On February 25, 2008, we had consulted with an Attorney here in Concord, NH to see if we could undo the damage that this scamming Attorney caused us. We were now so far in default that we thought our only option was bankruptcy. (Exhibit G) It was at this time that we found out that any company doing debt adjustments must be licensed with the State of NH. Neither Consumer Credit Counseling of America nor Richard A. Brennan was licensed in NH. Thereby making our contract with either of them illegal and making the fee Consumer Credit Counseling of America retained also illegal. He told us that we should write letters to the Attorney Generals Offices in NH and MD and the NH Banking Commission, which we did 2 days later. (Exhibit H) There is now an order to "Cease and Desist" here in NH along with paying back Consumer A, which is us. (Exhibit I) The Attorney General's Office in MD has managed to Disbar Richard A. Brennan from ever practicing law in the State of Maryland. (Exhibit J)

This Concord, NH Attorney also told us about a program in town that is a licensed, legitimate non-profit company and is affiliated with the credit card compa-

nies. Anyone who filed for bankruptcy in NH must use this program for 6 months before filing anyway so we joined the program in hopes that we didn't have to file bankruptcy. On March 10, we signed an agreement with Consumer Credit Counseling Service of NH and VT to have them help manage our credit card debt. (Exhibit K) At that time, our credit card debt had increased from $48,648 to $57,236 a difference of $8,588. This was not including the $3,895.08 we paid Attorney Brennan, so now we were $12,483 behind from where we started. Our credit card companies refused to take off the interest charges and fees due to our issue with Richard Brennan and to date we are still working with Consumer Credit Counseling Service of NH and VT to pay off our credit cards balances.

The far reaching affects from what this debt settlement lawyer did to us; is our credit scores have gone from excellent to poor; All credit extended to us now is in the higher interest rate bracket—if at all. Banks who financed our cars and we had in good standing with, won't look at us to finance another if we ever needed too. We can't refinance anything at lower rates, including our mortgage. Auto insurance companies have given us higher quotes due to our credit history.

What we have learned from our experience is; Debt Settlement companies have business names very similar to the "real" ones, so it's hard to tell who is legitimate and who isn't. Debt "management" is much different then debt settlements; these debt settlement companies will tell you the key words that you want to hear, like "reduce debt/payments in half", "first step toward building wealth", "build a bank account with liquid assets you never thought possible", "pay off your debt in 4 years". They are in business to make money, they are not in business to help consumers with financial debt problems, they have no regard for State or local Laws and in our opinion they don't work.

We have read the book by Dave Ramsey, "Total Money Make Over" and have followed his debt free living to the letter. We've learned that in order to get our heads above water and stay above water, we don't spend beyond our means; if we want to buy something, we must save a little each pay period and pay with cash when we have saved enough. We try to put more toward our credit card debt to get them paid off faster but that doesn't always happen each month. Since we started with CCCS of NH, we have not used credit cards even for Christmas or birthdays. When we first started with CCCS of NH we had $57,236 in debt. In 2 years we have paid $31,895 toward our credit cards and now owe approximately $34,037.

If we had started with a legitimate debt management company first, put what we paid Atty. Richard A. Brennan toward our debt, our current debt would be approximately $12,858. This means we would be completely credit card debt free in April 2011. With our current payment plan we will be debt free October 2012.

The CHAIRMAN. Thank you very much. That's a stunning, stunning experience.

Mr. Phil Lehman, Assistant Attorney General in the Office of North Carolina's Attorney General, Consumer Protection Division, Raleigh, North Carolina.

We welcome you.

STATEMENT OF PHILIP A. LEHMAN, ASSISTANT ATTORNEY GENERAL, NORTH CAROLINA DEPARTMENT OF JUSTICE

Mr. LEHMAN. Thank you, Mr. Chairman. I appreciate the opportunity to appear before the Committee.

And, as you said, Mr. Chairman, this is a very important and timely consumer protection issue, and one that is a very high priority for the attorneys general around the country, particularly in these very difficult economic times, when consumers are overwhelmed with debt and looking for ways out that are legitimate and that work.

Before I continue with my remarks, I'd like to follow up on what Mr. Kutz and what Mrs. Haas testified to. And I can tell you, as someone working in an attorney general's office, that the stories they told are not isolated examples. I, along with my colleagues around the country, hear these kind of stories every day. It's a very

serious problem, and what they talked about, again, is not uncommon.

Unfair and deceptive practices in the marketing and delivery of debt settlement services continue to be a major problem for consumers and for law enforcement. Financially distressed consumers are looking for help in managing their debt burdens. Unfortunately, too many of them have fallen prey to unscrupulous debt settlement companies. These companies advertise heavily on television and on the Internet. They make grandiose promises that they can cut consumers' debt burdens in half and leave the consumer completely debt-free in 12 to 36 months.

The reality is far different from the rosy view that's painted in these commercials. In the view of the attorneys general, deceptive conduct in the sale of debt settlement services is widespread. In our view, this is not a case of a reputable and beneficial industry that is marred by a few bad apples.

Last October, 41 State attorneys general joined in comments in support of the Federal Trade Commission's proposed rule on the sale of debt relief services. The comments noted that complaints to AGs' offices had more than doubled since 2007 and that the States had brought more than 128 enforcement actions against debt relief companies. The attorneys general reported that too many consumers have paid substantial fees for debt settlement services that were often not provided.

We identified a number of very specific, serious problem areas that regularly occur in the debt settlement industry. These are, first, as we have just heard, there are widespread deceptive representations in the sale of debt settlement services. In our experience, consumers are regularly misled about the likelihood of getting all their debts settled, the length of time it takes to get any debt settled, and the amount of money it will cost them as fees.

Second, another major problem is the failure of debt settlement companies to inform consumers about the negative consequences of the debt settlement process. Based on what consumers have told us, there are many pitfalls with debt settlement programs. Consumers are directed not to communicate with or make payments to their creditors. When that happens, collection efforts intensify. Debt balances balloon due to default interest rates and late fees. The consumer's credit standing will continue to deteriorate. Collection lawsuits and wage garnishment actions may follow.

And we have heard from the banking industry that they do have, and would like to offer, options to consumers who are overwhelmed with debt, but they can't, because consumers are told not to talk to their creditors and not to make payments.

The third problem, and a very significant one, is the charging of significant advance fees before any real services are delivered and before any results are obtained. By the industry's own admission, the majority of consumers drop out before debt settlements are completed. Since these fees are front-loaded, the debt settler gets paid whether or not it completes any settlements. There is little incentive to perform with this advance-fee model. If the debt settler does not perform and the consumer drops out after 6 months, the debt settler keeps the fees that it has collected, even though the consumer has obtained no benefit.

This is why the attorneys general that supported the FTC comments support a prohibition on the collection of advance fees for debt settlement services. We believe that the elimination of advance fees is the key to cleaning up this industry.

My State, North Carolina, has already taken that step. In 2005, our General Assembly enacted an advance-fee ban for debt settlement services. It has worked well, both for enforcement purposes and to limit debt settlement abuses.

Debt settlement companies can, and do, operate without charging very large advance fees. We've been informed by two major national companies that they can do business in North Carolina and that they can continue to do business by collecting fees only after successful settlement of debts. I know the debt settlement industry strongly opposes any prohibition or serious limitation on advance fees, but it is not, as they claim, a death sentence for the industry.

One other thing I would like to mention is that, despite our North—very strict North Carolina law—a problem that was highlighted by Mrs. Haas is that attorneys are now getting into this field, and we have seen a number of examples where attorneys are used as fronts by debt settlement companies to get around State regulatory laws. In many States, including ours, licensed attorneys are exempt from both the debt settlement laws and, generally, from our unfair and deceptive practices laws.

The CHAIRMAN. Can you further explain that, sir?

Mr. LEHMAN. Yes, I'd be happy to. The debt settlement industry—the services are—I would describe them as very segmented. As Mrs. Haas testified to—she responded to an ad by Consumer Credit Counseling of America. That is not a debt settlement company, it is a lead-generator. And the lead-generators then refer the consumer to somebody. In our case, in North Carolina, since debt settlement with advance fees is illegal, lead-generators may refer the consumer to a law firm, an out-of-state law firm. The law firm is there in name only. When the consumer signs the agreement, it's in the name of a law firm. It's a law firm retainer. So, the consumer thinks they're getting a law firm to represent them, which also would mean representation in the event of a lawsuit. And so, it gives the consumer an added comfort zone that they wouldn't get from a commercial debt settlement company.

The fact of the matter is, the law firm does none of the work. All of the customer service, negotiation, accounting, and management, is handled by an outsourced debt settlement provider. So, the law firm is there in name only, and they then contend they're not subject to State laws. They do not want to respond to subpoenas, because of attorney-client privilege, and so on. But, that is a fairly new problem, and I think it's done as a way to get around State laws.

In our State, we've had two litigated cases against law firms and a settlement in another case where a law firm was involved. So, yes, it is a problem.

Those are my remarks, Mr. Chairman. I'd be happy to answer any questions. And I can speak on behalf of other attorneys general offices, that we greatly appreciate the attention that you and your committee are giving to this very important issue.

Thank you.

[The prepared statement of Mr. Lehman follows:]

PREPARED STATEMENT OF PHILIP A. LEHMAN, ASSISTANT ATTORNEY GENERAL, NORTH CAROLINA DEPARTMENT OF JUSTICE

Chairman Rockefeller, Senator Hutchison, and members of the Committee, my name is Phil Lehman. I am an Assistant Attorney General in the Consumer Protection Division of the North Carolina Department of Justice. I have served in that capacity for 22 years and have specialized in litigation and legislation relating to consumer credit and credit fraud. I appreciate the opportunity to appear before the Committee and to share my experience about consumer protection issues relating to the business of debt settlement.

I. Unfair and Deceptive Practices in the Offering and Performance of Debt Settlement Services are Widespread and are a Major Consumer Protection Problem for State Attorneys General

Consumer abuses in the marketing and delivery of debt settlement services have been a major consumer protection problem for state attorneys general. The problem is particularly acute in the current economic downturn when many consumers are overwhelmed with debt, are delinquent in credit card payments, and are looking for legitimate ways to cope with their debt burden. Unfortunately, too many of these consumers fall prey to unscrupulous debt settlement businesses that make grandiose offers of debt reduction but deliver little relief. In our experience, most consumers are worse off after enrolling in debt settlement programs. Typically, consumers' debt balances increase with added interest, their payments are diverted to the debt settlement company instead of the creditor, and collection efforts, including legal action, are stepped up against the consumer.

Last October, the National Association of Attorneys General (NAAG) submitted comments on behalf of 41 attorneys general to the Federal Trade Commission in support of the FTC's proposed Rule on Debt Relief Services.[1] The attorneys general noted that unfair and deceptive activity in the debt settlement industry was widespread. Citing the fact that consumer complaints had substantially increased and that attorneys general had filed over 128 enforcement actions against debt relief companies, the comments welcomed the comprehensive regulatory initiative proposed by the FTC:

> The States view the eradication of unfair and deceptive practices in the debt relief industry—and the harm caused to consumers and the marketplace by these practices—as a consumer protection priority . . . [The States] submit that the comprehensive bright line approach reflected in the proposed rules would substantially aid law enforcement agencies in addressing the harms that have been caused to consumers by unscrupulous practices in the debt relief industry.

In the comments, the attorneys general described some of the prevailing problematic debt settlement practices based on information obtained from cases and numerous consumer complaints:

1. Deceptive solicitations, including unsubstantiated claims of consumer savings and the length of time required to complete the program. (See sample solicitations attached as Exhibit 1.)

2. Failing to adequately inform consumers that collection efforts, including lawsuits, will continue against them due to the extended nonpayment of consumers' accounts while in the debt settlement program and that the consumer's credit standing will deteriorate. (Sample solicitation: "You'll avoid bankruptcy, put an end to harassing phone calls from creditors, and allow your credit score to dramatically improve.")

3. Failing to adequately inform consumers that before debts are settled, the balances on their credit accounts will increase significantly due to accumulating interest and late charges. (Default rates on credit card accounts can be as high as 30 percent, so a consumer's $10,000 debt could rise to $13,000 after 1 year of nonpayment.)

4. Lack of adequate screening and individual budget analysis to determine whether a debt settlement program is suited for the consumer.

[1] FTC Notice of Proposed Rulemaking to amend the Telemarketing Sales Rule to address the sale of debt relief services, 74 Fed. Reg. 41988 (Aug. 19, 2009). The comments submitted by NAAG are available at *http://www.ftc.gov/os/comments/tsrdebtrelief/543670–00192.pdf*.

5. Deceptive disparagement of consumer credit counseling services and bankruptcy, which are often more effective alternatives for the consumer.

6. The collection of substantial advance fees before any meaningful services are rendered, so that the debt settlement company profits even if the consumer receives no benefits. (Fees typically range from 15 percent to 18 percent of the consumer's debt, and are collected in the earlier months of the program before settlements are concluded.)

7. Advising consumers to cease payments on their credit accounts and to cease communications with their creditors.

8. Failing to provide regular information to consumers about collection of fees, status of debt settlement accounts, and communications with creditors.

The consumer protection problems in the area of debt relief services are not limited to a few bad actors; they are pervasive throughout the industry. The whole premise of debt settlement is based on consumers not paying their debts and not communicating with creditors, *i.e.,* essentially encouraging breach of contract. The theory is that the older and more delinquent the debt, the easier it will be to negotiate. Only after sufficient funds are accumulated in the consumer's settlement account (after deduction of fees), which can take a year or more, the debt settler may initiate some settlement negotiation activity. Consumers are taking a big risk, while interest charges mount and the debt settler's fees are being collected, that they will eventually get relief from all their debts.

During the extended period of time while consumers are making payments to their debt settlement accounts, problems are likely to arise. Creditors have not agreed to any debt relief plan, they are not receiving any payments, and they are blocked from offering debt resolution options directly to their customers. These months of nonpayment and non-communication lead not only to increased debt, but also to increased collection efforts and legal action.

Further, a significant portion of the consumer's initial payments is diverted to the settlement company's fees.[2] If the consumer drops out before the settlement process is concluded, as is usually the case, he or she will lose the fee payments, while facing increased debt account balances.[3] The debt settler therefore profits whether or not it accomplishes anything for its client.

Because of these rampant consumer abuses in the debt relief industry, 41 attorneys general specifically support the FTC's proposal to prohibit debt settlement companies from collecting advance fees. The advance fee ban, while opposed by much (but not all) of the debt relief industry, is the key to preventing fraud and ensuring that debt settlement services will be performed. There is precedent for such an advance fee prohibition, particularly for suspect services that purport to help distressed debtors. The Federal Credit Repair Organizations Act, 15 U.S.C. § 1679b(b), and many similar state laws prohibit credit repair businesses from charging fees until all promised services are fully performed. Similarly, the Telemarketing Sales Rule, 16 C.F.R. § 310.4 (a)(4), prohibits advance fees for loan brokering services, another business activity characterized by deceptive promises and minimal performance. Many states prohibit advance fees for foreclosure relief and mortgage loan modification services because of widespread consumer fraud in the offering and delivery of those services. The FTC is also recommending an advance fee prohibition in its proposed Rule on Mortgage Assistance Relief Services (75 Fed. Reg. 10707, March 9, 2010).

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[2] Attached is a copy of a payment schedule offered to a North Carolina consumer by Heritage Debt Relief in December 2009. It calls for the payment by the consumer of $6,906 in fees to Heritage. The consumer has to make monthly payments of $575 for an unspecified period of time. The consumer's first 5 monthly payments of $575 are allocated entirely for Heritage's fees, followed by half ($287.74) of the next 14 months payments.

[3] A study published by the Colorado Attorney General's Office based on annual reports submitted by debt settlement companies from 2006 through 2008 revealed that only 7.8 percent of consumers who began debt settlement programs in 2006 had completed them by the end of 2008. 53.3 percent of consumers had dropped out of the programs. The Colorado information came from licensed debt settlement providers, not outlaws or "bad apples." See Comments of the Colorado Attorney General on the FTC's proposed debt relief amendments to the Telemarketing Sales Rule, *http://www.ftc.gov/os/comments/tsrdebtrelief/543670–00189.pdf.* In a lawsuit brought against debt settler National Asset Services (NAS), the Florida Attorney General alleged that over a six-year period, only 13.5 percent of Florida residents had completed NAS' debt settlement program. In a similar case brought against NAS, the New York Attorney General alleged that out of 1,981 New Yorkers enrolled in the NAS program, only about 3 percent completed it.

II. North Carolina Law Prohibits Debt Settlement Services If Advance Fees Are Charged

Debt relief services are not a new phenomenon, nor are the consumer abuses associated with such services. Over 40 years ago, at least 13 states, including North Carolina, enacted "debt adjusting" or "debt pooling" statutes not just to regulate, but to prohibit, the then-prevailing model of debt settlement. In fact, North Carolina and the other similar state statutes made debt adjusting a criminal offense. The 1963 preamble to the North Carolina statute, N.C. Gen. Stat. § 14–423, *et seq*., explained the reasons for banning debt adjusting services, reasons which are still very pertinent today:

> . . . these [debt adjusting] practices have grown to such proportions that for the most part they have become a national menace by preying upon unfortunate people and harassed debtors, and those engaged in such practices, except for a few, have engaged in false advertising, have falsely held themselves out as competent and able to solve debt problems regardless of any and all circumstances, have lured ignorant and unsuspecting people into executing contracts heavily loaded in their favor and have charged large fees for alleged services which results in piling debt upon debt.[4]

In 1963, the U.S. Supreme Court upheld the constitutionality of a similar Kansas debt adjusting statute in a case brought by the Kansas Attorney General against a company known as "Credit Advisors." The Court held that the prohibitory statute did not violate due process rights and noted the State's evidence that the business of debt adjusting "lends itself to grave abuses against distressed debtors." *Ferguson* v. *Skrupa*, 372 U.S. 726.

The original definition of debt adjusting in the North Carolina and similar statutes covered debt settlement activities but applied only where the debt adjuster received funds from the consumer to distribute to the consumer's creditors. To get around the statutes, debt settlers in recent years arranged for third party bank accounts to receive the consumer's funds. By this method, the debt settlement company did not hold consumers' money but could still direct the disbursement of funds to pay its fees and to pay creditors if and when settlements were reached.

In 2005, the North Carolina General Assembly, recognizing the abuses perpetrated by the new breed of debt settlers, amended the debt adjusting statute to simply prohibit advance fees for any debt settlement or foreclosure assistance services, whether or not the debt settler directly managed and disbursed consumer funds. The amendments have created a bright line test for compliance and have been effective enforcement tools. The 2005 amendments do not prevent debt settlement companies from operating in North Carolina as long as no fees are charged prior to completion of settlements. The Attorney General's Office is aware of at least two national debt settlement companies currently doing business in North Carolina without charging advance fees.

Licensed North Carolina attorneys are generally exempt from the debt adjusting statute but unfortunately, some attorneys have run their law firms as debt settlement businesses with some of the worst deceptive practices in the industry. Two of the North Carolina Attorney General's litigated enforcement cases have been against out-of-state law firms who defrauded consumers by diverting funds out of client settlement accounts. One continuing area of concern is the practice by some debt settlement companies to use attorneys as fronts to offer their services in states that have restrictive debt settlement laws. A debt settlement company will arrange for an out-of-state law firm to contract with a North Carolina resident. The law firm then assigns all of the accounting and debt negotiation work back to the debt settlement firm. To claim an exemption from the debt adjusting law, the law firm may associate a local North Carolina attorney to represent the client in name only.

III. Consumers Need Effective Debt Management Assistance

There is clearly a need for legitimate, effective debt relief for consumers who cannot pay off their credit card accounts and do not want to file for bankruptcy. However, the current model of debt settlement is not the answer. Most debt-strapped consumers can benefit from financial counseling, budgeting, and debt management services offered by nonprofit consumer credit counseling agencies. These agencies offer debt management plans that allow for the orderly reduction of debt under a payment plan agreed to by both the consumer and the creditor. Fees are nominal and monthly payments are paid promptly to creditors, not held back for 12 months

[4] 1963 N.C. Session Laws, Chap. 394.

or more as with debt settlement. While in the plan, the consumer gets protection from collection contacts.

One of the problems with current debt management programs is that they do not offer significant principal reduction. The logical next step, which would benefit both consumers and the banking industry, would be a combination of a multi-year payment plan followed by forgiveness of principal after successful completion of the payment plan. Principal reduction is now being incorporated into mortgage loan modification programs. Unfortunately, accounting rules relating to debt charge-offs have prevented principal reduction programs from being implemented. A coalition of bankers, consumer groups and credit counseling services have approached the Office of the Comptroller of Currency (OCC) to authorize these programs but the OCC has not been receptive to date.

IV. Conclusion

The debt settlement industry has been characterized by deceptive solicitations, overpromising of results, underperformance of services, and excessive fees. Too often, debt settlement companies have profited off of economically distressed consumers while delivering little relief in return. My colleagues in other attorneys general offices and I appreciate the attention the Committee is giving this important consumer protection problem.

Exhibit 1—Sample Debt Settlement Solicitations

NCRA
NORTH CAROLINA RELIEF ACT

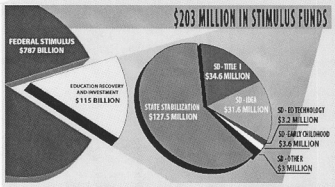
Are You Eligible?

Please use the Credit Relief Act Tool provided below, to see if you are among the Thousands of North Carolina Residents who qualifies for the Credit Relief Program! Debt Reductions vary based on Criteria and current Hardship Status...

HOME | INFORMATION | ELIGIBILITY | MEDIA | RESOURCES | FAQS | PROGRAM

INSTRUCTIONS

- Fill out the Form to the Right and answer the Three Questions, and find out if your Eligible for the State of North Carolina Credit Relief Program granting credit relief to North Carolina Residents.
- If you meet the eligibility requirements you will receive a security pin number with directions on how to access your Credit Relief Informational Package, please write down your Secure PIN Number for future reference.
- If your criteria does not match the necessary requirements you will be prompted to an explanation page for details of ineligibility.



- *Must be a Current North Carolina Resident
- *Must be over the Age of 18
- *Must be suffering from a Financial Hardship

Input Information Below...

What is your approximate Unsecured Debt amount? Please Select

How many dependents did you claim on your 2008 NorthCarolina State Tax Return? Please Select

Are You Experiencing Financial Hardship? ○ Yes ○ No

**By clicking below, you certify the above criteria is met and you have answered the questions truthfully and accurately.

Find out if you are eligible ▶

HOME | INFORMATION ELIGIBILITY MEDIA RESOURCES FAQS PROGRAM | PRIVACY POLICY | **800.965.3620**

www.ssa.gov | www.ftc.gov | www.USA.gov | www.FinancialStability.gov

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Revolving Credit - Payment Reduction			CODE US1
a. ID Number [redacted]	b. Debt Reduction Hotline 1-800-481-5922	Account Type: REVOLVING - CONSUMER	
c. NOMIC STIMULUS ACT 213 EXECUTIVE PARK ASHEVILLE, NC 28801		Notice Type: 009-S	Subject: NOTIFICATION
d. Addressee's Personal ID Number ST110888	State SC	RE: HR5140 Economic Stimulus Act of 2008	
e. Number, address, and Zip code [redacted]		BUY OUT PROGRAM	Issuer: PROGRAM DIRECTOR
		ESTIMATED TOTAL DEBT* $25,000	

Form **009-S** Payment Reduction Notification

2009

FORM 009
BALANCE REDUCTION NOTIFICATION
PLEASE READ ENTIRE DOCUMENT CAREFULLY

Dear [redacted]

Your Revolving Consumer Debt and Credit Card Payments are eligible for debt settlment programs created in response to the Governmental Economic Stimulus Act of 2008.

These new programs enable the Debt Service Center to reduce your existing consumer debt of **$25,000** a' ' receive a significantly reduced monthly payment, without the traditional restrictions on credit, i ne, or employment status.

If you have experienced financial hardship, have late payments, or would like to significantly reduce your monthly payments, call **1-800-481-5922.** When calling please reference **file number ST110888.**

YOU MAY BE ELIGIBLE FOR DEBT RELIEF UP TO **$12,500**

HR5140 Economic Stimulus Act of 2008 was designed to provide economic stimulus through recovery rebates to individuals, incentive for business investment, and increase in conforming and loan limits. This Act became Public Law No: 110-185 on February 13, 2008. HR 5140 information is available to anyone at: www.govtrack.us/congress/bill.xpd?bill=h110-5140.

Call U.S. Debt Relief:

1-800-481-5922

(press option 1)

Monday-Friday 9:00-9:00 EST. Saturday 11:00-4:00 EST.

This product or service has not been approved or endorsed by any government agency and this offer is not being made by an agency of the government. This is not a promise to lend. Rates and terms are subject to change. *Existing consumer debt and settlement amounts are estimated and may vary based on individual situations.

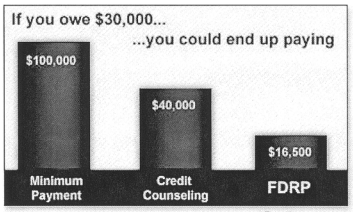
Federal Debt Relief Program

Federal Debt Relief Program has arrived. We offer the fastest and least expensive way to eliminate debt. Federal Debt Relief Program is an effective alternative to bankruptcy. If your credit cards, medical bills or personal loans have become overwhelming, we can reduce your debt so you can pay it off fast and be back on the road to financial freedom. Get a free savings quote today!

With Federal Debt Relief Program, you can be debt free in 24 – 48 months, plus:

- Reduce your debt by up to 50%
- Get one low monthly payment
- Eliminate harassing phone calls
- Avoid bankruptcy

Millions of American individuals and families today are drowning in debt. It doesn't have to be this way. Debt relief is available right here, right now. It's yours for the asking. Federal Debt Relief Program can negotiate on your behalf with your creditors to obtain the highest amount of debt elimination possible for you. Federal Debt Relief Program can help you regain your financial freedom and make personal debt a thing of the past. Get a free savings quote today!



* Results may vary

* First Name: * Last Name:

* Primary Phone: Secondary Phone:

This must be a valid, working phone number!

* Email Address: * Select your State: Please Select

* Amount of Debt: $30,000 - $39,999

Questions/Comments:

START GETTING OUT OF DEBT!

Help With Medical Bills • Credit Card Debt Elimination Service • Debt Relief Grant • Tax Debt Relief
Credit Card Debt Relief Counseling • Credit Card Debt Relief Program • Federal Debt Relief Program

LEGAL

Federal Debt Relief Program is not a government program or government related program. Estimates based on prior results and cannot be guaranteed; individual results will vary based on circumstances. Settlement percentages exclude program fees. We do not guarantee that your debts will be reduced by a specific amount or percentage or that you will be debt-free within a specific period of time. We do not make monthly payments to creditors, assume consumer debt, provide tax, bankruptcy, accounting or legal advice or credit repair services.

Exhibit 2—Sample Debt Settlement Fee Schedule

HERITAGE | DEBT RELIEF

Terms of Agreement

13. SERVICE FEES. Heritage Debt Relief charges a flat 10% service fee for all services provided.			
TOTAL SERVICE FEE:	$6,906.00	PAYMENT SCHEDULE:	
Payment Schedule: 1st payment	$575.50	Due on:	1/28/2010
Payment Schedule: 2nd payment	$575.50	Due on:	2/28/2010
Payment Schedule: 3rd payment	$575.50	Due on:	3/28/2010
Payment Schedule: 4th payment(if applicable)	$575.50	Due on:	4/28/2010
Payment Schedule: 5th payment(if applicable)	$575.50	Due on:	5/28/2010
Payment Schedule: Remaining Service Fee	14 Payments of $287.74	Beginning on:	6/28/2010

"HDR earns its fees as follows: 1/3 of the total fee is earned when HDR performs budget review, debt analysis and file setup. The second 1/3 of the total service fee is earned when HDR has prepared initial correspondence to the contracted creditors. The final 1/3 of the total fee is earned when HDR has received notification from CLIENT to begin settlement of the contracted accounts."

14. **Discharge or Withdrawal**. Either party may discharge the other by written notice when received by the discharged party. CLIENT will be obligated to pay COMPANY that portion of the service fees earned by COMPANY according to the attached payment schedule.

This written AGREEMENT constitutes the full and complete agreement between CLIENT and COMPANY and supersedes any and all other agreements or understandings whether written or oral. CLIENT verifies by signing below that CLIENT has read and understands the AGREEMENT and has been provided a copy for personal records.

CLIENT WILL BE OBLIGATED TO PAY COMPANY THAT PORTION OF TOTAL FEES ALREADY EARNED IN ACCORDANCE WITH PARAGRAPH 13 OF THIS AGREEMENT.

NOTICE

YOU THE BUYER MAY CANCEL THIS AGREEMENT AT ANY TIME BEFORE MIDNIGHT OF THE THIRD DAY AFTER THE DATE OF THE TRANSACTION. SEE ATTACHED NOTICE OF CANCELLATION FOR AN EXPLANATION OF THIS RIGHT.

THIS WRITTEN AGREEMENT constitutes the full and complete AGREEMENT between CLIENT and Heritage Debt Relief. This written AGREEMENT supersedes any and all other agreements or understands, whether written or oral for the matter described in Paragraph 2.

I VERIFY THAT I HAVE READ AND UNDERSTAND THE ABOVE AGREEMENT AND THE ABOVE NOTICE. I ALSO VERIFY THAT I HAVE BEEN PROVIDED WITH A COPY FOR MY PERSONAL RECORDS.

PRINT NAME	SIGN	DATE
[redacted]	X	
PRINT COSIGNER NAME (If applicable)	SIGN	DATE
	X	

The CHAIRMAN. Am I not correct in saying there are some 86 to 96 of the States' attorneys general that are active in this?

Mr. LEHMAN. Just from my experience, yes, most—the large majority of attorneys general are. And, as I said, 41 attorneys general signed very detailed comments in support of the FTC rule. And in those comments, which I would commend to the Committee, there are many examples of the kind that we've heard from today, and also examples of enforcement actions taken by attorneys general. But, that's—41 out of 50, that's 82 percent, yes.

The CHAIRMAN. Yes, that's what I meant to say.

Thank you very, very much.

Mr. John Ansbach, who is Legislative Director of the United States Organization for Bankruptcy Alternatives, USOBA, and General Counsel and Chief Compliance Officer for EFA Processing, from Houston, Texas.

STATEMENT OF JOHN ANSBACH, LEGISLATIVE DIRECTOR, UNITED STATES ORGANIZATIONS OF BANKRUPTCY ALTERNATIVES

Mr. ANSBACH. Thank you, Mr. Chairman.

Quick correction. I'm not the Chief Compliance Officer, I am the Chief Operating Officer of that company. I'm happy to correct that in the record.

Mr. Chairman, distinguished members, thank you so much for the opportunity to contribute to this very important meeting and this very important discussion.

My name is John Ansbach. I am the Legislative Director for USOBA. We are a trade group based in Houston, Texas. We represent approximately 200 companies that operate in the debt settlement industry. In addition to supporting those companies with best practices, we also serve as a resource to consumers who are looking for information about the debt relief process, generally, and how to select an honest and ethical provider in this industry.

I am also employed, as you pointed out, Mr. Chairman, by a company that actually performs debt settlement work. In my role, I directly oversee approximately 100 employees, Texans, who talk to consumers every day and who work to help these folks to find a way out of debt without ending up in personal bankruptcy.

There has been a lot of discussion today about personal experiences. The Chairman—sir, you've had some stories, and obviously, we've heard Mrs. Haas' story. If I may, I'd like to begin my remarks with a consumer story, as well.

A wonderful woman, by the name of Ms. Faith Zabriske, suffered an injury a few years ago. After utilizing her credit cards to pay her medical and her living expenses, she fell behind on those payments. At that point, she did exactly what the Better Business Bureau and others tell her and so many to do, which is to simply call your bank; they'll work with you. What she found instead, and what she was told candidly—the woman from the bank said, "I'm not supposed to tell you this, but until you fall behind on your payments for 6 months, we can't help you," essentially telling her to stop paying her debts or there would be nothing that the bank could do for her.

She tried credit counseling. They were similarly unhelpful. And she found her way to a debt settlement company in Dallas, Texas. After working her debt settlement program and saving the money and working with the counselor, I am very pleased to report that Ms. Zabriske is today debt-free. She is on her very last payments with her last creditor, and is well on her way to financial stability.

Mr. Chairman, Ms. Zabriske, as well as another gentleman named Mr. Gary Ross, another consumer that had a very successful debt settlement experience, are both here today. They are, in fact—that's Mr. Ross and Ms. Zabriske, who have held up their hands—they've come today from Texas and Illinois. I understand

it is not possible for them to tell their story to the Committee, or here in testimony, but I want the Chairman to know, and the members, that if there is any interest in visiting with folks who have, in fact, had a good experience, if there is something instructive in that, then they would be, both, very happy to appear and talk about what their experience was.

The CHAIRMAN. You must have come up with them at the last moment, because we asked you—the Committee asked you if you wanted to have anybody testify, and you declined to have anybody testify except yourself.

Mr. ANSBACH. I understand, Mr. Chairman. I don't think that's actually accurate. I do understand that the Committee staff visited with staff from both USOBA and our sister trade group. I understand that Mr. Ross, in particular—his name and contact information were provided. Of course, we only found out about this hearing 7 days ago. But, in any event, I assume that their ability to talk and, certainly, to share perhaps what makes a good debt settlement versus a bad experience, such as Mrs. Haas had—perhaps there is some instruction in that. And again, they're here, if anybody would like to visit with them.

It is certainly the case, Mr. Chairman, that—and I want to be very clear about this—despite the fact that Ms. Zabriske or Mr. Ross had a good experience—and, certainly, we are aware of hundreds and thousands of others who have had a good experience in debt settlement, both——

The CHAIRMAN. Would you say that again? You're aware of hundreds of thousands of people that have had——

Mr. ANSBACH. Hundreds and thousands. Yes, sir.

The CHAIRMAN. What is hundreds and thousands?

Mr. ANSBACH. Well, in particular, the Federal Trade Commission, when it held its hearing—a public forum and open public comment, there were 200 comments that were submitted by consumers directly who had, unlike me, been through a debt settlement program. And they ran 40-to-1 in support of, and in favor of, at least preserving the options of debt settlement. In addition to those, my company alone, and many of those that are represented here today, also have literally piles and piles of written testimonials that we would be very happy to share.

We don't think, by any means, that that means there is no problem in the industry. In fact, I would very much agree with what's been said by Mr. Lehman and Mr. Kutz, and having heard Mrs. Haas' experience, it's very clear to us that we have significant challenges in our industry. And, candidly, it's the reason that folks, like myself, my counterpart at TASC, and a number of us, spend so much of our time going to different states, working on debt settlement-specific legislation.

Along these lines, I wanted to share a couple of examples of what we think is a very important and needed regulatory approach. I know Senator Boxer is not with us today, but in California specifically, we have been working now for 3 years on Assembly Bill 350, which not only has fee regulation in it, which I think we all agree is critical, but it is a comprehensive piece of legislation that has insurance and surety and licensing and bonding requirements, as well as some of the things that the Federal Trade Commission have

proposed, which we fully support. AB 350 has passed the House. It is pending in the Senate. We are hopeful, although, obviously, they have budget difficulties in the State, and I'm not sure where that will go, but we're hopeful it will move.

I think an even better model is the Tennessee model. Tennessee passed a piece of legislation that is very specific on fees. And I want to be very clear on——

The CHAIRMAN. Mr. Ansbach, this is fascinating testimony, and you're speaking to your own advantage by not speaking to the nature of the hearing. You're talking about what states are doing to try and get rid of the kinds of problems that your association causes. You're leading us to believe that what you do is absolutely wonderful and that all of these other experiences are just anomalies.

It is our impression that it is quite exactly the opposite of that and that you're fundamentally making happy talk in front of a very serious problem. And I don't appreciate that.

Now, if you have testimony which reflects upon, not what States are doing, but how you see this problem, which is being represented here and which will be further represented by the person next to you—the lady next to you—that's what I want to hear. That's what you're here for. You're not here to talk about what various States are doing.

Mr. ANSBACH. Mr. Chairman, I do apologize if in any way I've insulted this body. Because we were discussing fee regulation, I thought it would be instructive to know what has been worked on for the last 5 years. It was only in that respect that I wanted to offer what Tennessee has done.

The CHAIRMAN. OK, well, you've done that now, so let's get back to the subject.

Mr. ANSBACH. What I want to be very clear about, Mr. Chairman, is—and I, again, apologize—this is not a rosy picture. I have 160 people that I employ, that do this work every single day. We work very hard to help folks. Now, that does not mean that we are 100-percent successful and that, in any way, Mrs. Haas or any of the other stories have been anomalies. I don't think that's true at all. I think there are some significant issues in the industry, and we need to address them.

With that said, the Federal Trade Commission has proposed a number of things in the Notice of Proposed Rulemaking. Eighty percent of it is incredibly important. We need more disclosure requirements. We need more prohibited misrepresentation rules. We need fair advertising rules. The one portion of the rule that we are unable to support, as Mr. Lehman has pointed out, is the advance-fee ban.

The CHAIRMAN. Yes, which is—of course, is the only thing that makes you money.

Mr. ANSBACH. Respectfully, I would——

The CHAIRMAN. I apologize, Senator McCaskill; I seem to be asking questions, and I shouldn't be doing that. But, I can't quite help myself.

Senator MCCASKILL. You'll get a chance, Mr. Chairman.

The CHAIRMAN. Oh, I know that. I'm just taking any chance I can get.

[Laughter.]

Senator MCCASKILL. I just thought maybe you, you know, hadn't been around here long enough, and I could——

The CHAIRMAN. Yes, right. Right.

[Laughter.]

The CHAIRMAN. Please proceed.

Mr. ANSBACH. Yes, sir.

The CHAIRMAN. But, you don't disagree with my statement, that the one thing that you don't agree with is the one thing which puts money in your pocket.

Mr. ANSBACH. I do, respectfully, disagree. Yes, sir.

The CHAIRMAN. And how would you disagree with—no, I'll ask that question later. Proceed with your testimony.

Mr. ANSBACH. Yes, sir.

The advance-fee ban that's proposed essentially says that a small business owner that does this work must operate without revenue for up to a year. That is the absolute—I mean, that's what it does. And because it—the reason it's a year is because consumers must have time to create a savings. In that year, up to that time period, folks that I employ, and others, must be able to stay on the phones, to talk with them, to empower them with information about this process. The reality is, I cannot afford to pay my employees for a year without any revenue at all. That is the reason that we characterize this as the death of the industry. That is the reason, I suspect, that 85 percent of our members have indicated, in response to surveys, that they will go out of business if an advance-fee ban, in particular, is passed.

All—to be very clear, all of the rest of the rule is incredibly necessary and needed. There are, absolutely, issues in this industry that must be addressed, but an advance-fee ban, actually, as Mr. Lehman has already pointed out, has a very obvious consequence. Most, if not all, of our members don't do business in North Carolina anymore, because they can't afford to. I don't see that as a successful outcome, because what has then happened, consumers no longer have any other option. They have bankruptcy, they have credit counseling, and nothing in the middle.

I do not believe, with all due respect, that that is the consumer-protective outcome that we are trying to get to with this regulation.

Mr. Chairman, I—you've been very gracious with your time. If I may just share a few very last things. And I will promise to answer any questions that you may have.

Under the very fee structure that is being proposed to be outlawed, our members, as well as our sister trade group's members, have resolved almost $3 billion in unsecured debt for consumers. Clearly, there are positive results that are happening in this industry. We would simply ask that we be given the opportunity to stay at the table. And again, we're incredibly grateful that we were invited today. We simply want to continue to participate in this process. We want to help find appropriate and strong consumer protection regulation, whether it is here in Washington, D.C., or in the states.

And in that regard, I'm happy to answer any questions that you might have.

[The prepared statement of Mr. Ansbach follows:]

PREPARED STATEMENT OF JOHN ANSBACH, LEGISLATIVE DIRECTOR, UNITED STATES ORGANIZATIONS OF BANKRUPTCY ALTERNATIVES

Chairman Rockefeller, Ranking Member Hutchison, distinguished members of the Committee, thank you so much for the opportunity to be here today and to contribute to what I hope is a helpful and informative hearing for you on the topic of debt settlement.

My name is John Ansbach, and I volunteer in service as the Legislative Director of the Unites States Organizations for Bankruptcy Alternatives or "USOBA." USOBA is a trade association in Houston Texas whose members are ~ 200 companies that offer debt relief services to financially strapped consumers who are trying to avoid bankruptcy. In addition to supporting these member companies, USOBA also serves as a resource to consumers who are trying to find out information about the debt resolution process and what to look for in an honest, ethical provider. It is in my capacity as the Legislative Director of USOBA that I appear before you today.

I want you to know, as well, so that I can shed light on other areas of interest to the Committee, that I am also the Chief Operating Officer and Genera Counsel of what we in the industry refer to as a "back-end" company. As such, our company works for other companies servicing their clients. In this role, I directly oversee more than 100 Texas employees in the City of Frisco just north of Dallas who talk to debt settlement consumers every day, supporting them, negotiating for them, giving them information about the unsecured debt process and otherwise helping them to meet their savings goals and succeed in their programs.

The title of today's hearing is "The Debt Settlement Industry—The Consumer's Experience." In this regard, I want to offer as much information as I can to help this committee better understand debt settlement and what it can and has done to help consumers.

In this regard, please let me begin today with a real life example of debt settlement. It is the story of Faith Zabriske, a wonderful woman in my home state of Texas who has lived the nightmare of being overwhelmed by debt, and who utilized the services of a debt settlement company to not only survive that nightmare, but to emerge from it stronger and financially stable.

Ms. Zabriske suffered an injury a few years ago and like many Americans was forced to turn to her credit cards to pay medical bills and other living expenses to survive.

Although she recovered from her injuries, she was soon overwhelmed by the debt created by her ordeal. At that point she did exactly what the Better Business Bureau and consumer advocates tell consumers to do who are in such situations: she called her credit card company to find out if they would work with her on repayment of the debt. At the time, Ms. Zabriske had a credit score in the high 700s and had always paid her debts timely.

Unfortunately, what Ms. Zabriske found from her creditor was not help, but rather a refusal to work with her. She was told that until she was 6 months delinquent, the bank wouldn't work with her. She tried credit counseling, as well, but they were similarly unhelpful.

It wasn't until she enrolled in a debt settlement program that she found true support. After working her program, saving money as needed, her provider was able to help Ms. Zabriske settle all of her debts and today she is debt free, on the path to financial stability.

Ms. Zabriske is here today, having traveled all the way from Texas to tell her story. USOBA offered to have her appear today to tell this story herself, but she was not extended an invitation.

Mr. Gary Ross from Illinois, another consumer who had a successful experience with debt settlement is also here and prepared to tell his story. HE was also offered, but like Ms. Zabriske was not extended an opportunity to tell his story.

If any member of this committee or anyone else would like to visit with either of these good folks to hear their story and their experience, they welcome the opportunity to visit after this hearing.

Ladies and gentlemen of this committee, Ms. Zabriske and Mr. Ross represent just two of hundreds of stories of consumers who have had successful outcomes in debt settlement programs. In fact, in the Federal Trade Commission's own public comment period, of the 200 consumer testimonials the Commission received, we understand those testimonials ran 40:1 in favor and in support of preserving debt settlement as an important option for consumers in need.

And in fact, that is truly what we are here to talk about: preserving options. The truth is that USOBA, as well as our sister trade group the Association of Settlement Companies ("TASC"), supports strong consumer protection regulation in the debt

settlement industry, including the overwhelming majority of what has been proposed by the FTC in its August Notice of Public Rulemaking. Stronger consumer disclosure requirements are needed and should be adopted. Rules proscribing certain misrepresentations in advertising are needed and should be adopted. In fact, USOBA and TASC have been arguing and working in support of these actions as well as others for more than 5 years now in roughly 20 states, including but not limited to licensing and registration requirements; bonding and insurance requirements; strong advertising rules; reasonable fee regulation including limits on amount and timing of fee collection; contract requirements that set out specific language that must be included for the benefit of consumers; requiring education for consumers; even requiring multiple language efforts where debtors in need don't speak English as a first language to ensure an understanding of the program. These efforts are ongoing even as we sit here today in California, Texas, Florida, Pennsylvania, New York, Illinois, Connecticut and Maryland. Nevada, Tennessee, Minnesota, Oregon, Utah, Montana, Delaware, Rhode Island and Colorado have already adopted debt settlement statutes with input from both consumer groups and industry trade organizations.

In short, the industry has supported and continues to work for strong consumer protection regulation of this industry; regulation that manages to enact such protection while preserving the ability of honest, ethical companies to provide consumers with the services and options they need.

What we cannot support, however, and what we understand the FTC is attempting to implement via the Telemarketing Sales Rule, is fee regulation that would kill the industry. The FTC's proposed "advance fee ban" would put 85 percent of our members—most of whom are small business owners—out of business. They would accomplish this by essentially starving these businesses of revenue, disallowing the collection of any fees for services rendered unless and until there was a settlement of a debt, a process that often takes up to a year or more. In short, the FTC proposes to require American businesses owners to work for free for up to a year—paying their own employees to talk to and help consumers; paying their rent; addressing expenses related to information technology and required infrastructures—all the while being unable to collect fees from the very consumers they are trying to help.

The truly troubling part of this effort is that there exists another more reasonable alternative, which the states themselves have adopted and which would be preempted by this effort. More specifically, the states of Colorado, Utah, Montana, Nevada, Delaware and Tennessee have adopted a capped and limited pay as you go fee structure that both limits the amount of money a consumer may be charged and when the fees may be collected.

Tennessee in particular has a very workable system that balances good consumer protection and the rights of honest ethical providers to be compensated for their services. Under the Tennessee law, a provider may charge in one of two ways: a savings model that allows for fee recovery based on what the provider saves the consumer; and, a "pay as you go" fee system, under which no more than 17 percent of a consumer's enrolled debt may be charged. Further, fees cannot be collected any sooner than in equal payments spread out over half the life of a consumer's program. In a typical case where $10,000 in debt is enrolled then, a consumer may not be charged more than $1,700. This fee must then be collected over half the life of a program. Where programs typically last thirty-six months, half the life would be eighteen months, thus fees of $1,700 over eighteen months or $94 per month. The result is a good, middle of the road approach than ensures a consumer does not face high up front fees, while preserving a modicum of revenue for his or her provider, allowing the business to pay its employees and rent.

Distinguished members, the allegations that are often made by the consumer groups in particular, and which you may hear today, resonate around one critical point: that debt settlement services are "rarely if ever provided to consumers" as promised. Well ladies and gentlemen, please allow me to report the following facts that we believe refute such assertions:

- USOBA members alone have settled more than *$1.4 billion in unsecured debt* over the last few years.
- This debt was settled for consumers who experienced an *average reduction of 53 percent*; that is, they settled their debt for 47 cents on the dollar.
- Our members alone are right now servicing *more than 277,000 consumers*, consumers who will be stranded and left to bankruptcy if the FTC's rule is passed as drafted and these providers go out of business.
- When you add TASC's members into this mix, you find that roughly *$3 billion of unsecured debt* has been settled for America consumers.

If I may, let me also add for you the very most recent numbers from my company, just one USOBA member company that services other providers working for consumers:

Last month alone, in March 2010, we:

- Settled 1,491 individual accounts with a value at enrollment of $9.14 million.
- Those accounts were settled for $3.9 million, or $0.36 on the dollar, a savings of 64 percent to the consumers.

Over the last 3 months (Jan–March), we:

- Settled 3800 accounts (3,793) with a total value at enrollment of $22.9 million.
- Those accounts were settled at an average of $0.36 on the dollar, again saving those consumers 64 percent on their outstanding debts.

To date, my company has settled more than 39,000 accounts with a value of $214.5 million at approximately $0.40 on the dollar—a 60 percent savings to American consumers. We are currently working on settling $1.17 billion in debt for our consumers, again most if not all of whom will be stranded and abandoned to bankruptcy if we are forced out of business by the FTC's proposed fee ban.

On this last note, I do want you to know the impact of the FTC's proposed fee regulation on employees. In my home state of Texas, alone, we estimate more than 1,100 Texans will lose their jobs if this rule is adopted. These are hard working folks employed by USOBA member companies, only. If we add the TASC companies, we estimate this number is closer to 2,500–3,000 jobs lost just in Texas. While we do not have numbers in every state, we do know that hundreds if not thousands of more jobs will be lost from this rule, specifically in California and Florida, where debt settlement is a much needed service due to economic conditions and the still lingering effects of the housing bubble. In short, it is likely if not certain that as many as 10,000 Americans will lose their jobs if the FTC rejects the approach adopted by the states and proceeds instead with the radical fee ban they propose.

Senators, we know you—like USOBA and TASC—want to protect consumers. And we know you—like USOBA and TASC—want to ensure that honest, ethical debt settlement companies can continue to help those consumers, keeping employed the thousands of hard working folks who dedicate their days to helping people get out of debt responsibly and ethically. In that, please allow us to work with you and the Commission on a reasonable approach that includes reasonable fee regulation, as well as the many other consumer protections we and so many others support.

On behalf of the 160 people in my company in Frisco, Texas, the thousands of others employed by our members companies, the more than a quarter million consumers they serve right now across the country, as well as the folks employed by TASC and the consumers they serve, I thank you so much for the opportunity to contribute to this discussion and I look forward to trying to answer any questions you may have.

The CHAIRMAN. Thank you.

And finally, the Honorable Julie Brill, Commissioner of the Federal Trade Commission.

STATEMENT OF HON. JULIE BRILL, COMMISSIONER, FEDERAL TRADE COMMISSION

Ms. BRILL. Thank you very much.

The CHAIRMAN. We're trying to save your life, incidentally.

Ms. BRILL. Oh, really?

The CHAIRMAN. Of the FTC. There are those who are——

Ms. BRILL. Oh, yes.

The CHAIRMAN.—who are malevolently proceeding to try and remove your powers. That will not happen.

Ms. BRILL. And we certainly appreciate all your efforts in that regard, Mr. Chairman. Thank you very much.

Chairman Rockefeller, members of the Committee, I am Julie Brill, a Commissioner of the Federal Trade Commission.

Thank you for inviting me to testify about a critical issue for consumers during these difficult economic times: problematic practices in the debt relief industry.

I'm honored to be here today in my brand new role as an FTC Commissioner. As you know, I've spent almost my entire career working to protect consumers from unscrupulous business practices. I'd like to thank the Committee for giving me the opportunity to bring my consumer protection skills and experience to the FTC.

American consumers are overwhelmed with mortgage and credit card debt. At least 13 million Americans owe $10,000 or more in credit card debt. Of those households that are carrying credit card debt, the average amount of the debt load is approximately $16,000. And over 14 million American households are 30 or more days delinquent in their credit card bills. Many of these consumers have lost their jobs or have seen their working hours cut back, making their debt load all the more worrisome.

Such financially distressed consumers are vulnerable to schemes that promise miraculous solutions to their debt problems. As I stated in my confirmation hearing, these consumers have a target on their back.

You've heard compelling testimony this afternoon from the GAO regarding the deceptive and unfair marketing of debt settlement services. While there are some consumers, like Ms. Zabriske and Mr. Ross, who have benefited from the services offered by debt settlement companies, the GAO's disturbing findings are consistent with what the FTC has encountered in many of our own investigations. Debt settlement firms frequently convince consumers to pay large fees by falsely promising to obtain deep reductions in the consumers' debt.

You've probably heard the advertisements on the radio or late-night TV: "In debt? Can't pay your bills? Debt collectors calling you at all hours? Call us now. We will negotiate with your creditors so that you can become debt-free." Through advertisements like these and follow-up aggressive telemarketing pitches, debt settlement companies often make dramatic savings promises that they cannot keep.

They also sometimes make misleading statements about the fees that the consumers must pay for their services. Consumers may end up shelling out large sums of money up front, hundreds or even thousands of dollars, with nothing in return but empty promises.

Now, keep in mind, the financially strapped consumers who respond to these sales pitches are having trouble paying creditors before piling on the fees of a debt settlement company. Many consumers, like Mr. Spaulding in West Virginia and Mr. and Mrs. Haas, who are here today, simply can't keep up with paying the new fees and covering their existing debt, and are forced to drop out of these programs, often forfeiting all the money they've paid in fees, leaving them worse off than when they started.

The Commission has been actively pursuing those debt relief service providers and other fraudsters who prey on Americans hardest hit by the financial crisis. In an effort to improve law enforcement and set clear standards for the debt relief industry, the Commission published a proposed rule last August. The proposal

would amend the telemarketing sales rule to cover debt relief providers that promote and sell their services over the telephone.

It would be premature to speculate about whether the Commission will issue a final rule, and, if so, what the rule might contain. But, I can assure you that the proceeding has been thorough, thoughtful, transparent, and fair. The Commission received written comments from over 300 individuals, corporations, and organizations. The Commission also hosted a public forum to discuss the proposed amendments, with stakeholders representing a wide variety of viewpoints. And the Commission staff has had extensive discussions with industry representatives, consumer advocates, and other interested parties.

Thank you, again, for the opportunity to describe how the FTC is protecting financially strapped consumers from those debt relief services that engage in deceptive and abusive practices.

I'd be happy to answer any questions.

[The prepared statement of Ms. Brill follows:]

PREPARED STATEMENT OF HON. JULIE BRILL, COMMISSIONER, FEDERAL TRADE COMMISSION

I. Introduction

Chairman Rockefeller, Ranking Member Hutchison, and members of the Committee, I am Julie Brill, a Commissioner of the Federal Trade Commission ("FTC" or "Commission").[1] I appreciate the opportunity to appear before you today, and the Commission thanks this Committee for its interest in the work of the FTC to protect consumers from deception and abuse in the sale of debt relief services.

The Commission has long been active in protecting consumers of financial products and services offered by entities within the agency's jurisdiction. With Americans continuing to feel the effects of the recent economic downturn, the Commission has stepped up its efforts to stop fraudulent financial schemes that exploit consumers who are particularly vulnerable as a result of financial distress. Stopping deceptive debt relief practices is one of our highest consumer protection priorities. Providers of debt relief services purport to help people who cannot pay their debts by negotiating on their behalf with creditors. Debt settlement companies, for example, market their ability to dramatically reduce consumers' debts, often by making claims to reduce debt by specific and substantial amounts, such as "save 40 to 60 percent off your credit card debt." To be sure, some debt relief services do help consumers reduce their debt loads. In too many instances, however, consumers pay hundreds or thousands of dollars for these services but get nothing in return.

The FTC utilizes its four principal tools to protect consumers of debt relief services: law enforcement, rulemaking, consumer education efforts, and research and policy development. To halt deceptive and abusive practices and return money to victimized consumers, the Commission has brought 20 lawsuits in the last 7 years against sham nonprofit credit counseling firms, debt settlement services, and debt negotiators, including 6 in the past year alone.[2] These cases have helped over 475,000 consumers who have been harmed by deceptive and abusive practices.[3] The Commission continues to actively investigate debt relief companies and will continue aggressive enforcement in this arena. As the Commission's law enforcement experience has shown, victims of these schemes often end up more in debt than when they

[1] The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions you may have are my own, however, and do not necessarily reflect the views of the Commission or any other Commissioner.

[2] A list of the Commission's law enforcement actions against debt relief companies is attached as Appendix A.

[3] In addition to consumers who lost money from fraudulent debt relief companies, hundreds of thousands, if not millions, of consumers have been harassed by automated robocalls pitching services in violation of the Do Not Call provisions of the Telemarketing Sales Rule. The Commission has charged companies engaging in these robocalls with violations of the rule. *See, e.g.,* FTC v. *Economic Relief Techs., LLC*, No. 09–CV–3347 (N.D. Ga., preliminary injunction issued Dec. 17, 2009); *FTC* v. *2145183 Ontario, Inc.*, No. 09–CV–7423 (N.D. Ill., preliminary injunction issued Dec. 17, 2009); *FTC* v. *JPM Accelerated Servs. Inc.*, No. 09–CV–2021 (M.D. Fla., preliminary injunction issued Dec. 31, 2009).

began. Especially in these difficult economic times, when so many consumers are struggling to keep their heads above water, this is unacceptable.

Below, this testimony provides an overview of the three common types of debt relief services, as well as the Commission's law enforcement efforts with respect to each. The testimony then describes the Commission's proposal to amend its Telemarketing Sales Rule ("TSR")[4] to strengthen the agency's ability to stop deception and abuse in the provision of debt relief services. Finally, the testimony addresses the FTC's ongoing efforts to educate consumers about debt relief options and how to avoid scams.[5]

II. The Commission's Authority

The Commission enforces Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices in or affecting commerce,[6] as well as the Telemarketing and Consumer Fraud and Abuse Prevention Act ("Telemarketing Act"),[7] and the associated TSR that prohibit certain deceptive and abusive telemarketing practices.[8] The Commission has used this authority to challenge debt relief providers within its jurisdiction[9] who have engaged in deceptive or abusive practices. In addition, the Commission works to protect consumers from a wide range of other unfair, deceptive, and abusive practices in the marketplace, such as credit-related and government grant scams, mortgage loan modification scams, deceptive marketing of health care products, deceptive negative option marketing, and business opportunity and work-at-home schemes.[10] The FTC works closely with many state attorneys general and state banking departments to leverage resources in consumer protection.

III. Overview of Debt Relief Services and FTC Law Enforcement Efforts

Debt relief services have proliferated over the past few years as greater numbers of consumers are struggling with debts they cannot pay. A range of nonprofit and for-profit entities—including credit counselors, debt settlement companies, and debt negotiation companies—offer to help consumers facing debt problems. As detailed below, consumers have complained of deceptive and abusive practices in all of these services, resulting in the FTC and state enforcement and regulatory bodies bringing numerous cases.[11]

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[4] 16 C.F.R. § 310.1 et seq.

[5] With respect to its research and policy development in this area, in September 2008, the Commission held a public workshop entitled "Consumer Protection and the Debt Settlement Industry," which brought together stakeholders to discuss consumer protection concerns associated with debt settlement services. Workshop participants also debated the merits of possible solutions to those concerns. An agenda and transcript of the Workshop are available at *www.ftc.gov/bcp/workshops/debtsettlement/index.shtm*. Public comments associated with the Workshop are available at *www.ftc.gov/os/comments/debtsettlementworkshop/index.shtm*.

[6] 15 U.S.C. § 45.

[7] 15 U.S.C. §§ 6101–6108. Pursuant to the Telemarketing Act's directive, the Commission promulgated the original TSR in 1995 and subsequently amended it in 2003 and in 2008.

[8] The Commission also has law enforcement authority and, in some cases, regulatory powers under a number of other consumer protection statutes specifically related to financial services, including the Truth in Lending Act, 15 U.S.C. §§ 1601–1666j; the Consumer Leasing Act, 15 U.S.C. §§ 1667–1667f; the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692–1692o; the Fair Credit Reporting Act, 15 U.S.C. §§ 1681–1681x; the Equal Credit Opportunity Act, 15 U.S.C. §§ 1691–1691f; the Credit Repair Organizations Act, 15 U.S.C. §§ 1679–1679j; the Electronic Funds Transfer Act, 15 U.S.C. §§ 1693–1693r; the privacy provisions of the Gramm-Leach-Bliley Act, 15 U.S.C. §§ 6801–6809; and the Omnibus Appropriations Act of 2009, Pub. L. No. 111–8, § 626, 123 Stat. 524 (Mar. 11, 2009).

[9] The FTC Act exempts banks and other depository institutions and bona fide nonprofits, among others, from the Commission's jurisdiction. 15 U.S.C. §§ 44 and 45(a)(2). These exemptions apply to the Telemarketing Act and the TSR as well.

[10] Since the beginning of 2009, the FTC has brought 40 cases against defendants engaged in deceptive practices targeting financially-distressed consumers.

[11] The Commission has addressed similar problems with respect to companies offering to resolve consumers' mortgage debts. The Commission has engaged in an aggressive, coordinated enforcement initiative to shut down companies falsely claiming the ability to obtain mortgage loan modifications or other relief for consumers facing foreclosure. In the past year, the FTC has brought 17 cases (against more than 90 defendants) targeting foreclosure rescue and mortgage modification frauds, with other matters under active investigation. In addition, state enforcement agencies have brought more than 200 cases against such firms. Further, as directed by Congress under the Omnibus Appropriations Act of 2009, Pub. L. No. 111–8, the Commission has initiated a rulemaking proceeding addressing the for-profit companies in this industry. Under the proposed rule, companies could not receive payment until they have obtained for the consumer a documented offer from a mortgage lender or servicer that comports with any promises previously made. *Mortgage Assistance Relief Services*, 75 Fed. Reg. 10707 (Mar. 9, 2010).

A. Credit Counseling Agencies

Credit counseling agencies ("CCAs") historically were nonprofit organizations that worked as liaisons between consumers and creditors to negotiate "debt management plans" ("DMPs"). DMPs are monthly payment plans for the repayment of credit card and other unsecured debt that enable consumers to repay the full amount owed to their creditors but under renegotiated terms that make repayment less onerous.[12] Credit counselors typically also provide educational counseling to assist consumers in developing a manageable budget and avoiding debt problems in the future. Beginning in the late 1990s, however, some CCAs registered as nonprofit organizations with the Internal Revenue Service, but in reality operated as for-profit companies and engaged in aggressive and illegal marketing practices. Other CCAs incorporated and openly operated as for-profit companies.

Since 2003, the Commission has filed six cases against for-profit credit counseling providers for deceptive and abusive practices.[13] In one of these cases, the FTC sued AmeriDebt, Inc., at the time one of the largest CCAs in the United States.[14] On the eve of trial, the FTC obtained a $35 million settlement, and thus far has distributed $12.7 million in redress to 287,000 consumers.[15] In the various cases, the FTC charged that the credit counseling agencies engaged in several common patterns of deceptive conduct in violation of Section 5 of the FTC Act and the TSR, including:

- misrepresentations about the benefits and likelihood of success consumers could expect from the services, including the savings they would realize;[16]
- misrepresentations regarding CCA fees, including false claims that they did not charge upfront fees;[17] and
- deceptive statements regarding their purported nonprofit nature;[18]
- violations of the TSR's provisions that require certain disclosures and prohibit misrepresentations, as well as the requirements of the TSR's Do Not Call provisions.[19]

Over the last several years, in response to abuses such as these, the IRS also has challenged a number of purportedly nonprofit CCAs—both through enforcement of existing statutes and new tax code provisions—resulting in the revocation, or proceedings to revoke, the nonprofit status of 41 CCAs.[20] In addition, state authorities have brought at least 21 cases against CCAs under their own statutes and rules.

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[12] To be eligible for a DMP, a consumer generally must have sufficient income to repay the full amount of his or her debts, provided that the terms are adjusted to make such repayment possible.

[13] *See* Appendix A (items 10, 12, 13, 16, 18, and 20).

[14] *FTC* v. *AmeriDebt, Inc.*, No. PJM 03–3317 (D. MD., final order May 17, 2006).

[15] *See* FTC Press Release, FTC's AmeriDebt Lawsuit Resolved: Almost $13 Million Returned to 287,000 Consumers Harmed by Debt Management Scam (Sept. 10, 2008), *www.ftc.gov/opa/2008/09/ameridebt.shtm*. A court-appointed receiver is continuing to track down the defendant's assets, and the FTC expects to make another distribution this year.

[16] *See United States* v. *Credit Found. of Am.*, No. CV 06–3654 ABC(VBKx) (C.D. Cal., final order June 16, 2006); *FTC* v. *Integrated Credit Solutions, Inc.*, No. 06–806–SCB–TGW (M.D. Fla., final order Oct. 16, 2006); *FTC* v. *Debt Mgmt. Found. Servs., Inc.,* No. 04–1674–T–17–MSS (M.D. Fla., final order Mar. 30, 2005).

[17] *See FTC* v. *Express Consolidation*, No. 06–cv–61851–WJZ (S.D. Fla., final order May 5, 2008); *FTC* v. *AmeriDebt, Inc.*, No. PJM 03–3317 (D. MD. 2006).

[18] *See FTC* v. *Integrated Credit Solutions, Inc.,* No. 06–806–SCB–TGW (M.D. Fla. 2006); *FTC* v. *Express Consolidation*, No. 06–cv–61851–WJZ (S.D. Fla. 2008); *United States* v. *Credit Found. of Am.*, No. CV 06–3654 ABC(VBKx) (C.D. Cal. 2006); *FTC* v. *Debt Mgmt. Found. Servs., Inc.*, No. 04–1674–T–17–MSS (M.D. Fla. 2005); *FTC* v. *AmeriDebt, Inc.*, No. PJM 03–3317 (D. MD. 2006). Although the defendants in these cases had obtained IRS designation as nonprofits under Section 501(c)(3) of the Internal Revenue Code, they allegedly funneled revenues out of the CCAs and into the hands of affiliated for-profit companies and/or the principals of the operation. Thus, the FTC alleged that the defendants were "operating for their own profit or that of their members" and fell outside the nonprofit exemption in the FTC Act. 15 U.S.C.§ 44.

[19] *See FTC* v. *Express Consolidation*, No. 06–cv–61851–WJZ (S.D. Fla. 2007); *United States* v. *Credit Found. of Am.*, No. CV 06–3654 ABC(VBKx) (C.D. Cal. 2006).

[20] Eileen Ambrose, *Credit firms' status revoked; IRS says 41 debt counselors will lose tax-exempt standing*, *Baltimore Sun,* May 16, 2006; *see generally TSR Proposed Rule*, 74 Fed. Reg. 41988, 41992 (Aug. 19, 2009). To enhance the IRS's ability to oversee CCAs, Congress amended the IRS Code in 2006, adding Section 501(q) to provide specific eligibility criteria for CCAs seeking tax-exempt status as well as criteria for retaining that status. *See* Pension Protection Act of 2006, P.L. 109–280, § 1220 (Aug. 2006) (codified at 26 U.S.C. § 501(q)). Among other things, Section 501(q) of the Code prohibits tax-exempt CCAs from refusing to provide credit counseling services due to a consumer's inability to pay or a consumer's ineligibility or unwillingness to agree to enroll in a DMP; charging more than "reasonable fees" for services; and, unless allowed by state law, basing fees on a percentage of a client's debt, DMP payments, or savings from enrolling in a DMP. In addition, as a result of changes in the Federal bankruptcy code, 158 non-

B. Debt Settlement Services

For-profit debt settlement companies purport to obtain lump sum settlements for consumers with their unsecured creditors for significantly less than the full outstanding balance of the debts. Unlike a traditional DMP, the goal of a debt settlement plan is to enable the consumer to repay only a portion of the total owed. Debt settlement providers heavily market through Internet, television, radio, and print advertising. The advertisements typically make claims about the company's supposed ability to reduce consumers' debts to a fraction of the full amount owed, and then encourage consumers to call a toll-free number for more information.[21] During the calls, telemarketers repeat and embellish many of these claims.

Most debt settlement companies charge consumers hundreds, or even thousands, of dollars in upfront fees, in many cases with the entire amount of fees due within the first few months of enrollment and before any debts are settled. An increasing number of providers spread their fees over a longer period—for example, 12 to 18 months—but consumers generally still pay a substantial portion of the fees before any of their payments are used to pay down their debt. And most consumers drop out of these programs before completion because they cannot afford, as many of the plans require, to simultaneously: (1) pay the provider's fees, (2) save money for the settlements, and (3) continue making their monthly payments to creditors to avoid late charges and additional interest. Consumers who drop out typically forfeit all of the money they paid to the debt settlement company, regardless of whether they received any settlements from their creditors.

Since 2004, the Commission has brought eight actions against debt settlement providers, alleging that they failed to deliver the results promised to consumers and deceived consumers about key aspects of their programs.[22] The defendants' misrepresentations included claims that:

- the provider will, or is highly likely to, obtain large reductions in debt for enrollees, *e.g.,* a 50 percent reduction or elimination of debt in 12 to 36 months;[23]
- the provider will stop harassing calls from debt collectors as well as collection lawsuits;[24]
- the provider has special relationships with creditors and is expert in inducing creditors to grant concessions;[25]
- the consumer will not have to pay substantial upfront fees,[26] and
- the consumer will be able to obtain a refund if the provider is unsuccessful.[27]

The Commission also has alleged that debt settlement companies represented that consumers can, and should, stop paying their creditors, while not disclosing that failing to make payments to creditors may actually increase the amount consumers owe (because of accumulating fees and interest) and would adversely affect their credit rating.[28] In addition to the FTC cases, state attorneys general and regulators

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profit CCAs, including the largest entities, have been subjected to rigorous screening by the Department of Justice's Executive Office of the U.S. Trustee. Finally, nonprofit credit counseling agencies must comply with state laws in 49 states, most of which specify particular fee limits.

[21] *See, e.g.,* FTC v. *Debt-Set, Inc.*, No. 1:07–cv–00558–RPM (D. Colo., final order Apr. 11, 2008); *FTC* v. *Edge Solutions, Inc.*, No. CV–07–4087 (E.D.N.Y., final order Aug. 29, 2008); *FTC* v. *Connelly*, No. SA CV 06–701 DOC (RNBx) (C.D. Cal., final order Oct. 2, 2008); *FTC* v. *Jubilee Fin. Servs., Inc.*, No. 02–6468 ABC (Ex) (C.D. Cal., final order Dec. 12, 2004).

[22] *See* Appendix A (items 1, 7, 8, 11, 15, 16, 17, 19).

[23] *See, e.g.,* FTC v. *Edge Solutions, Inc.*, No. CV–07–4087 (E.D.N.Y. 2008); *FTC* v. *Innovative Sys. Tech., Inc.*, No. CV04–0728 GAF JTLx (C.D. Cal., final order July 13, 2005).

[24] *See, e.g.,* FTC v. *Debt-Set, Inc.*, No. 1:07–cv–00558–RPM (D. Colo. 2008); *FTC* v. *Better Budget Fin. Servs., Inc.*, No. 04–12326 (WG4) (D. Mass., final order Mar. 28, 2005); *FTC* v. *Jubilee Fin. Servs., Inc.,* No. 02–6468 ABC (Ex) (C.D. Cal. 2004).

[25] *See, e.g., FTC* v. *Debt-Set, Inc.*, No. 1:07–cv–00558–RPM (D. Colo. 2008); *FTC* v. *Better Budget Fin. Servs., Inc.*, No. 04–12326 (WG4) (D. Mass. 2005). Some providers are also misrepresenting that their service is part of a government program through the use of such terms as "government bailout" or "stimulus money." *See, e.g.,* Steve Bucci, *Settle Credit Card Debt For Pennies?*, Feb. 2, 2010, *www.bankrate.com/finance/credit-cards/settle-credit-card-debt-for-pennies–1.aspx*; *see also* FTC, Press Release, FTC Cracks Down on Scammers Trying to Take Advantage of the Economic Downturn (July 1, 2009), available at *www.ftc.gov/opa/2009/07/shortchange.shtm*.

[26] *See, e.g., FTC* v. *Debt-Set,* No. 1:07–cv–00558–RPM (D. Colo. 2008).

[27] *See, e.g., FTC* v. *Innovative Sys. Tech., Inc.*, No. CV04–0728 GAF JTLx (C.D. Cal. 2005).

[28] *See, e.g., FTC* v. Connelly, No. SA CV 06–701 DOC (RNBx) (C.D. Cal. 2008); *FTC* v. *Jubilee Fin. Servs., Inc.*, No. 02–6468 ABC (Ex) (C.D. Cal. 2004).

have filed over 117 law enforcement actions against debt settlement providers under state statutes that, among other things, ban unfair or deceptive practices.[29]

C. Debt Negotiation

For-profit debt negotiation companies assert that they can obtain interest rate reductions or other concessions from creditors to lower consumers' monthly payments. Such companies often market debt negotiation services through so-called automated "robocalls." Like debt settlement companies, many debt negotiation providers charge significant upfront fees and promise specific results, such as a particular interest rate reduction or amount of savings.[30] In some cases, the telemarketers of debt negotiation services refer to themselves as "card services" or a "customer service department" during calls with consumers in order to mislead them into believing that the telemarketers are associated with the consumer's credit card company.[31]

The FTC has brought six actions against defendants alleging deceptive debt negotiation practices.[32] In each case, the Commission alleges that defendants: (1) misrepresented that they could reduce consumers' interest payments by specific percentages or minimum amounts, (2) falsely purported to be affiliated, or have close relationships, with consumers' creditors,[33] and (3) violated the TSR's Do Not Call provisions, among other TSR violations.[34]

Our law enforcement colleagues at the state level also have focused attention on bogus debt negotiation companies. The states have brought at least ten cases against such firms, and the FTC will continue to work closely with our state partners on these and related issues.

IV. The Commission's Rulemaking Proceeding

In August 2009, the Commission published in the Federal Register proposed amendments to the TSR to address abuses in the debt relief industry.[35] Congress authorized the FTC to conduct rulemaking proceedings under the Telemarketing Act using the Administrative Procedure Act's "notice-and-comment" procedures,[36] and this proceeding has moved expeditiously and is nearing completion.

The TSR amendments proposed last August would, among other things:

- extend the existing protections of the TSR to inbound debt relief calls, *i.e.,* those where consumers call a telemarketer in response to a general media or direct mail advertisement;[37]
- mandate certain additional disclosures and prohibit misrepresentations in the telemarketing of debt relief services; and
- prohibit any debt relief service from requesting or receiving payment until it produces the promised services and documents this fact to the consumer.

In response to this proposal, the Commission received written comments from 314 stakeholders, including representatives of the debt relief industry, creditors, law enforcement, consumer advocates, and individual consumers.[38] In November 2009, Commission staff hosted a public forum on the proposed TSR amendments, at which participants representing all of the major stakeholders discussed the key consumer protection issues and problems that are present in the debt relief industry and pos-

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[29] *See, e.g., Minnesota* v. *American Debt Settlement Solutions, Inc.*, No. 70–CV–10–4478 (Minn., 4th Dist., filed Feb. 18, 2010); *Illinois* v. *Clear Your Debt, LLC*, No. 2010–CH–00167 (Ill. 7th Cir., filed Feb. 10, 2010); Colorado Attorney General Press Release, *Eleven Companies Settle with the State Under New Debt-Management and Credit Counseling Regulations* (Mar. 12, 2009), available at *www.ago.state.co.us/press_detail.cfmpressID=957.html*; *Texas* v. CSA-Credit *Solutions of Am., Inc.*, No. 09–000417 (Dist. Travis Cty, filed Mar. 26, 2009); *Florida* v. *Boyd*, No. 2008–CA–002909 (Cir. Ct. 4th Cir. Duval Cty, filed Mar. 5, 2008).

[30] *See FTC* v. *Economic Relief Techs., LLC*, No. 09–CV–3347 (N.D. Ga. 2009); *FTC* v. *2145183 Ontario, Inc.*, No. 09–CV–7423 (N.D. Ill. 2009); *FTC* v. *JPM Accelerated Servs. Inc.*, No. 09–CV–2021 (M.D. Fla. 2009); *FTC* v. *Group One Networks, Inc.*, No. 8:09–cv–352–T–26–MAP (M.D. Fla.2009); *FTC* v. *Select Pers. Mgmt.*, No. 07–0529 (N.D. Ill., final order May 15, 2009); *FTC* v. *Debt Solutions, Inc.*, No. 06–0298 JLR (W.D. Wash., final order June 18, 2007).

[31] *See* cases cited *supra*, note 30.

[32] *See* Appendix A (items 2, 3, 4, 5, 6, and 14).

[33] *See FTC* v. *Economic Relief Techs., LLC*, No. 09–cv–3347 (N.D. Ga. 2009); *FTC* v. *2145183 Ontario, Inc.*, No. 09–cv–7423 (N.D. Ill. 2009); *FTC* v. *Group One Networks, Inc.*, No. 8:09–cv–352–T–26–MAP (M.D. Fla. 2009); *FTC* v. *Select Pers. Mgmt.*, No. 07–0529 (N.D. Ill. 2009); *FTC* v. *Debt Solutions, Inc.*, No. 06–0298 JLR (W.D. Wash. 2007).

[34] *See FTC* v. *Economic Relief Techs., LLC*, No. 09–CV–3347 (N.D. Ga. 2009); *FTC* v. *2145183 Ontario, Inc.*, No. 09–CV–7423 (N.D. Ill. 2009); *FTC* v. *JPM Accelerated Services Inc.*, No. 09–CV–2021 (M.D. Fla. 2009).

[35] *TSR Proposed Rule*, 74 Fed. Reg. 41988 (Aug. 19, 2009).

[36] 15 U.S.C. § 6102(b).

[37] Outbound calls to solicit the purchase of debt relief services are already subject to the TSR.

[38] These public comments are available at *www.ftc.gov/os/comments/tsrdebtrelief/index.shtm*.

sible solutions for them.[39] After the forum, Commission staff sent letters to industry trade associations and individual debt relief providers that had submitted public comments, soliciting follow-up information in connection with certain issues that arose at the forum.[40] Sixteen trade associations and companies responded and provided data. At this time, the Commission staff is reviewing the entire record in this proceeding and drafting a final rule for the Commission's consideration.

V. Efforts to Educate Consumers

To complement its law enforcement and rulemaking, the Commission has made significant efforts to educate consumers about debt relief services and alert them to possible deceptive practices. Most recently, the agency released a brochure entitled "Settling Your Credit Card Debts," which offers struggling consumers tips on seeking assistance with their debts and spotting red flags for potential scams.[41] This brochure, along with additional educational materials on debt relief,[42] is available at a new FTC web page, *www.ftc.gov/MoneyMatters*.[43]

In addition, the Commission has conducted numerous education campaigns designed to help consumers manage their financial resources, avoid deceptive and unfair practices, and become aware of emerging scams. For example, the FTC has undertaken a major consumer education initiative related to mortgage loan modification and foreclosure rescue scams, including the release of a suite of mortgage-related resources for homeowners.[44] Moreover, the agency has focused outreach efforts on a number of other issues faced by people in economic distress, including stimulus scams, rental scams, church "opportunity" scams, offers for bogus auto warranties, and solicitations for phony charities that exploit the public's concern for the welfare of our troops and public safety personnel in a time of crisis.

The Commission encourages wide circulation of all of its educational resources and makes bulk orders available free of charge, including shipping. We provide FTC materials to state attorneys general and other local law enforcement entities, consumer groups, and nonprofit organizations, who in turn distribute them directly to consumers. In addition, media outlets—online, print, and broadcast—routinely cite our materials and point to our guidance when covering debt-related news stories.

VI. Conclusion

The FTC appreciates the opportunity to describe to this Committee its work to protect vulnerable consumers from deceptive and abusive conduct in the marketing of debt relief services. Stopping the purveyors of empty promises who prey on consumers facing financial hardship is among the FTC's highest priorities, and we will continue our aggressive law enforcement and educational programs in this area.

APPENDIX A

FTC Law Enforcement Actions Against Debt Relief Companies

1. *FTC* v. *Credit Restoration Brokers, LLC*, No. 2:10–cv–0030–CEH–SPC (M.D. Fla., complaint issued Jan. 20, 2010) (debt settlement and credit repair)
2. *FTC* v. *2145183 Ontario, Inc.,* No. 09–CV–7423 (N.D. Ill., preliminary injunction issued Dec. 17, 2009) (debt negotiation)
3. *FTC* v. *Econ. Relief Techs., LLC*, No. 09–CV–3347 (N.D. Ga., preliminary injunction issued Dec. 14, 2009) (debt negotiation)
4. *FTC* v. *JPM Accelerated Servs. Inc.*, No. 09–CV–2021, (M.D. Fla., preliminary injunction issued Dec. 31, 2009) (debt negotiation)

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[39] A transcript of this forum is available at *www.ftc.gov/bcp/rulemaking/tsr/tsr-debtrelief/index.shtm*.

[40] The letters are posted at *www.ftc.gov/os/comments/tsrdebtrelief/index.shtm*.

[41] The brochure is available at *www.ftc.gov/bcp/edu/pubs/consumer/credit/cre02.shtm*.

[42] *Fiscal Fitness: Choosing a Credit Counselor* (2005), available at *www.ftc.gov/bcp/edu/pubs/consumer/credit/cre26.shtm*; *For People on Debt Management Plans: A Must-Do List* (2005), available at *www.ftc.gov/bcp/edu/pubs/consumer/credit/cre38.shtm*; *Knee Deep in Debt* (2005), available at *www.ftc.gov/bcp/edu/pubs/consumer/credit/cre19.shtm*. In the last year and a half, the FTC has distributed more than 248,000 print versions of these three publications combined, and consumers have accessed them online more than 760,000 times.

[43] Over the last 6 months, the Money Matters website has received approximately 50,000 hits per month.

[44] NeighborWorks America, the Homeowners Preservation Foundation (a nonprofit member of the HOPE NOW Alliance of mortgage industry members and U.S. Department of Housing and Urban Development-certified counseling agencies), and other groups are distributing FTC materials directly to homeowners at borrower events across the country, on their websites, in their statements, and even on the phone. The Nation's major mortgage servicers now provide to consumers, while they are on hold, information derived from FTC materials about the tell-tale signs of a mortgage foreclosure scam.

5. *FTC* v. *MCS Programs, LLC*, No. 09–CV–5380 (W.D. Wash. preliminary injunction issued July 13, 2009) (debt negotiation)
6. *FTC* v. *Group One Networks, Inc.*, No. 09–CV–00352 (M.D. Fla., preliminary injunction issued March 25, 2009) (debt negotiation)
7. *FTC* v. *Edge Solutions, Inc.,* No. CV 07–4087–JG–AKT (E.D. N.Y., final order Aug. 29, 2008) (debt settlement)
8. *FTC* v. *Debt-Set*, No. 1:07–cv–00558–RPM (D. Colo., final order Apr. 11, 2008) (debt settlement)
9. *FTC* v. *Select Pers. Mgmt., Inc.*, No. 07C 0529 (N.D. Ill., final order May 15, 2009) (debt negotiation)
10. *FTC* v. *Express Consolidation*, No. 0:06–CV–61851–WJZ (S.D. Fla., final order May 5, 2007) (credit counseling)
11. *FTC* v. *Connelly,* No. SA CV 06–701 DOC (RNBx) (C.D. Cal., final order Oct. 2, 2008) (debt settlement)
12. *United States* v. *Credit Found. of Am.*, No. CV06–3654 ABC(VBKx) (C.D. Cal., final order June 16, 2006) (credit counseling)
13. *FTC* v. *Integrated Credit Solutions, Inc.*, No. 8:06–CV–00806–SCB–TGW (M.D. Fla., final order Oct. 16, 2006) (credit counseling)
14. *FTC* v. *Debt Solutions, Inc.*, No. CV06–0298 (W.D. Wash., final order June 18, 2007) (debt negotiation)
15. *FTC* v. *Jubilee Fin. Servs., Inc.*, No. 02–6468 ABC(Ex) (C.D. Cal., final order Dec. 12, 2004) (debt settlement)
16. *FTC* v. *Nat'l Consumer Council, Inc.*, No. ACV04–0474CJC (JWJX) (C.D. Cal., final order Apr. 1, 2005) (credit counseling and debt settlement)
17. *FTC* v. *Better Budget Fin. Servs., Inc.*, No. 04–12326 (WG4) (D. Mass., final order Mar. 28, 2005) (debt settlement)
18. *FTC* v. *Debt Mgmt. Found. Servs., Inc.*, No. 8:04–CV–1674–T–17MSS (M.D. Fla., final order Mar. 30, 2005) (credit counseling)
19. *FTC* v. *Innovative Sys. Tech., Inc.*, No. CV04–0728 (C.D. Cal., final order July 13, 2005) (debt settlement)
20. *FTC* v. *AmeriDebt, Inc.*, No. PJM 03–3317 (D. MD., final order May 17, 2006) (credit counseling)

The CHAIRMAN. Thank you very much.

Senator McCaskill, do you have a—opening thoughts, comments that you would like to make?

Senator MCCASKILL. Well, I have questions, and I will certainly defer to the Chairman for questions first.

My thought is that, if doing away with advance fees does away with these companies—probably a good thing. Probably a good thing.

So, I will defer to your questions and look forward to my opportunity to ask questions.

The CHAIRMAN. I think you are looking forward to your opportunity.

Mr. Kutz, I'd like to ask you the following. First of all, thank you for your testimony. And thank you, in fact, for all the work that GAO does, in general. And I understand that, in your testimony, you've not named the particular companies you've investigated. You've given them case numbers. It's very—that's very professional, and it's correct. I've decided that I'm not particularly professional, and so, I'm just naming the names of all the companies. And I hope that you'll forgive me for that.

So, let's start with what you call "case number 1." Your investigators, who were pretending to be financially distressed consumers, started a website called "FreeDebtSettlementNow.com" Can you please describe this website?

Mr. KUTZ. Yes. If we could also put up, on the monitor, one of the advertisements they had on that.

[The information referred to follows:]

Source: Debt settlement company Web site. Images enhanced by GAO.

But, actually, Senator, this case came to us through a spam e-mail from Lebanon. And when you actually clicked on the e-mail, it took you to FreeDebtSettlementNow. And so—and, for example, on the monitor, it shows some of the advertisements they had about a government program. If you read that, you can see that's another one of these outrageous cases of false, deceptive—in this case, I call this fraudulent marketing. So, that's a company that then led you—so, they're one of the front companies that Mr. Lehman described here, and they were funneling work to companies called Procorp and Web Credit, which are members of the trade associations: TASC and USOBA. And that's where the actual back-end processing of the actual debt settlement was.

And within that, there were a whole number of, I guess, deceptive and fraudulent claims. For example, one of the companies—Web Credit—claimed a 100-percent success rate—and you heard that in the tape, at the beginning, or the excerpts in the beginning—I mean, "100 percent of consumers successfully settle within 3 years." And, as you've heard from my colleagues at the table, that's just an outrageous claim.

The CHAIRMAN. All right. And you say, in your testimony, that Web Credit advisors belongs to a debt settlement industry association, which is called USOBA, United States Organization of Bankruptcy Alternatives. That's an organization that Mr. Ansbach is representing here today, is that not correct?

Mr. KUTZ. That's correct.

The CHAIRMAN. And you also say, in your testimony, that the telephone representative from Web Credit advisors made multiple statements that GAO found to be, quote, "deceptive or questionable," close quote. Can you please describe these statements, and explain why they are deceptive, and why they are questionable?

Mr. KUTZ. Certainly. The first one is the 100-percent success rate for people enrolling in the program. As we've described, I believe the FTC and the State AGs would say it's closer to less than 10 percent. No one knows for sure, I don't think. If you look across the industry, one of the organizations says it's 34 percent. But, 100 percent is something that would not be reasonable to expect under any circumstances.

Another one says everyone in the program makes the independent decision to stop paying their creditors. Worst-case sce-

nario, you will save 40 cents on the dollar. They also promise that hiring the company would ensure that calls from creditors would slow down and eventually stop. So, those are combinations, Senator, in my view, of some fraudulent claims or, at a minimum, deceptive or otherwise questionable.

The CHAIRMAN. And, as I think you mentioned before, they sort of claim to be somehow a part of government activity.

Mr. KUTZ. Yes. In this particular case, you see on the monitor exactly what they had advertised.

The CHAIRMAN. I think what you've just described to me is out-and-out fraud. I'm not a lawyer. Senator McCaskill is. And don't mess with her; she's a very good one.

[Laughter.]

The CHAIRMAN. Mr. Ansbach testified that companies in his organization are "honest and ethical." That was in quotes. It sounds like you don't agree.

Mr. KUTZ. I can't speak to all 150 or 200 companies, but several of our worst cases were, in fact, members of his trade association, yes.

The CHAIRMAN. I'm just going to—we're going to have some fun here, Senator McCaskill. We've got lots of time and few members. So, it's yours.

STATEMENT OF HON. CLAIRE MCCASKILL, U.S. SENATOR FROM MISSOURI

Senator MCCASKILL. I—let me first ask Mr. Ansbach. Mr. Ansbach, have you made public all the members of your organization?

Mr. ANSBACH. No, ma'am, we have not.

Senator MCCASKILL. And why not?

Mr. ANSBACH. I think that's something that's going to change. We've discussed that. We've been asked about that. As the Senator may know, the Association of Settlement Companies does. That's our sister group. In the past, the leadership in our trade group, candidly, was concerned that publishing a list of members ended up being a subpoena list. We were concerned about——

Senator MCCASKILL. Probably a genuine concern.

Mr. ANSBACH. Well, ma'am, we do think that we represent a lot of very good folks. But, the reality is, I think that these are good folks, and we have an agenda item on our conference this summer to talk about that. I think that all that should be published.

Senator MCCASKILL. Well, I'm looking at all the case studies—GAO's case studies—and I see that Prime Debt Services is a member of yours. American Debt Settlement Group is a member of yours. Credit Solutions of America, I'm familiar with, because our attorney general has sued them. They're a member of yours.

You have to understand that the premise of the business is offensive, in this way. The premise is that when people are in debt and worried, they are more easily persuaded that someone can help them, because they're desperate for help. And when someone tells them, "You don't have to pay your bills anymore and we're going to make a lot of your bills go away," that is like asking a 5-year-old if they want to get a Happy Meal. It is equivalent to that. And what is hard for me to understand is how your association thinks

you can stop the inevitable march of regulation, lawsuits, enforcement actions, because I don't think you can produce statistics that show that you're helping anyone.

I have prepared for this hearing. I'm not aware of any statistics that show that you've helped anyone. In fact——

And let me ask Mr. Lehman this. It's my understanding, Mr. Lehman, that one of the problems in these lawsuits that are being brought by the attorneys general is the fights over discovery, that it has been very difficult to get the documents, to get the data, to be able to make sure that every fact is uncovered so that, first, the members of Mr. Ansbach's organization have due process, but, most importantly, if—whether or not these are civil cases for consumer action, or whether or not these are criminal fraud cases.

Mr. LEHMAN. Yes, Senator McCaskill. That is true; it's been very difficult for the attorneys general to get any verification of any of the claims that are made.

Senator MCCASKILL. I'm sorry. I don't think you have your—does he have his microphone on?

Mr. LEHMAN. I'm sorry.

Senator MCCASKILL. Yes. There you go.

Mr. LEHMAN. Yes, it has been very difficult for attorneys general to get any verification of the claims made by debt settlement companies about success rates and amounts of—numbers of debts settled and that kind of thing. And I know, in the Credit Solutions case that you refer to, that the Missouri attorney general has brought, and along with, I might add, four or five other States, they have said that it has been very difficult to get information from—on their investigations of that company.

Senator MCCASKILL. Mr. Ansbach, do you have data that you could give the Committee today?

Mr. ANSBACH. Yes, ma'am.

Senator MCCASKILL. OK. And is it data that has been—that is subject to our questioning of the companies and getting at the—I mean, are you actually maintaining that the majority of people that you sell this service to, that you actually produce?

Mr. ANSBACH. Senator, I have data that I would provide to you, and the only reason I would bring it to you is if I trusted it. What I can tell you, if I may—and I apologize, I don't remember if you were in the room when we first started—our members, alone, have settled $1.4 billion in unsecured debt.

Senator MCCASKILL. And how much was the unsecured debt that they were—that was the outer perimeters of what they were given to try to settle? Does that represent 10 percent? Five percent? Forty percent?

Mr. ANSBACH. Sorry, I don't appreciate the question.

Senator MCCASKILL. Well, you say you've settled $1.4 billion in debt.

Mr. ANSBACH. Yes, ma'am.

Mr. ANSBACH. That means you have saved your customers that much debt?

Mr. ANSBACH. No, I'm sorry. The aggregate value of the debt that was——

Senator MCCASKILL. OK.

Mr. ANSBACH.—held is $1.4 billion.

Senator MCCASKILL. OK.

Mr. ANSBACH. TASC, the other trade association, last year alone, settled another $1.1 billion in debt. That debt is settled at roughly somewhere around 53 to 50 cents on the dollar. So, with all due respect, Senator, when you say that we're not providing any value, there are a lot of folks that would disagree—folks that received these settlements—folks that got their debts settled and ultimately paid 53 cents on the dollar and who are now on their way to financial stability. I think there is significant value in that.

Senator MCCASKILL. Well, then, why isn't a contingency fee appropriate? Why do you have to have the money up front?

Mr. ANSBACH. Right. The——

Senator MCCASKILL. Why is that—why do you go out of business—if, in fact, you are successful in settling that percentage of your debt, there is no way you go out of business with depending on your success as the parameter for your fee payment.

Mr. ANSBACH. Again, with respect, Senator, I disagree. The issue is really a very simple one. No business, big or small—but most of ours are small business owners—can operate without revenue for a year. It cannot be done. I run a business. I don't think you'll find anyone in this room that runs a business that will tell you that it is a stable financial model to operate without revenue.

Now, please, if that—that being said, I agree absolutely 100 percent with what's being said here today, particularly about these egregious ads that have government seals on them. Every time we've gotten one, we've sent it to the Federal Trade Commission or some of the Senators that have expressed interest in that. The question here is not regulation or no regulation. And you said we can't stop the inevitable march. I don't want to stop the inevitable march. I spend more time in Sacramento and Tallahassee and Austin and Springfield, Illinois, than I do in my hometown, trying to get regulation in place. The question is, Can we get regulation that will protect consumers from this very bad stuff, but still allow honest, ethical companies to provide the services?

Senator MCCASKILL. Well, you now have the premier auditing investigative agency in the world that has now determined that a number of your members engaged in flat-out fraud—uncontroverted facts. Now, are you going to ask those members to leave your organization because they have participated in this kind of activity? Are you going to take any action against them, and clear out these clearly deceptive practices that are going on? Because I know why these people did this on the phone. They get paid by how many people they sign up. Correct?

Mr. ANSBACH. Not all do. No, ma'am.

Senator MCCASKILL. Are you telling me that the people that he did these case studies on—are they all your members, or just some of them?

Mr. ANSBACH. I do not know.

Senator MCCASKILL. Well, let me read them to you.

Web Credit. Are they one of your members?

Mr. ANSBACH. Senator, we have 200 members. I do not know all——

Senator MCCASKILL. You don't have a list with you?

Mr. ANSBACH. No, ma'am. I do not.

Senator MCCASKILL. You—is Procorp Debt Solution a member of yours?

Mr. ANSBACH. Ma'am, I just saw the GAO report as—well, actually I've not seen the report. So——

Senator MCCASKILL. OK.

Mr. ANSBACH. I don't know——

Senator MCCASKILL. Well, here's what—here's—you understand the credibility gap that exists in this hearing, I assume, by now.

Mr. ANSBACH. Senator, what I understand is that there are serious problems that we need to talk about. And what I also understand is that there is an attempt to say that, because there are serious problems, that nobody should do business in this industry. And with that, I absolutely disagree.

Senator MCCASKILL. Well, I will tell you, that since the Chairman is in a frisky mood—as Desi Arnaz would say, "You've got some 'splainin' to do."

There is a serious issue facing this country. I will not sit on this committee—and I know the Chairman—the Chairman will not—and I know, having gone through the confirmation for the new Commissioner at the FTC—I can't decide which is worse, the FreeCreditReport.com or you guys. You are preying upon the fears of people. You're making a lot of money, and you're delivering a substandard product; and many, many times, you're engaging in fraud to get the customers, by promising something that you know is not true, that they can quit paying their bills, that you've had 100-percent success, that you're going to settle the debts, and your record of success—and you've had so few dropouts—on and on and on. And, you know, you should just tell your members—and I look forward to learning all—will you give us the list of all 200 of your members?

Mr. ANSBACH. Yes, ma'am, I will talk—again, I'm not the legislative director, and I'm certainly not—I'm sorry—I'm not the executive director and I'm not the owner of the trade group. My plan is to go back to our board and say, "This is important and we should publish the list." So, assuming that, then, yes, ma'am, you have my word.

Senator MCCASKILL. OK, well I will be checking in with the Missouri attorney general. We are told that Credit Solutions of America is one of your members.

Mr. ANSBACH. Yes, ma'am.

Mr. ANSBACH. And if they have to keep fighting for discovery, I think the U.S. Congress is going to have their back. So, I think the word needs to go out—if you can prove what you say, I suggest you get to proving it.

Mr. ANSBACH. Senator, I'm trying my very best with you to say that anybody that makes a claim of 100 percent—I'm a born and raised Texan, so pardon me if say this with some lack of delicacy—let's take him out back and beat him with a stick.

Senator MCCASKILL. Well——

Mr. ANSBACH. I mean, I don't—you are not going to find me or my group, or anybody that believes in responsible service, defending any of that. Now, what I would like to say to you, and I'm desperately trying, is to say to you, "I have statistics. I have numbers." I even have some numbers that are specific to Missouri that show

how much money we've saved consumers in Missouri. I'm simply asking you, please don't throw the baby out with the bathwater. There are people that do this well, and there are customers that get help. Two of them are right here with us today.

Senator MCCASKILL.—well, I—listen, I'm willing—you know, I'm from the "Show Me State." But, it's awfully hard, when an organization won't even tell who's in the organization, to take your data very seriously. And I say that as a former auditor. You've got to show the data, and you've got to let us look, and let these attorney generals look, and let the people that are trying to fight for consumers look, and they've got to get everything. And if what you're saying is true, you've got nothing to be afraid of. But, it doesn't appear that way. It appears that everyone has circled the wagons. You've told your salespeople, "Close them, close them, close them. Get the money up front. If they drop out, don't worry about it; we've already made our money." That's what it looks like, Mr. Ansbach. And it looks that way to anybody with common sense.

So, I'm just giving you the challenge—and I know the Chairman wouldn't have this hearing if he didn't feel the same way—I'm giving you the challenge, and telling you, if what you're saying is true, then you've got to show us.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator McCaskill.

I believe the states, Mr. Kutz, that have sued are Texas, New York, Maine, Missouri, Florida, Illinois, and Idaho. Now, that's just on case number 6, which is Credit Solutions of America, which is part of your organization, right?

Mr. KUTZ. Yes, sir.

The CHAIRMAN. Now, you answered that rather quickly, but when asked by Senator McCaskill about other companies—you know, a list of 200 is very small, and you pointed out that you weren't the——

Mr. KUTZ. Executive Director, Mr. Chairman.

The CHAIRMAN. Yes. No, that you weren't the Chief Compliance——

Senator MCCASKILL. [inaudible.]

Mr. ANSBACH. It's OK, ma'am. I—I mean, at the risk of perhaps talking out of turn, I understand the passion in this. I'm sitting two chairs down from Mrs. Haas, who obviously had a horrific experience that I would never, in my life, defend. But, you know, I have an office full of folks that I believe in very much. I know sometimes even they make mistakes. But, I think there's good work to be done here, and I just want to find us a way to do it.

The CHAIRMAN. That's just an amazing statement.

Let me try to get at it a different way. What percentage of the people that you say that you serve—I mean, 200 companies is a very small amount. You're actually the Chief Operating Officer—you corrected me—you're not Chief Compliance, you're Chief Operating—you have even more reason to know what these—what the 200 companies are. But, you don't. You simply don't.

Mr. ANSBACH. I'm sorry, Mr. Chairman. Perhaps I misspoke. I'm—my role with USOBA, the trade association is—I'm the volunteer as a Legislative Director. I'm the Chief Operating Officer of just my company.

The CHAIRMAN. So, you didn't have to get—you didn't have to pay up front. You didn't have to get paid up front. I'm sorry. I'm just being cynical.

The—what percentage of the people that you take on, and your 200 organizations take on, do you think do well by their clients?

Mr. ANSBACH. If you'll permit me, I want to—I know I've got some data to provide you with. And, by the way, I want to encourage you—if you want to ask questions to anybody else on the panel, I'm sure——

The CHAIRMAN. No, you're my interest right now.

[Laughter.]

Mr. ANSBACH. I just—I don't want to hog the microphone—so I'd be happy to do that.

The CHAIRMAN. You can joke about this, if you want.

Mr. ANSBACH. No, sir, I don't think it's a joking matter at all. I will tell you that the statistics that we've discussed—the 35-percent number—34, 35 percent, which I think was referenced—is a TASC number. We think that number has merit. That means that 35 percent of consumers will settle all of their debts in a particular debt settlement program. What that means is that there's still 65 percent that do not complete the program. It's very important to understand what that means. And this is the difficulty we've had with the discussion on success rates.

The CHAIRMAN. How would you react to that, Mr. Kutz and Commissioner Brill—35-percent successful?

Mr. KUTZ. It was 34. But—and I think there may be a question of what the definition is of "success" there, because, I mean, I think success—we would assume that you settle all your debts. I think the success rate there may have been some or all of the debts. But, it's very different from what the State AGs have found, which is less than 10 percent. So, certainly less than 50 percent is clearly—makes sense to me, given who you're talking about. And I don't know if FTC has any further data on that. But, I think less than 34 or—34 has got to be the high end of what we're talking about.

The CHAIRMAN. Commissioner Brill?

Ms. BRILL. Mr. Chairman, we have asked for this kind of data as part of our rulemaking procedure, and we are currently analyzing data that has been provided to us, not only by Mr. Ansbach and some of his compatriots in the industry, but also by the State attorneys general and others. And at this point, because the rulemaking process is underway, I don't want to comment on my view or the Commission's view about that data. But, to the extent that the information we have is public, we'd be more than happy to share that with you. I don't have the numbers with me right here today. But, we'd be more than happy to share what——

The CHAIRMAN. OK, well——

Ms. BRILL.—with you what we have.

The CHAIRMAN.—you could have just said that.

Mr. Ansbach, in your testimony, you present a lot of numbers showing the debt settlement companies that save consumers money. I didn't hear anything about the numbers showing how much your industry costs consumers. Remember, in my opening statement I said they often end up owing more than they did be-

fore. So, you say that you're saving them money. How much are you costing them money?

Mr. ANSBACH. If I understand the Senator's question, you're asking, What damage does debt settlement, as a program, cause?

The CHAIRMAN. Yes.

Mr. ANSBACH. You know, it's—actually, it's a very important question, and it gets to the root of the 35-percent number. In and of itself, a debt settlement program does not cause damage. What does cause damage is not paying your creditors. Obviously, that's whether you're in a debt settlement program or not. What does cause damage—of course, not paying your bills causes damage in the form of a worsened credit rating or litigation. And that's the very reason, Mr. Chairman, that I would join with the colleagues here at the table—disclosure agreements in contracts must tell people that, "If you stop paying your bills, then these things will happen." And that is a disclosure requirement for USOBA. It is a disclosure requirement for TASC. Clearly, the members that have been related here today failed, and did not, in those respects. And I know Senator McCaskill has left us, but to that extent, we will absolutely be following up with those companies.

The CHAIRMAN. I think that—Mrs. Haas, didn't you say that you and your husband owe $20,000 more now than when you enrolled?

Mrs. HAAS. We owed $13,000 more, 6 months after we enrolled, immediately after we terminated our attorney—$13,000.

The CHAIRMAN. So, you ended up owing $13,000 more.

Mrs. HAAS. Thirteen—that's not including what we had already paid our attorney. We had paid our attorney $3,800.

The CHAIRMAN. And, Mr. Kutz and Commissioner Brill, would you say this is pretty standard? Because, that's the question, Mr. Ansbach, I was asking you—costing people, as opposed to saving.

Mr. KUTZ. Well, I would say you have the additional fees, plus, of course, many creditors are going to continue to charge interest, penalties, and late fees. So, again, how the numbers shake out with the industry savings, I'm not sure how they calculate that, but there's—it's a fairly interesting possible calculation you could make.

Ms. BRILL. I agree. There are different levels of potential damage. And I think that was what your question was getting at. So, I agree that it's something that's important to consider as a whole.

The CHAIRMAN. Mr. Lehman, the—when a company decides to go into business, it's not my understanding that they raise their capital to go into business from customers and then offer, as an excuse, that, "We couldn't have—since we charged you fees up front, that's the way we could do business." And then, I believe that Mr. Ansbach said that only went on for a year. But, this has been around for quite a long time. Does that mean—do you think he thinks that, after that first year, that the fees don't have to be paid up front? It would be my impression that they continue to have to be paid up front as new customers come in.

Mr. LEHMAN. Mr. Chairman, I think one of the——

The CHAIRMAN. I mean, is business done that way in this country?

Mr. LEHMAN. Well, I think any kind of business that you start, even a law practice—you've got to start it and you've got to buy

books, you have to have clerical help, you have to have equipment of various kinds. I know people who have started a law practice, and it takes—it does take some time to make any money. You do have to have a capital investment. If you're starting a restaurant or a car repair shop, you have to put money into it first.

The CHAIRMAN. But, you put your money into——

Mr. LEHMAN. You put money into it.

The CHAIRMAN.—it first. Somebody else puts their money into it first. You don't——

Mr. LEHMAN. And what——

The CHAIRMAN. You don't charge the restaurant customer upfront fees and then feed that person a month or a year later, right?

Mr. LEHMAN. Exactly right. It would be like—yes—somebody contributing to the restaurant today for the privilege of having a meal, 2 years from now. And that is one of the problems with the industry, is that the entry barriers are very low. That's why we have, by the industry's estimates, over 1,000 of these companies out there. You need very little money. Most of the work, that we've found, is outsourced. Somebody can set up a debt settlement company, outsource all the marketing and lead-generation work, can outsource the work to actually do the negotiations, to the extent they're done, can outsource the accounting, the drafting of consumers' banks accounts to deposit in the debt settlement account. And, frankly, this confuses consumers, because they don't know where the "there" is, who is actually doing the work. As I gave the example before, with the law firm, the law firm is out there, in its name and with the retainer agreement, but it wasn't performing the services. So, you have this kind of network of companies, and it's hard for the consumers to identify who is the responsible party. And it could be hard for regulators, too, to determine, you know, where the real action is.

The CHAIRMAN. Mr. Ansbach, you say you're a volunteer? Are you here as a volunteer?

Mr. ANSBACH. As hard as it is to believe, yes, sir.

The CHAIRMAN. You believe in it so strongly that you're here as a volunteer.

Mr. ANSBACH. I have seen the benefits of this program, when done right. I do believe in it. Yes, sir.

The CHAIRMAN. Why is it, Mrs. Haas, that I'm having a hard time accepting that as anything but a joke?

Mrs. HAAS. Chairman, because I've been through a lot, I don't believe him, either. I don't think debt settlement should be allowed to practice any kind of consumer help whatsoever.

The CHAIRMAN. Do you think, if they charge fees before they provide services, which, in most cases, they don't do, that they should be in business at all?

Mrs. HAAS. Absolutely not. Absolutely not. The attorney that we had paid took our money and did absolutely nothing. And we got no refund.

The CHAIRMAN. And if that were the case in, let's say, 60 percent of all their clientele—and let's—and it's probably more than that—would that not be enough reason to say they should not be in business at all, that they are harming the majority of their customers?

Mrs. HAAS. I don't think they should be in business, because of their illegal practices. They don't follow State and local rules. They mislead the consumers. And they take their consumers' money and are—and the credit reports—the credit—your credit is damaged beyond belief.

The CHAIRMAN. Mr. Kutz, and particularly Commissioner Brill—no, I would say, actually, particularly Mr. Lehman—the—there is so much of this we—in this country, right now and always. Americans can always find a way to skim a buck, and they can always find a way to take it off of somebody who is in crisis, is desperate, and who will fall for what they have to say. And they don't have to make their promise. And the glorious way that America works is that we concentrate on the big picture and on the big people, and we don't concentrate on the little people who are hurting and in trouble. That's what you do. That's what you do, and that's what you do, and that's what you do. And that's what you have suffered through. It's sad.

My question is, how can they remain in business? And is there a way, if they are practicing fraud—and you say deceptive—the fraud and deceptive practices—why are they in business?

Mr. LEHMAN. Mr. Chairman, as I mentioned, there are many, many companies out there. If that over-1,000 figure is accurate, that's a lot of companies. We have a lot of attorneys general that are interested in this issue that are bringing enforcement actions. There is no way that we can target the number of companies that are out there.

And, as I also said, the barriers to entry to this business are very low, so it is not hard for companies to shut down, move on, and reopen. So, for enforcement purposes, it's kind of like playing a game of whack-a-mole. You can get a few, but you cannot cover the whole realm of bad practices out there.

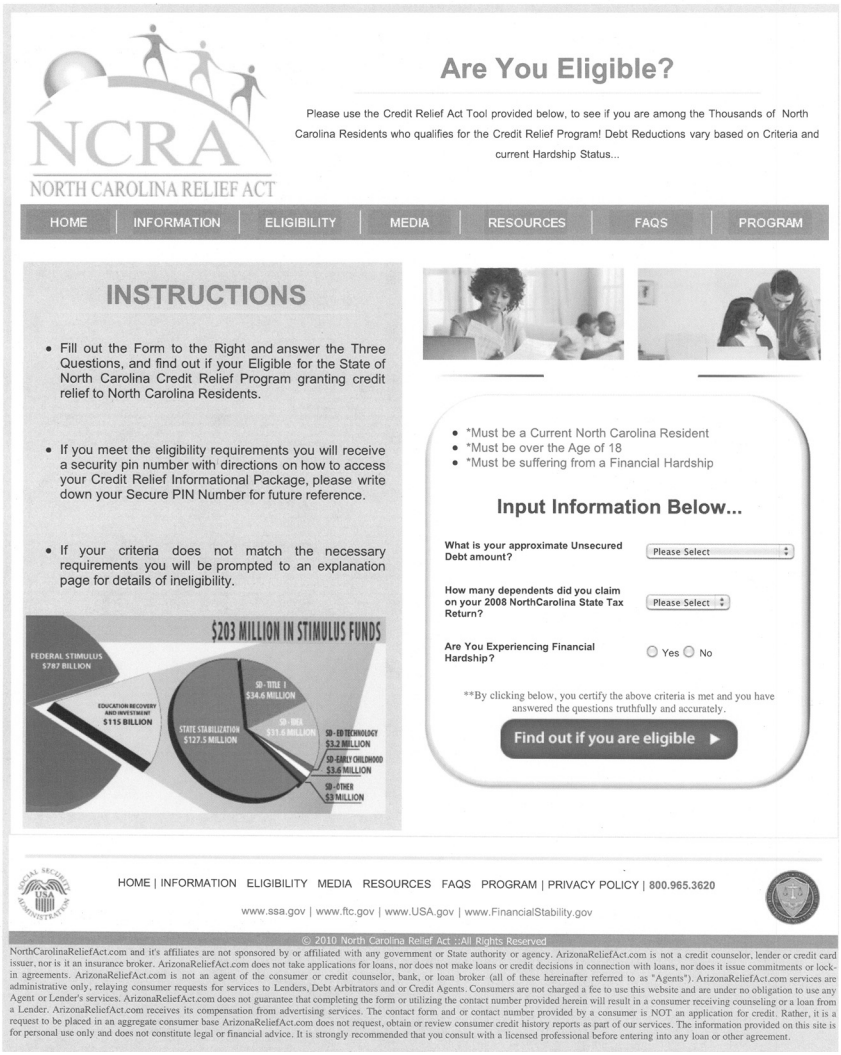
But, I—you know, the—I think the answer is to continue enforcement, to continue cooperative enforcement efforts among the States, to advocate for strong Federal rules or Federal legislation and to—you know, and encourage legislation in the states. But, it's—it is a big problem, and it's going to take a lot of resources to address it.

The CHAIRMAN. Is this something—I mean, I would be delighted to prepare legislation in this committee. Is this better done by states?

Mr. LEHMAN. The—as I said earlier, the 41 attorneys general supported the proposed FTC rule. So, I think it's fair to say the attorneys general would approve and appreciate Federal legislation to create at least a Federal floor of practices for the debt settlement industry. There are some States that do have laws. And it was interesting for me to see some of the attorneys general of those States that still advocate for a—for Federal law in this area.

The CHAIRMAN. This has already been gone over, but it's so utterly repulsive to me that I can't help but talk about. This is one of their products. And we've had many other hearings on the scamming of poor people. And we had one which simply—see this way, this is, "Find out if you are eligible," in big blue print.

[The information referred to follows:]



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- If you meet the eligibility requirements you will receive a security pin number with directions on how to access your Credit Relief Informational Package, please write down your Secure PIN Number for future reference.
- If your criteria does not match the necessary requirements you will be prompted to an explanation page for details of ineligibility.

- *Must be a Current North Carolina Resident
- *Must be over the Age of 18
- *Must be suffering from a Financial Hardship

Input Information Below...

What is your approximate Unsecured Debt amount? Please Select

How many dependents did you claim on your 2008 NorthCarolina State Tax Return? Please Select

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And in this previous one, this—the fact that this was big blue print—and you don't have a lot of small print on here; it's down here. The other one, there's a lot of small print. And so, people sort of "find out if you're eligible." Well, you can't very well say "no" to that. You're desperate. You've got debts. You've got people closing in on you. So, you push it. And then you're kind of hooked into that thing.

This is the—what is this? The—yes, that's your Commission. Now, Mr. Ansbach has already said that he's appalled that this is on this piece of material. But, this is available broadly, under the companies that he represents.

And then, I think we have, over here, the Social Security Administration, which strikes me as an enormously—those two—an enormously cynical attempt to—along with the—sort of, the stimulus-

package aspect of this—it's a cynical attempt to sort of give credibility to a group that doesn't have any credibility.

And I look up here. Where's that lovely American flag? No. I'm talking about the other chart. Yes. See, now this—I—this is really wonderful, "The future of debt settlement begins with accountability, credibility, and transparency."

[The information referred to follows:]

I would say to—ask Mr. Kutz, Mrs. Haas, Mr. Lehman, Commissioner Brill, How many of those tests do you think that his group of 200, with this eagle and American flag as their symbol, meet?

Mr. LEHMAN. It doesn't measure up, from the evidence and the complaints we've received, Mr. Chairman.

The CHAIRMAN. Mrs. Haas, would you have a view on that?

Mrs. HAAS. I know when we looked into our credit counseling on the Internet, and we found Credit—Consumer Credit Counseling of America, that's what sold us. It was American. Why—you know, we can't go wrong. If it says "America" in there, we can't go wrong.

The CHAIRMAN. And there's no way that you can analyze this, because you haven't gotten into it.

Mrs. HAAS. No.

The CHAIRMAN. Commissioner Brill?

Ms. BRILL. We have been very concerned about offers that make representations that they're somehow part of the government, part of the stimulus plan, that have shields like this on it. We've brought cases in this area, as have the States. It's a tremendous concern, for the exact reasons that Mrs. Haas is pointing out. It lends an air of credibility. That is the concern.

The CHAIRMAN. Well, but the question I was asking Mr. Lehman—and then I'll say Mr. Kutz—they don't measure up on those three promises, do they? That's not a question; I shouldn't have said that. Do they measure up on these three promises?

Mr. KUTZ. All but one of the USOBA members we spoke to and dealt with did not meet up to them. And the other one, we just didn't get anything that was not—that was bad, necessarily. One was reasonably good. The other five or so would not measure up to those standards, in our judgment.

The CHAIRMAN. OK. I sort of think that we've gotten what we can out of this. There are a lot of questions. I feel a great sense of sadness about this. And also anger—not denying that there may be, you know, a couple of your companies that do a good job. And you've got some nice people sitting in the back who are ready to

come up front and testify. But, boy, we sure didn't run into any of those people. And we've worked very hard, and these are professional investigators behind me, and they are hired on to this committee to do—that's what they do, they investigate. They look for wrong-doers and people who take advantage of people. And we have a lot of hearings about this. And it's very, very sad to me that, at a time of such economic distress, that there are so many companies, in so many ways with people, whether they are pop-up Internet deals or, you know, all kinds of scams. People fall victim to them.

I come from the State of West Virginia, where there are a lot of very, very poor people who are desperate and, for a whole lot of reasons, are in all kinds of trouble. And they—you know, they give their faith to God and their money to these companies. And I don't know how you—-on a net basis, I guess you probably turn out all right, in that case; but, you certainly don't turn out all right financially.

And I just express disdain and contempt for these kind of efforts. And I, frankly, am glad there are committees, like us and the Federal Trade Commission, that look for these things and try to stop them. We've got to be honest in this country. We've got to treat our people with respect. A lot of people don't. Or——

Do any of you have closing comments?

Mr. KUTZ. Can I make a comment——

The CHAIRMAN. Please.

Mr. KUTZ.—on what you said, I mean the faith in God? Interesting thing is, three of the companies used Christianity as the link to bring people in. Giving, of course——

The CHAIRMAN. Good point.

Mr. KUTZ.—an air of credibility. Then they provided the fraudulent and deceptive information after that. And I found that, Senator, to be particularly despicable.

The CHAIRMAN. Any others?

Mr. LEHMAN. Mr. Chairman, I'd just say, attached to my written remarks that I've submitted to the Committee are some other examples of misuse of Federal information or Federal debt relief programs, stimulus money, and that kind of thing. The one that was blown up, that you just displayed, is one that is running right now. We heard about that within the last week. And it's—if you go onto the Internet, on many sites, that link will pop up and it's—the one you showed said "North Carolina Relief Act," but there are similar sites for West Virginia—West Virginia Relief Act, Florida Relief Act, and so forth.

So, yes, the problem is still ongoing.

Mr. ANSBACH. Mr. Chairman, just the few last remarks that I would leave the Committee with. One of the things that we did not get to today, but I think perhaps the Chairman wants to be sure that you consider. There does appear—and it's not just from our point of view, but consumer activists have stated this, as well—there is going to be some type of a need to help people that cannot afford credit counseling, but who want to still avoid bankruptcy. And, in that regard, we have tried—obviously with some failing, but we have tried very hard to fill that particular void. Some numbers say as high as 30 percent of folks cannot afford credit coun-

seling, but want to avoid bankruptcy. I would simply ask the Chairman that, as we move forward on this important issue, allow us to continue to work on this and get better at this, allow us to join you in condemning some of the particularly egregious ads that we've seen here today. And we will continue to join, as best as we are able to do, if you allow us for that.

The CHAIRMAN. That was a touching closing statement. I guess mine would be, I don't know how you sleep at night.

Mr. ANSBACH. Well, with all due respect, Senator——

The CHAIRMAN. This hearing is adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Thank you, Mr. Chairman, for holding this afternoon's hearing. The continuing home foresclosures, high unemployment, and unprecedented levels of consumer debt that have accompanied our current economic recession have given rise to new industries tailored to helping those in need. The recession has also given rise to just as many scams and unscrupulous individuals willing to take advantage of those who have fallen on hard times. We have a responsibility to understand the services available to consumers to address their economic troubles and ensure those services are accompanied by appropriate consumer protections.

As more and more people are being overwhelmed by their debt, there is a greater demand for debt relief services. Consumers unable to fully repay their debt generally have three choices—credit counseling, where consumers enroll in a program designed to allow them to pay off the full balance of their debts over a longer period of time; debt settlement, where a third party negotiates with creditors to lower the overall balance due from the consumer; and bankruptcy.

Debt settlement can seem very appealing, with promises of lowering the overall debt owed and avoiding the negatives associated with filing for bankruptcy. Unfortunately, too little is known about the debt settlement industry. It is unclear exactly how many of these businesses are in operation, how many consumers use their services, and—more importantly—whether the current debt settlement business model benefits a significant number of consumers.

There have been a number of concerns raised about debt settlement. Foremost among these is the allegation that many companies use deceptive advertising to lure vulnerable consumers. These misrepresentations may include promises about settling debts in an extremely short timeframe, for unrealistically high savings, and without disclosing the actual costs to the consumer. In Texas, such misrepresentations have given rise to more than half a dozen enforcement actions by Attorney General Greg Abbott's office.

Last fall Chairman Rockefeller commissioned GAO to conduct an investigation into the advertising and marketing practices of debt settlement companies, and I am interested to hear their findings.

I am also interested in learning more about the fee structure used by debt settlement companies. Many reportedly charge a significant portion of their fees at the outset of a consumers' program, and critics have expressed concern that these fees are being paid before any real service has been performed or any debt has been settled. The fee structure is the subject of a current rulemaking at the Federal Trade Commission, and we are fortunate to have Commissioner Brill here today to discuss this. I am curious to hear how different fee models work. There is no question that a business must have revenue to operate. However, there does appear to be the potential for abuse in a system where the majority of fees are paid before any tangible benefit to the consumer is realized.

I am also pleased to welcome John Ansbach here today as a representative of the debt settlement industry. Mr. Ansbach, who is from my home state of Texas, is Legislative Director for the United States Organization of Bankruptcy Alternatives (USOBA) and General Counsel for EFA Processing, based outside Dallas. My staff has met with Mr. Ansbach on a number of occasions, and he has been a tireless advocate for the industry, relaying USOBA's support for sound business practices among debt settlement companies. Mr. Ansbach and other representatives of the industry have worked very closely with the FTC during the creation of their proposed rule, and I know they support many of its provisions.

Among other things, I understand Mr. Ansbach is prepared to discuss the stories of some consumers who may have benefited from debt settlement services. At the same time, we will hear from Mrs. Holly Haas and her husband today. I want to thank them for being willing to share their experience with us, so that we can better understand how a consumer can be negatively impacted by a debt settlement program.

Again, Mr. Chairman, thank you for holding this hearing today. I look forward to hearing from all of our witnesses.

PREPARED STATEMENT OF HON. MARK PRYOR, U.S. SENATOR FROM ARKANSAS

I thank Chairman Rockefeller, for holding this hearing on the consumer's experience in the debt settlement industry. Today's dialogue is important as many consumers continue to be targeted in a distressed economy.

According to the Commission's 2010 annual report on the Fair Debt Collection Practices Act, "the FTC receives more complaints about the debt collection industry than any other specific industry." In 2009, the FTC received over 88,000 complaints about third-party debt collectors—comprising almost 17 percent of all consumer complaints the agency received that year.

The FTC report also notes that many consumers may never file a complaint with an entity other than the debt collector. Therefore, consumers may not recognize that debt collection violations have occurred or that the FTC manages a complaint database and enforces specific consumer protection laws. By extension, this means that not all consumers' experiences may have been recorded.

In Arkansas, abusive debt collection practices appear to be on the rise. Our state attorney general's staff has reported a steady increase in the number of abusive debt collection consumer complaints received in the state. In 2007, the state received 510; in 2008, 659 complaints; in 2009, 667 complaints.

As Chairman of the Consumer Protection, Product Safety, and Insurance Subcommittee with oversight authority over the Federal Trade Commission, I recognize the FTC's important work to enforce against consumer abuse in the debt collection and debt settlement areas. I look forward to hearing Commissioner Brill's perspective and her thoughts about what else should be done.

We also will hear from members of the business community with us today. I welcome their thoughts regarding how to better police the marketplace from actors that violate consumer protection statutes.

In this tough economic environment, Americans are repeatedly targeted by fraudulent actors seeking to exploit their vulnerabilities. I know today we will hear from some consumers first-hand about their experience and I welcome their insights.

The investigation instigated by Senator Rockefeller is important and I commend him for his vigilance and illumination of consumer abuse. As we strive to protect Americans from unfair or deceptive financial practices, the importance of the FTC's role in this domain is underscored. I look forward to a robust conversation.

PREPARED STATEMENT OF JOHN MARK SPAULDING

Thank you, Chairman Rockefeller, Ranking Member Hutchison, and members of the Committee for the opportunity to share my experience with you. My name is Mark Spaulding and I am a resident of South Charleston, West Virginia. I am writing to tell you about an experience I had with a debt settlement company.

A few years ago, my wife and I were both having medical problems and were starting to fall behind on our bills. I did not want to file for bankruptcy, so I contacted a debt settlement company. In March 2008, I contacted U.S. Debt Settlement Company (USDS) from an Internet advertisement that I had seen. When I called, I spoke to a lady and told her I was trying to pay off some hospital bills, some old and some new. I was asked what other types of unsecured debt I had, and I told her that I had some credit card debt, but was current with all of my payments. I was asked how much I owed the hospitals and the credit card companies, and I told her. I was then asked to fax copies of my bills for them to review.

After the review, I was told that USDS could help me reduce my debt as much as half, and sometimes for as low as 40 cents on the dollar. I was told they have the best success with credit card companies. I was also told I could be well on my way to financial freedom and reestablishing my good financial situation. This all sounded very good to me, so I went with it.

I filled out an application and gave USDS all of my medical bills and credit card information. I also gave my banking information so they could automatically withdraw the enrollment fee and monthly service fee. I was asked to sign a "power of attorney" form so they could contact my creditors on my behalf. After that, I was signed up for a 48-month pay-off schedule.

I was told it was best not to have any contact with my creditors, and that USDS would handle them. Within 2 months the credit card companies were calling me for payments. I called USDS to ask what I should do. I was told that I should screen my calls and send any and all correspondence to USDS and they would take care

of it. I asked if I should let the credit card companies know that I was in a debt settlement program. They said no, and that if I were to do that, they would not negotiate a settlement. I was reassured that settling with credit card companies is what they do best.

During that time, calls and letters from my creditors were coming in. Calls at home and at work seemed nonstop. I would fax the collection letters to USDS and they said that they would handle it and not to worry.

After paying $296.41 per month for 6 months and $55.00 per month after for service fees, nothing in the way of negotiations had started. I called USDS to ask why nothing had started yet, and I was told that waiting is all part of the negotiation process. They told me that I should start saving money to start negotiations, and wait.

A few months later, I started receiving letters from my creditor's lawyers and summons from the courts. Again, I forwarded this information to USDS, and they told me not to worry and that this was all part of the negotiation process. At that point, 14 months had gone by and nothing had been done to settle my debt. I called USDS to express that I was afraid of being sued by the credit card companies. I was told I should "hurry up and wait." At that point, USDS asked me how much money I had saved in my banking account. I told them about $1,200.00. They told me that was not enough to settle anything, and that I should agree to the terms of the credit card lawyers.

Now I have two judgments against me and will end up paying 40 cents more on the dollar than I originally owed. In December 2009, my negotiator said bankruptcy would be my best option. I had paid over $2,400.00 to USDS for a service that I never received. I was strung along all that time for them to say that they could not help me. I was furious about the lack of service and their slow response time.

I asked for a refund and was told that they would settle with me for $600.00. That is when I decided to file a complaint with the West Virginia State Attorney General's Office. Since then, USDS has given me a full refund. No one should have to go through this type of grief from a company that has been entrusted to help with someone's personal finances. Now I am back to square one, only worse off than I was before. This has been a costly lesson that will take me several years to recover from.

AMERICAN COALITION OF COMPANIES ORGANIZED TO REDUCE DEBT (ACCORD)

Phoenix, AZ, April 20, 2010

Hon. JOHN D. ROCKEFELLER IV,
Chairman,
Committee on Commerce, Science, and Transportation,
U.S. Senate,
Washington, DC.

Hon. KAY BAILEY HUTCHISON,
Ranking Member,
Committee on Commerce, Science, and Transportation,
U.S. Senate,
Washington, DC.

Dear Chairman Rockefeller and Ranking Member Hutchison:

The American Coalition of Companies Organized to Reduce Debt (ACCORD) is a trade association representing debt settlement firms and related businesses that are committed to ensuring the highest standards of professionalism and integrity in the debt settlement industry. ACCORD and its members support fair regulation of debt settlement practices that will fully protect the interests of consumers who can benefit from debt settlement services.

Responsible debt settlement is unquestionably a benefit to consumers, especially in economic times like these, when large numbers of consumers are facing unmanageable credit card debt. One conservative estimate of the obligations to credit card issuers and other unsecured creditors that debt settlement companies resolved for consumers last year is $1 billion.[1] Not only do consumers facing financial hardship benefit from debt settlement, creditors do as well because it allows them to collect debts that might otherwise be discharged in bankruptcy or sold to debt buyers for a small fraction of their face value.

Despite these benefits, the bona fide debt settlement industry has suffered from bad publicity arising from bad actors in the industry and consumers who, for various reasons, did not achieve expected results. Consumer groups and law enforcement have charged some companies with exploiting the financial vulnerability of

[1] *See* October 26, 2009, and March 8, 2010, letters from Andrew Housser, on behalf of The Association of Settlement Companies, to the Federal Trade Commission, available at: *http://www.ftc.gov/os/comments/tsrdebtrelief/index.shtm*.

debt-strapped consumers by taking fees from them and not delivering the promised services. In some cases, it appears that purported debt settlement firms engaged in outright fraud.

Often, however, debt settlement firms enroll consumers who simply lack the financial resources to succeed in a debt settlement program. Front-loaded fees provide a strong economic incentive for debt settlement companies to do this. Consumers complain when they find themselves unable to save the money needed to settle with their creditors. They may have already paid hundreds or thousands of dollars in fees to a debt settlement firm, only to find themselves with unpaid debts to their creditors that have grown even larger through accumulated interest and late fees. When debt settlement companies have the contractual right to collect fees whether or not a consumer's debts are settled and creditors paid, this sad outcome is often inevitable. Creditors remain unpaid; consumers fall even deeper into debt. The only person who benefits is the debt settlement company.

The essential problem is that, under this fee model, debt settlement companies have the incentive to sign up every possible consumer for their programs. Whether the consumer succeeds or not, the company collects its fees. In many cases, careful screening of potential clients would reveal that a consumer is not a suitable candidate for debt settlement. Debt settlement companies have no incentives, however, to perform such screening. This is the disincentive the Federal Trade Commission's current rulemaking would correct.

A key initiative of ACCORD since its 2009 formation has been to support the Commission's proposed amendments to the Telemarketing Sales Rule addressing the practices of debt settlement companies and other providers of debt relief services to consumers. *In particular, ACCORD believes that the proposed ban on collecting fees until services are performed is a vitally important provision, which will benefit both consumers and the debt settlement companies that work for them.*

ACCORD believes that adhering to two principles will generate the respect the industry deserves from consumers, consumer advocates, Congress, law enforcement, and the consumer financial services industry.

1. A ban on advance fees;[2] *and*

2. Fees based on the savings achieved for consumers.

These two principles protect consumers from the nightmare we all fear—a debt settlement program that leaves a consumer in worse financial shape than when he started the program. By agreeing to take no fee until a creditor is paid, and by basing the fee on the amount of savings negotiated, the debt settlement company will ensure that its client debtors always benefit from its services. ACCORD members have either already adopted these two principles or pledged to transition their operations to incorporate them in the coming months.

With these two simple changes, a true ban on advance fees and a fee calculation based on the success of debt settlement negotiations, abuses in the debt settlement industry can end. These principles align consumers' interests with their debt settlement company's interests—the consumer can work her way out of unmanageable unsecured debt and the company can earn an appropriate fee for its services.

Critics of the debt settlement industry sometimes point out that some consumers drop out of the program before a single settlement is negotiated. When that occurs today, the debt settlement company can usually collect its fee even though the consumer has received no meaningful benefit from the program. This is a situation ripe for abuse. Careful screening of prospective clients will reduce the chance of enrolling consumers for whom debt settlement is not a suitable choice. This is precisely the effect of the Commission's proposed advance fee ban. The debt settlement company will bear the risk that the consumer will not see the program through to the settlement of her debts.

Some industry members will point out that many consumer "drop outs" do so through no fault of the debt settlement firm and that even the most careful screening will not eliminate the problem of drop outs. This is unquestionably true. AC-

[2] The common short-hand reference to an "advance fee ban" can cause confusion. Some industry members have begun to advocate a "pay-as-you-go" model, which they define as collecting a fixed fee on a monthly basis over the first half of the expected duration of the program. This model, which at best is a very accelerated pay-as-you-go scheme, does little to solve the problem of collecting fees from consumers unlikely to experience any or much debt relief. It entitles the debt settlement firm to collect sizable fees regardless of whether any debt is settled. On the other hand, proposals that require a debt settlement firm to settle all of a consumer's debts before collecting any fee go too far in the opposite direction. ACCORD advocates a fair compromise: the debt settlement firm should be permitted to collect a portion of its fee as each debt is settled and the creditor is paid the negotiated amount.

CORD and its members have found, however, that careful screening, excellent customer service, and full disclosure greatly reduce this problem.

The ban on advance fees is an important step in transforming the industry to one that always works for consumer interests. Alone, however, it is not enough. Equally important is the concept of a fee based on the company's success for the consumer. This provision ensures that a consumer will not be left worse off by beginning a debt settlement program.

Some industry members suggest that abuses can be prevented by simply capping the fees a debt settlement company can charge, based on the amount of a consumer's unsecured debt. ACCORD disagrees. Such an approach still allows companies to collect fees even when the consumer receives no benefit. Even when a settlement occurs, under this approach the net cost to the consumer, including the debt settlement company's fees, can exceed the original debt. Indeed, ensuring a debt settlement company's right to collect a fee based on the enrolled *debt ensures a disconnect* between the value of the service and the size of the fee. In contrast, a success-based fee links the consumer's benefit and the amount of the company's fee, providing the debt settlement company with a strong incentive to achieve good results for its clients.

Occasions will exist in which the debt settlement company cannot negotiate a significant savings for the client debtor from a particular creditor. It may seem unfair to the company to deny it a fee despite its best efforts on the consumer's behalf. This objection does not withstand scrutiny, in ACCORD's view. On average, creditors do negotiate significant reductions for appropriate consumers. Despite the occasional situation in which the success-based fee structure yields no fee, the debt settlement company will generally be able to earn fair fees while achieving valuable benefits for its clients.

Perhaps the most important issue facing the Federal Trade Commission as it considers its final rule on debt relief service providers is whether to provide a broad exemption from the advance fee ban when debt settlement services are offered by licensed attorneys. ACCORD believes that such an exemption is unjustified and will effectively negate the consumer protection provided by the advance fee ban. Today, in anticipation of a likely FTC rule banning the collection of fees before debts are settled and paid, debt settlement companies are affiliating with "attorney networks" that hope to circumvent the advance fee ban. If affiliating with attorneys proves to be an effective strategy for the continued collection of advance fees, the Commission rulemaking is likely to have little impact on the abusive practices that have concerned the agency and this committee.

ACCORD is grateful for the Committee's leadership and continued interest in this important consumer protection issue. We appreciate the opportunity to make our views part of the record of this hearing.

Best regards,

JEAN NOONAN,
Counsel.

CONSUMERS UNION
San Francisco, CA

To: Federal Trade Commission, Office of the Secretary
From: Gail Hillebrand, Financial Services Campaign Manager, Consumers Union
Re: Telemarketing Sales Rule—Debt Relief Amendments—R411001
Date: October 9, 2009

Consumers Union, the nonprofit publisher of *Consumer Reports*, will be filing joint comments during the extended comment period with the Consumer Federation of America, the National Consumer Law Center, and other consumer and community groups. We are also separately submitting this analysis of the white paper entitled 'Economic Factors and the Debt Management Industry" by Richard A. Briesch, PhD, Associate Professor, Cox School of Business at Southern Methodist University (August 6, 2009). The white paper has significant limitations that render questionable its ability to support claims about the level of any benefit to consumers from using debt settlement services. That report fails to demonstrate that debt settlement services benefit most consumers who sign up for it.

This report was released by the industry-sponsored organization Americans for Consumer Credit Choice (ACCC) and is branded as ACCC. The report does not disclose whether it was funded by ACCC or by members of the debt settlement industry. The ACCC's website does not disclose its members. When ACCC released the report in August 2009, it stated that: "ACCC, with other industry and interested groups" requested the analysis. (Press Release, "Americans for Consumer Credit

Choice Releases Debt Management Industry Study," August 7, 2009, *http://www.consumercreditchoice.org/node/4.*) ACCC also stated that it asked the study's author for an independent objective assessment of the consumer benefit, if any, provided by debt settlement companies.

The study includes data from only one debt settlement company, which is not identified. *There is no way to tell from the study report if that company, its undisclosed fee structure, practices, dropout rate, or success rate are or are not representative of the debt settlement industry as a whole.* In addition, the study does not describe important information relevant to the consumer experience such as the amount or timing of the fees, the total fees paid by the consumers in the sample to the debt settlement company, or the amounts by which the debt grew during the time of the debt settlement program. The study also does not provide data on the number or percentage of debts settled for all consumers in the sample, nor even for all of the 40 percent of consumers who did not drop out of the program during the study period.

The study's author forthrightly admits some of its limitations. The study's author discloses that: "it is unclear whether or not the findings can be generalized beyond this firm to the industry as a whole." (p. 23) The study also states bluntly that: "Accurate measures of consumer completion and cancellation cannot be calculated." (p. 2) For consumers with canceled accounts—those who dropped out of debt settlement—the author states: ". . . it is very difficult to determine if value was generated for these customers." (p. 23) The study states that the dataset included no information about either settlements or offers of settlement for the consumers who canceled, even though that was more than a majority of the sample.

The study documents a shockingly high cancellation rate.

The study reports that that 60 percent of the customers in the large sample canceled the service within 2 years. (p. 2) The majority of consumers who signed up for debt settlement dropped out. For more than half of these consumers, the only reason given in the study for cancellation is "other." The consumers who owed the most dropped out at a higher rate than the overall dropout rate (64.5 percent vs. 60.57 percent overall). (p.15, Table 2)

This is a very high cancellation rate for an industry that often charges substantial fees upon signing up. The author asserts that a 60 percent cancellation rate is not excessive because other subscription-based businesses such as wireless service providers also have high cancellation rates. (p.15) However, there is no discussion about how the fee structures of those services compare to the fee structure in debt settlement. In addition, consumers who pay monthly for a cell phone also receive services each month, and are heavily marketed to upgrade their current plans or to switch companies. In debt settlement, consumers pay sizable fees upfront, and those who cancel without having any debts settled have not gotten what they sought- relief from their debts. The median duration of the debt settlement contract at cancellation was 5 to 6 months.

The study contains incomplete information about the reason for consumer cancellations. Reasons for cancellation are attributed as follows: bankruptcy—13.5 percent; inability to save—6.8 percent; buyer's remorse, that is, cancellation in an initial period of up to 90 days—9.2 percent; actual or attempted settlements directly by the consumer—14 percent; and "other"— 56.5 percent. (p.16) Because more than half the canceling consumers are listed under "other," the study gives no detail on the reasons for cancellation for the majority of consumers who canceled. Categories such as "debt not being settled"; "unhappy with service"; "program unsuitable for the consumer" or "consumer did not understand the program" or "promises to consumer not kept" apparently were not used.

The author suggests that the cancellation rate is overstated because the debt settlement company's records indicated that 14 percent of those who canceled did so in order to "settle/try to settle on own." (p.16) But these consumers still canceled; presumably after paying some fees. It is not reported whether those consumers later settled their debt on their own; but even if they did so there is no reason to attribute that to the efforts of the debt settlement company. In addition, if consumers did not settle their own debts, those debts presumably may have grown in size before the consumer canceled the debt settlement contract due to creditor charges such as late fees or penalty interest rates.

With respect to the category of consumers who canceled due to bankruptcy, the study's author states that these consumers were "forced out of the program due to litigation." A different perspective is that these consumers should have filed for bankruptcy instead of signing up for debt settlement and saved paying an upfront fee of perhaps 2 percent to 4 percent to start a debt settlement program.

Common reasons that consumers would cancel any type of service are that they are unhappy with the service, think it costs too much, or it doesn't meet their expec-

tations. The large "other" category may include customers who were signed up for an unsuitable program, those who were not satisfied with the program, and those with other reasons. It is simply impossible to tell from this study.

The study cannot support any conclusions about the results for consumers, because information about any settlements or even offers is missing for more than half the sample.

The report fails to include any information about debt settlements or offers of settlement for those customers who canceled, because the company studied did not retain this information. (p.17) Consumers who canceled may have experienced worse results than other consumers—they may not have had any debts settled at all. Indeed, this might be why they chose to cancel. The study's author forthrightly concedes: "it is very difficult to determine if value was generated for those customers [who canceled]." (p.23)

The remaining conclusions are of limited value because they don't reveal what portion of the non-canceling consumers are excluded from the table on consumer welfare metrics.

For that 40 percent of the sample for which there is data about offers and settlements, the study reports information about the size and frequency of offers and settlements, but only for those consumers who had at least one settlement or one offer of settlement. The report doesn't disclose how many consumers had no debts settled, and how many had no offers of settlements. It simply reports settlement data "conditional on the client settling at least one account." (p.17) While it is not entirely clear, it appears that the information about offers also includes only consumers who had at least one offer. The study appears to essentially divide the non-canceling 40 percent of the sample into groups—those with at least one settlement or offer, and those without. The study doesn't disclose the size of each group, and it gives success-related data only for the first group—those who experienced some success. This is like calculating average results by first omitting from the average all of the people who received zero results.

The comparison between debt settlement costs and consumer credit counseling costs attributes some costs to credit counseling that are not paid by the individual in order to receive that service.

The study's comparison of the relative costs of consumer credit counseling and debt settlement include payments made by creditors, and not by the consumer, in the cost of consumer credit counseling. (p.11) The author suggests that creditors should be indifferent between making a fair share payment to a consumer credit counseling agency or giving individual consumers a discount of up to the same amount on the debt. However, the study offers no evidence that this is the case in practice. In addition, this argument ignores the value that creditors place on the services that legitimate credit counseling services provide such as education, advice on budgeting, and overseeing monthly payments to creditors over multiple years.

Since the cost analysis in the study includes some costs not paid directly by the individual consumers using the service, but instead spread throughout the credit system, the cost comparison discussion in the study does not provide a valid cost comparison from the perspective of the individual.

The study's discussion about the relative cost of consumer credit counseling and debt settlement also does not appear to consider the fact that the 60 percent of consumers who dropped out of debt settlement in the sample still owe all of the debt they started with; may have paid a set-up fee plus monthly fees or more; and because of late fees or penalty interest rates, may owe more debt at the end of the program than they did at the beginning on any debt that has not been settled.

The study cites another source stating that the average cost of consumer credit counseling services with a 5-year plan to pay off debt is $910 paid by the consumer and another $764.89 paid by the creditors. (p.11) Debt settlement would cost these consumers much more in fees. If these consumers were charged a total fee of 18 percent fee of the debt, which is within the range cited in the report, then they would owe an average debt settlement fee of $4,338 (averaging the three mean debt levels for the three subsamples to yield an overall mean debt for the sample of $24,099). (See p.15, Table 2; calculation of the overall sample mean by Consumers Union) *These numbers make clear a conclusion not drawn by the report; that consumers pay much higher service fees for debt settlement than for debt management plans offered through consumer credit counseling agencies.* Of course, it is difficult to compare the costs of apples and oranges. If consumers do get their debts settled, they should pay less on those debts, but the report provides no basis to assess how frequently that occurs overall for the full sample. Also, with a debt management plan administered by a consumer credit counseling organization, the amount owed falls each month as the payments are made. That benefit is missing in debt settlement.

The study shows that many consumers did not benefit from debt settlement.

In spite of the methodological limitations, the numbers reported in the study suggest that the majority of consumers did not feel that they were benefiting from debt settlement since 60 percent of them canceled. The study also shows that even those consumers who did not cancel received offers or settlements on less than all of their debt at each of the three time periods comprising the sample of 12, 18, and 24 months. (p.15)

The study's reported percentages of debts settled appear to be calculated using only consumers for whom at least one debt was settled. (p.17) These results do not reveal how many consumers had no debts settled at all. These results also do not reveal how many consumers came in with the apparent median of four debts, and left the program with some of those debts unsettled and having grown larger in the time elapsed during debt settlement program. (p.15, Table 2) *This is like estimating the consumer benefit without averaging in all of the "zero benefit" people who got no settlements at all.*

Even for those consumers for whom at least one debt was settled, it appears that the debt settlement provider studied was consistently unable to settle all of the debt during the time of the sample. (For reasons not disclosed by the author, the study did not sample results at a time period that matched the usual end time for a debt settlement program.) The study concludes that "conditional on receiving at least one offer, clients seem to receive offers from more than 67 percent of their accounts and debts." (p.20) This means that even if the consumer had saved enough to fund all of the offers, and accepted all of the offers, this would still leave the consumers who got some offers saddled with 33 percent of the debts they started out with, plus additional creditor charges which might include late fees, additional interest, and perhaps penalty interest, accrued during the time period for debt settlement.

The numbers from the study's tables can illustrate some points not drawn by the study (Data from study is noted, other calculations are by Consumers Union)

The study examined 4,500 customers of one debt settlement provider. (p.15) Here is some further analysis by Consumers Union using the average debt, cancellation rate, and average results reported in the study.

The sample was divided into three groups of consumers, who owed an average (mean) debt of $7,927; $16,966; and $47,404. (p.15, Table 2) Since each group was equally represented, this yields an overall initial average debt for the full sample of $24,099.

Just over 60 percent, or 2,700, of those consumers canceled the program within 6 months to 2 years of entering the program. (p.15) The study doesn't disclose the total fees paid by those consumers. *Using the mean debt in the sample and a 2 percent set up fee, which is the low end of the range cited in the study, those consumers who dropped out would have paid $1.3 million in fees, and there is no evidence as to whether or not they received any settlements before leaving the program.* Under the 6 percent set up fee cap promoted by the trade organization USOBA in its recent model act, a similar group of consumers could be charged $3.9 million in front-loaded set up fees before canceling.

Of the 1,800 consumers who remained in the program, the study does not disclose how many settled at least one account. However, for consumers who did settle at least one account, the author reports at Table 5 that the mean " percent total debt" for the three sub-samples was 54.7 percent, 54.1 percent, and 53.1 percent, respectively. (p.17) The average of those three numbers is 54 percent. In other words, an undisclosed percentage of the minority of consumers who did not cancel had at least one debt settled, and among those consumers, 54 percent of their debt was settled at either 12, 18, or 24 months from entering the program. These consumers still had substantial remaining debt—46 percent of what they started with.

These consumers also had a substantial number of accounts remaining. For the undisclosed percentage of consumers who had at least one account settled, the percentages of all accounts settled were 52 percent, 51.5 percent, and 53 percent, for a mean of 52 percent. (p.17, Table 5)

Let's look at those results in plain language:

- After one to two years under a debt settlement contract, even those consumers who had not canceled and who had at least one debt settled still owed 46 percent of the total debt that they owed when they started the debt settlement program, plus whatever amount that debt had grown to during the interim.
- After one to two years under a debt settlement contract, even those consumers who had not canceled and who had at least one debt settled still owed money on 48 percent of the debt accounts that they brought into the debt settlement program.

The study's numbers suggest that the 4,500 studied consumers:

- Cancelled at a rate of 60 percent, or 2,700 consumers. (p. 2)
- Owed a total of $108.5 million in debt. (extrapolation from table 2, combined mean debt of $24,099 for each of 4,500 consumers)
- Paid $2.2 million in set up fees if they were charged a 2 percent set up fee. (This is a conservative estimate; the study cites other sources noting a range of 2 percent to 4 percent set up fees). (p.12)
- Lost $1.3 million in those set up fees when 60 percent of them dropped out.
- Would owe over $19 million in fees if they were charged an overall fee of 18 percent of the debt, which is within the two ranges cited by the report of 14–20 percent or 15–25 percent (this does not include a reduction for any fees still owed when the consumer dropped out). (p.12)
- Continued to owe $85 million in debt one to 2 years after starting debt settlement.

The remaining debt calculation is based on the full initial debt, of just over $65 million, for the 60 percent who canceled and just under $20 million for the 46 percent of remaining debt for those who got at least one settlement. The actual remaining debt number may be higher, because this calculation applies to the entire 40 percent non-canceling group the remaining debt percentage of 46 percent which the study provides for that subset of consumers in the non-canceling group who received at least one settlement, and the study does not document or claim that each non-canceling consumer had even one debt settled during the study period. Of course, the debt numbers could actually be higher because the debt amounts for unsettled debt can be expected to continue to increase during the settlement program.

The study does not analyze or discuss the cost to consumers of high upfront payments for debt settlement.

The study asserts that charging consumers reasonable upfront fees, *i.e.,* fees before settlement, "can be justified" but it offers no analysis of the actual fee amounts charged for debt settlement. (p. 24) The fee structure and fee amounts imposed on the 4,500 consumers in the sample is not disclosed, and the report also has no discussion of the amount of fees lost by the 60 percent of customers who canceled, every presumably after paying both a setup fee and monthly fees.

The study also contains some internal inconsistencies.

As released in August 2009, the study contains some inconsistencies and makes some assertions it does not support. The study states on page 13 that 20.5 percent of consumers who canceled did so because of bankruptcy, while Table 3 on page 16 says that bankruptcies accounted for 13.5 percent of cancellations.

Table 3 identifies 14 percent of consumers who canceled in order to "settle/try to settle on own," but the text on pages 16 and 20 treats the consumers in that 14 percent as if all of them in fact did pay off their debt on their own.

On page 3, the study says that more than 57 percent of clients have offers to settle at least 70 percent of their debt, but the only table of data to support this, found at page 17, contains data only on the offers for those consumers who received at least one offer to settle a debt. *Consumers who received no offers are omitted from the analysis of results, which would bias the reported results upwards by excluding the "zero" category from the calculations of mean (average) results.*

Analysis prepared by:

GAIL HILLEBRAND,
Financial Services Campaign Manager.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO GREGORY D. KUTZ

Question 1. What is the average fee amount charged to consumers as a percentage of the consumer's unsecured debt?

Answer. We are unable to provide information about the average fee amount charged to actual consumers nationwide, as this analysis was beyond the scope of our investigation. However, we were able to obtain fee information from 18 of the 20 debt settlement companies we called while posing as fictitious consumers. Of these 18 companies, 17 represented that they collect advance fees before debts are settled. Representatives of these companies told us that the advance fees are calculated based on a percentage of the consumer's debts to be settled. The advance fees cited most commonly ranged between 15 and 17 percent. Moreover, representatives from several companies told us that our monthly payments would go entirely to fees for up to 4 months before any money would be reserved for settlements with our creditors. Only 1 of the 20 companies we called represented that it followed a

contingent fee model where primary fees are charged based on a percentage of the reduction of debt it says it obtains for consumers (in this case, 35 percent). Some companies also represented that they assessed monthly maintenance and other fees. One of the 17 advance-fee companies also revealed that it charged a contingent fee after each debt is settled based on a percentage of the debt reduction.

Question 2. On average, how long does it take for consumers to buildup sufficient funds in an escrow account before those funds are used by debt settlement companies to negotiate and reduce the consumers' credit card balances?

Answer. We are unable to provide information about how long it takes for actual consumers to buildup funds to be used for settlements, as this analysis was beyond the scope of our investigation. However, based on our knowledge of the industry, the length of time needed to obtain a settlement for a consumer may depend upon several factors, including: the consumer's number of accounts, amount owed to each creditor, availability of pre-existing funds, the length of time the consumer's accounts are past due, and the willingness of creditors to negotiate settlements, among other things.

Question 3. In instances where consumers with insufficient income indisputably cannot pay a debt settlement company, how often do debt settlement companies turn away consumers after their initial consultation?

Answer. We are unable to provide information about how often companies turn away actual consumers who do not have sufficient income to afford a debt settlement program, as this analysis was beyond the scope of our investigation.

Question 4. Could you describe to the Committee, based on your investigation, the method of solicitation most often associated with consumer abuse in this area? (Are you seeing mostly online solicitations touting consumer savings, telemarketing, mailings, radio advertisements)?

Answer. We did not conduct an assessment of method of solicitation most often associated with consumer abuses as part of our investigation. However, during the process of identifying debt settlement companies and selecting 20 companies to call, we found examples of online, television, print, and radio solicitations, some of which we found to be fraudulent, abusive, or deceptive. In one case, we identified a company through an unsolicited spam message received by one of our investigators through his private e-mail account. This message advertised debt settlement services, listed a mailing address in the country of Lebanon at the bottom, and contained a link that took us to the company's website. Most of our investigative work to identify debt settlement companies was conducted online.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO WILLIAM AND HOLLY HAAS

Question 1. By what percentage were you told your principal would be reduced? Did your chosen debt settlement company achieve that level of promised reduction?

Answer. We were told (and it's written in the contract) our principal would be reduced to 46 percent of the total debt that we owed. We did NOT receive any reduction from our debt. Instead, numerous fees and penalties were added onto our balances because we were not paying them (as instructed by the debt settlement company). It actually increased our debt approx. $9,000 more than what we owed before going thru debt reduction for the 6 months that we continued with them.

Question 2. Did your debt settlement company clearly explain to you how your monthly payments would be used?

Answer. No. The referring company told us that the monthly payments would go into a holding account where it would stay until there was enough money in the pot to pay a settlement and pay the attorney fees. They did not tell us that the $7,500 attorney's fees would be paid first, before the credit card companies and the debt settlement company negotiated our settlement.

Question 3. What do you believe law makers should do to encourage better protection of consumers from abusive debt collection practices?

Answer. Clearly, there should be some regulation of the way they take your money. Debt settlement companies, if allowed to exist, should have to document and prove how much time they work on your settlements each month, and be allowed to take out a certain percentage each month when they do work on your case, with a maximum cap of some sort (5 percent) of your monthly payments, just for overhead expenses. Only after they negotiate and the settlement is complete, should they be allowed to charge and receive payment for their services. What incentive to do they have to negotiate a settlement if they take their fees off right from the start? This is how any "normal" business works, and so it should be for debt settle-

ment. We also believe that these debt settlement companies should receive heavy monetary fines if they don't document time as required, (or falsely report time) and for falsely advertising things that they simply cannot do. They should be licensed in the same state that they do business, regulated and watched with a paper or electronic trail, and affiliated with credit card companies so the consumer knows that they are honest and legitimate.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO PHILIP A. LEHMAN

Question 1. Mr. Lehman, consumer complaints related to debt collection are on the rise in Arkansas. You mentioned in your testimony, "In our experience, most consumers are worse off after enrolling in debt settlement programs." Could you elaborate upon that for the Committee please?

Answer. The typical debt settlement program requires a consumer to pay substantial advance fees, to cease direct communications with creditors, and to cease making payments on credit accounts. As a result, the consumer's limited funds are diverted to the debt settler instead of the consumer's creditors. The consumer becomes further in arrears while interest and default charges mount and the consumer's credit standing deteriorates. Since the consumer is not communicating with creditors, collection efforts intensify and collection lawsuits are more likely. The debt settler offers little protection against collection activity and typically does not begin settlement efforts for a year or more. In the meantime, the consumer is left to deal with collection pressure and ballooning account balances.

It is undisputed that the large majority of consumers drop out of these debt settlement programs before they are completed. Many of these consumers cancel because they are not seeing any results. These consumers may have paid thousands of dollars in advance fees to the debt settler. They are not likely to get refunds because the fees are deemed fully earned when paid. Therefore, these consumers have lost valuable time and money due to being sidetracked in a debt settlement program. Many could have resolved their delinquent accounts directly with their creditors. Many end up filing for bankruptcy after the debt settlement program fails.

Question 2. Do you think that a fixed-fee pro-rated payment structure over a certain period of time, as proposed by some members of the debt settlement business community, is a salient solution to the consumer complaints reported by many state attorneys general?

Answer. No. The prorated payment models we have seen still frontload the consumer's fees. Typically, they require the consumer to pay a total of 15 to 18 percent of the consumer's debt as a fee collected over the first 12 months of the program. Since settlements often do not take place until after a year or more, the debt settlement company gets paid whether it delivers results or not.

Once its fees have been fully earned, the debt settler has little economic incentive to perform. The program becomes like a Ponzi scheme, requiring new customers to generate revenue in order to provide services to earlier customers.

Question 3. What do you see as Congress's or the Federal Trade Commission's role in further preventing consumer abuse in the area of debt collection and other relief services?

Answer. A Federal role is appropriate because debt settlement abuses are national in scope and most debt settlement providers operate on an interstate basis. The State Attorneys General, in their public comments to the Federal Trade Commission, have strongly supported the FTC's proposed debt relief services amendments to the Telemarketing Sales Rule. The FTC's proposed Rule comprehensively addresses consumer abuses through enhanced disclosures, prohibitions on deceptive representations, coverage of attorney-led debt settlement providers, and prohibitions on advance fees. S. 3264, the Debt Settlement Consumer Protection Act, sponsored by Senators Schumer and McCaskill, has a similar comprehensive approach that will protect consumers.

While the Attorneys General support Federal regulation and enforcement in this area, it is important that the States have the authority to enforce any Federal laws or rules. The Federal standards should set a floor of consumer protection and should not prevent the States from enacting stronger legislative measures.

Question 4. What is our recommendation for better protecting consumers from debt collection abuses moving forward?

Answer. The debt settlement industry has been characterized by deceptive advertising, misleading representations, spotty performance and the charging of excessive fees before delivery of services. As noted above, a comprehensive approach as pro-

posed by the FTC rulemaking and S. 3264 is best suited to address the widespread consumer protection problems.

However, the key to protecting consumers from future harm is a prohibition on advance fees. Debt settlement companies should not be allowed to profit while the consumer loses. North Carolina and now Illinois have adopted strict limitations on advance fees for debt settlement services. There is precedent for such a prohibition from regulation of other debt-related services that were notorious for widespread consumer abuses. Under the Federal Credit Repair Organizations Act and most state credit repair laws, advance fees are prohibited for credit repair services. The FTC's Telemarketing Sales Rule bars advance fees in loan brokering, another area characterized by false promises and minimal performance. Many states currently prohibit advance fees for foreclosure relief or mortgage loan modification services, and the FTC has recommended a similar ban in its proposed Mortgage Assistance Relief Services Rule.

Question 5. What qualities or criteria would help distinguish debt settlement programs that legitimately help consumers versus those that take advantages of vulnerable people?

Answer. A legitimate debt settlement program should have a demonstrated record of performance and should earn its compensation from successful completion of settlements. Unfortunately, reliable evidence of completion rates and settlement results has not been available from the debt settlement industry. Without such evidence, it is difficult to acknowledge any debt settlement company as beneficial to consumers.

A more responsible debt settlement program would incorporate the best features of credit counseling and debt management plans. Consumers would be offered budget and financial planning counseling before beginning any payment program. As with debt management, consumers would make monthly payments that would be distributed to creditors under a plan agreed to by the creditors. The consumers would then be relieved of collection efforts and escalating finance charges. If the consumer performed under the payment plan, the consumer would receive an earned benefit of significant principal reduction. This hybrid debt management/principal reduction model is supported by lenders and nonprofit credit counseling agencies but accounting rules from Federal banking regulators have impeded its implementation.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO JOHN ANSBACH

Question 1. What is the range of administrative fees charged to consumers by your member companies?

Answer. Although USOBA has not surveyed its members to determine the range of fees charged to consumers by each, USOBA believes that the most common service fee charged by USOBA members is 15 percent of the debt enrolled by a consumer at the time of contract formation. Further, we are pleased to share the following data and statistics, all of which were provided to the Federal Trade Commission in January:[1]

(a) 77.58 percent of USOBA member companies providing information in a recent survey primarily use a "fixed fee" model in which fees are spread out in a series of payments over a fixed period of time.

(b) 10.34 percent of USOBA member companies providing information in a recent survey primarily use a "front-end fee model" in which the company requires consumers to pay as much as 40 percent or more of the fee within the first three or 4 months of enrollment and collects the remaining fee over an ensuing period of 12 months or less.

(c) None of USOBA member companies providing information in a recent survey primarily use a "back-end model" in which the consumer pays all of the fee upon program completion, paying a fee equal to a percentage of total savings.

Question 2. What do you believe is the ideal pay structure a debt settlement company should implement to assist consumers in reducing unsecured debt?

Answer. USOBA believes that the "ideal pay structure" is the one adopted in State of Tennessee. Under such a structure, fees are capped not only in amount, but in timing, as well, *i.e.,* fees are capped at 17 percent of the enrolled debt and providers are then required to spread fee collection out over "half the life" of a con-

[1] Please note that the definitions reflected here were provided by the Federal Trade Commission and were posed to USOBA members verbatim.

sumer's program.[2] Because programs are typically 3–4 years in length, this means that fees must be spread out over a period of 1½ to 2 years. Such an approach has been adopted in Nevada, Colorado, Delaware, Iowa, Montana, Idaho, Tennessee and Utah and is under consideration in Texas, California, New York and several other states.

Question 3. Do any of your member companies encourage consumers to discontinue communication with their credit card companies?

Answer. While USOBA cannot speak to the specific practices of every one of its members, it is against USOBA member policies to encourage consumers to discontinue communication with their creditors. What USOBA does support in this area is member companies fully informing consumers of their rights as well as providing information, generally, pertaining to the repayment of unsecured debts. Whether or not to continue servicing any particular debt is ultimately a decision that consumers must make on their own and in consideration of their own personal circumstances. It is a debt settlement company's responsibility to arm consumers with as much information as possible so that such a decision can be made considering all of the facts and consequences.

Furthermore, USOBA would also advise that most of USOBA's members' clients are already unable to meet their monthly creditor obligations by the time they first contact a debt settlement provider. A recent survey of USOBA members revealed that approximately 61 percent of consumers were missing debt payments[3] prior to starting their program. This number climbed to 93 percent when consumers who would be missing payments "very soon" were factored in.

In short, although USOBA is aware of instances where consumers have been told not to pay their bills, USOBA also believes that many if not most potential debt settlement consumers are already not able to pay their bills when they come to a debt settlement program. What they need is accurate information to make informed decisions about how to address their specific situations, and USOBA encourages its member companies to provide that information.

Question 4. What do you see as the best solution for preventing consumer harm in the debt settlement sector?

Answer. USOBA believes that the best solution for preventing consumer harm in the debt settlement sector is a strong state licensing and registration regime, coupled with insurance and/or surety bonding requirements for providers to ensure ability to address consumer wrongs. While we do believe that the states are best positioned to articulate appropriate rules and regulations pertaining to contract requirements, as well as reasonable fee regulation, we do also believe that there is a role for the Federal Trade Commission to play in prescribing debt settlement rules, regulations and guidelines for what is and is not proper advertising. We would also respectfully suggest that there is an additional role for the FTC to play in working with the industry to promulgate appropriate standards for consumer disclosures and a common vocabulary that could normalize disclosures across all forms of debt relief providers, not just debt settlement companies. USOBA also respectfully suggests that the debt settlement law recently enacted in the State of Tennessee, which contains many of these provisions, should serve as a model for any effort to prevent consumer harm in the provision of debt relief services.

Further, two additional regulatory and/or legislative tools should be considered to prevent abuses in the debt settlement sector. First, a change in the United States tax code regarding debt settlement tax treatment should be considered. In much the same way that short sales under certain circumstances no longer create a taxable event (pursuant to the Mortgage Forgiveness Debt Relief Act and Debt Cancellation), debt settled by consumers (through the services of an intermediary and otherwise) should not create a taxable event. This change would remove a major impediment to debt resolution and eliminate abuses created by such taxation.

Second, USOBA would also respectfully suggest the provision of some measure of protection from creditors for consumers who can demonstrate they are actively, faithfully working a debt settlement program, similar to the forbearance enjoyed by customers of credit counseling programs. Because aggressive collection activity is generally the single most significant reason why consumers are forced to withdraw from debt settlement programs, often seeking protection in bankruptcy, providing

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[2] By way of example, if a consumer enrolls $10,000 of debt in a debt settlement program, the maximum allowable fee would be 17 percent of that debt, or $1,700. That fee would then be spread out over half the life of the consumer's program, or 18 months in an average three-year program. As such, the maximum allowable monthly fee under this hypothetical would be $94.44 per month ($1,700 in equal payments over 18 months).

[3] "consistently," "often" or "occasionally"

insulation from collection efforts to those consumers would go a long way toward raising program completion rates.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. KAY BAILEY HUTCHISON TO JOHN ANSBACH

Question. Mr. Ansbach, you stated at the hearing that two individuals that had positive debt settlement experiences had prepared statements about their experience. Please provide copies of those statements to the Committee.

Answer. As requested, please see the statements from Mr. Gary Ross and Ms. Faith Zabriske, which are attached to this document. Both Mr. Ross and Ms. Zabriske are individuals who had positive debt settlement experiences and traveled to Washington, D.C. (from Illinois and Texas, respectively) to tell their stories. They were both in attendance at the Senate hearing.

TESTIMONIAL

Gary Ross
Harwood Heights, IL

My name is Gary Ross and I've come here today to tell my story of how debt settlement successfully helped me get my finances in order. Without the option of turning to a debt settlement company, I would be either sinking further into a debt load from which I would never escape. This industry is very important for people, like myself, who have fallen into hard times. Please do not take away this option when you are drafting your legislation.

My story begins 5 years ago. I had always made it a point to pay my debts on time, but, when I was terminated from my position after thirty-nine years of service, I was faced with enormous financial hardship. I was out of work for a year and a half. During this time, I accrued a great deal of debt. And although I was lucky enough to find a job, my expenses including mortgage, utilities, groceries and credit card payments seemed insurmountable.

I was paying the minimum on my debts but I couldn't keep up. With the late fees and high interest my creditors were charging, I fell into even greater debt. I was scared and felt desperate. I wanted to pay my debts, and I certainly did not want to file for bankruptcy or I was petrified of losing my home. Even after I got a job, I was paying the minimum payments and I felt like I would never be able to pay off everything I owed.

After researching my options, I decided to pursue debt settlement. I had heard good things and I liked that the debt settlement company would take responsibility for all of my debts and communicating with my creditors. As soon as I started working with the debt settlement company, I felt relieved. They took over everything. All of their personnel were polite, understanding and professional.

They explained the program, what was required of me and what I could expect. I was told the importance of good communication and keeping current with my payments. They explained that while I was accumulating money in my account, they would make settlements with my creditors. They also explained that if I was sued by any of my creditors, they would point me to resources that would guide me through the process. That was exactly what happened! I was sued, but I wasn't scared. I was able to complete the paperwork and appear in court. This company gave me the courage to handle court appearances.

After 3 years, I completed the program and am now debt free. I did not lose my house like I would have in Chapter 7 bankruptcy—I have since paid off my house and I own it. I have to say that without debt settlement, I would not have been able to resolve my financial problems. I think it's very important for consumers like me to have this option. Please keep that in mind as you look at the industry.

Thank you for letting me tell my story.

GARY ROSS

Distinguished Members of the Committee:

My name is Faith Zabriskie and I live in Bedford, Texas. I am the Director of Finance for a prestigious downtown Dallas business. While money matters are an important part of my professional career, like so many American citizens, health concerns placed me in a difficult financial situation. Without the help of debt settlement, I might have lost my home or wound up in bankruptcy, both of which would have been devastating on both a personal and professional level.

In 2007, I suffered an injury to my knee and was forced to turn to my credit cards in order to pay medical bills and other expenses necessary to survive. I recovered but was overwhelmed with the debt created by my ordeal.

I contacted my credit card company to find out if they could work with me on repaying my debt. I had an "excellent" credit score in the high 700s and had always paid my debts on time. To my dismay, I was told that until I was 6 months delinquent they would not help me.

I tried credit counseling as well, but they were even more unhelpful. Among other things, they advised me to sell my house and move into an apartment. I simply could not accept that my only options were losing my home or filing for bankruptcy.

It wasn't until I enrolled in a debt settlement program that I found true support. After working the program and saving money as needed, my provider was able to help me settle all of my debts. I am currently making payments on my last account and am well on my way toward being debt free and financially stable.

I am so thankful to have had debt settlement available to me and I implore you to preserve it as an option for other American consumers who are so desperately in need. Thank you for your time.

Best Regards,

FAITH ZABRISKIE
Bedford, Texas

SUPPLEMENT TO THE STATEMENT OF FAITH ZABRISKE

The following is from an unsolicited e-mail dated May 3, 2010, received by a debt settlement provider from their debt settlement consumer Faith Zabriske:

"I wanted to share with you an absolutely exciting experience that occurred this weekend but was in the making for the last 2 years—with the help of your company. . .

As you know, back in 2007, a slip and fall at home resulted in reduced income—thus a fall back on credit cards to make ends meet. Increased rates by the cc companies created disaster and I connected with (your debt settlement company) -

Prior to the slip & fall—I had zero balances on credit cards and a credit score of 780. My mortgage rate is 3.125 percent. After the fiasco with the credit cards, my score plunged as low as 480!!!

After 2 yrs and a successful settlement on all accounts (almost debt free)—my score has climbed back.

Trans Union score: 651—which qualified for a "preferred" customer rate with Honda finance—I was able to purchase a new 2010 Odyssey EX-L with ease—the credit report did indicate that several credit cards were paid on a reduced scale—settlement. And, because scores are also based on debt to income ratio, the debt that was erased through [your company's] negotiations, left a revolving balance $4.0k—down from $90k!!!! And, yes, I was required to pay taxes on portions settled—and planned accordingly. In addition, the paid on time mortgage, utilities, etc assisted the cause. [Your] consumer counseling encouraged paying these items FIRST—and then cc debt next.

The Honda Pre-approval process—on line—was painless! By following the Consumer Report new car process—[I] realized a $4.0k savings via Internet sale and a waiver of $700 destination fee by choosing a vehicle on their lot—pre-visit assisted choice of dealer—by knowing their inventory. Self-education of consumer issues was also encouraged by your counselors.

I wanted you to know how good it feels to be able to reclaim my life—provide for my family—and truly enjoy the accomplishments of my hard work—and the help and guidance (you) provided played a huge role. . . .

I can't thank you and your team enough!!!!

Best,
Faith"

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO HON. JULIE BRILL

As I stated in my testimony, in August 2009, the Commission published in the Federal Register proposed amendments to the Telemarketing Sales Rule ("Rule") to address abuses in the debt relief industry. Given the pendency of the Rule before the Commission, it would be inappropriate for me to comment on matters on which the Commission may have to render a judgment in that proceeding. Accordingly, my

answers are limited to information the Commission has obtained in its law enforcement in this area.

Question 1. In your opinion, why have reported consumer complaints of unscrupulous debt settlement companies been on the rise over the past few years?

Answer. Consumer debt has soared to record levels in the past 2 years, and when consumers are in financial distress, fraudsters peddling phony solutions generally follow. As you stated, reported complaints about debt settlement companies have increased in recent years. Complaints to the FTC about debt relief services (which include debt settlement companies) have increased about 18 percent in the last year.

The FTC takes into account the nature and number of complaints it receives when making enforcement decisions. The Commission has brought eight cases against debt settlement companies in recent years, alleging that the defendants deceived consumers into paying hundreds or thousands of dollars in upfront fees through false promises that they would obtain settlements of consumers' credit card debt for substantially reduced amounts, such as 50 to 60 cents on the dollar. The Commission also has brought a number of cases against other debt relief operations, including actions against sham nonprofit credit counselors and debt negotiators.

In addition, State Attorneys General and state regulators are extremely active in this area. In recent years, the states have brought 124 actions against debt settlement companies.

Question 2. Based on the cases the FTC has brought and research conducted by your staff, do these debt settlement companies generally retain upfront and administrative fees even in instances where they have not successfully reduced consumers' debt?

Answer. All of the debt settlement companies sued by the FTC allegedly had fee structures allowing them to retain all upfront and administrative fees, even in instances where they did not successfully reduce consumers' debt. Some of the defendants provided partial refunds in isolated cases when consumers complained, typically to the Better Business Bureau, the State Attorney General, or the FTC, although this appears to have been infrequent.

Question 3. Are there some legitimate companies in the debt settlement industry that do in fact achieve their stated goals and aid consumers in reducing their debt? If so, how do they achieve these goals and how do their approaches differ from the practices of the unscrupulous companies?

Answer. The extent to which there are companies in the debt settlement industry that achieve their stated goals and aid consumers in reducing their debt is a central issue in the ongoing rulemaking proceeding. It would therefore be inappropriate for me to express a view on this issue at this time.

Question 4. You mention in your written testimony the FTC has alleged that some companies were encouraged to "stop paying their creditors" while failing to disclose that not making payments to creditors could increase the amount owed and could adversely affect their credit score. Could you elaborate on that for the Committee please? How common is that practice in the debt settlement industry?

Answer. Based on the cases the FTC has brought, many debt settlement companies advise consumers to stop paying their creditors without disclosing that this could increase the consumer's debt burden (through accrued interest and late charges) and adversely affect his or her credit rating. The FTC has charged five companies with advising consumers to stop paying their creditors. I also note that the GAO testified that, out of calls that investigators made to 20 debt settlement companies, 17 companies encouraged the investigator to stop paying creditors.

Question 5. How does the Commission alert consumers to deceptive financial practices including some abusive debt collection activities and what else do you think needs to be done to protect consumers?

Answer. To complement its law enforcement and rulemaking activities, the Commission works diligently to educate consumers about deceptive financial practices, providing information to consumers in both English and Spanish. For example, the agency recently released English and Spanish versions of a brochure entitled "Settling Your Credit Card Debts," which offers struggling consumers tips on how to obtain assistance with their debts and spot red flags for potential debt relief scams. The FTC has distributed more than 248,000 print versions of this or two other debt relief brochures in the past 18 months, and consumers have accessed one or more of them online more than 760,000 times. These materials are now available at a new FTC web page, *www.ftc.gov/MoneyMatters*. Over the last 6 months, the Money Matters website has received approximately 50,000 hits per month.

More broadly, the Commission has conducted numerous education campaigns designed to help consumers manage their financial resources, avoid deceptive and unfair practices, and become aware of emerging scams. For example, the FTC has un-

dertaken a major consumer education initiative directed at consumers who are struggling to pay their mortgages. The initiative, which includes a suite of mortgage-related resources for homeowners, explains how to avoid mortgage loan modification and foreclosure rescue scams. NeighborWorks America, the Homeowners Preservation Foundation (a nonprofit member of the HOPE NOW Alliance of mortgage industry members and U.S. Department of Housing and Urban Development-certified counseling agencies), and other groups are distributing FTC materials and information directly to homeowners at borrower events across the country, on their websites, in their mailings, and over the telephone.

With respect to abusive debt collection activities, the FTC educates consumers about their rights and responsibilities in a number of ways. An FTC brochure, entitled "Debt Collection FAQs: A Guide for Consumers," explains the Federal Fair Debt Collection Practices Act in plain language. The brochure is accessible at *www.ftc.gov/bcp/edu/pubs/consumer/credit/cre18.shtm*. In 2009, the FTC distributed 123,500 paper copies of the brochure to consumers in response to inquiries to the FTC and through non-profit consumer groups, state consumer protection agencies, Better Business Bureaus, and other sources of consumer assistance. In addition, online users accessed the brochure on the FTC's website 456,162 times. The FTC also publishes Spanish-language versions of this and related brochures, including "Credit and Your Consumer Rights" and "Knee Deep in Debt."[1] The FTC distributed 12,400 paper copies of the Spanish version of "Debt Collection FAQs" in 2009. Online users accessed the brochure in Spanish 7,792 times in 2009. Most recently, in September 2009, the FTC released a video explaining consumer rights regarding debt collection. The video can be found at *www.ftc.gov/debtcollection* and *www.youtube.com/ftcvideos*.

The Commission also provides consumer education through its Consumer Response Center ("CRC"), whose highly trained contact representatives respond to telephone calls and correspondence from consumers, in both paper and electronic form, and provide them with relevant information and materials. A toll-free number, 1–877–FTC–HELP, makes it very easy for consumers to contact the CRC.

The Commission encourages wide circulation of all of its educational resources and makes bulk orders available to anyone free of charge, shipping included. We provide FTC materials to State Attorneys General and other local law enforcement entities, consumer groups, and nonprofit organizations, who in turn distribute them directly to consumers. In addition, media outlets—online, print, and broadcast—routinely cite our materials and point to our guidance when covering debt-related news stories. Finally, the FTC extends the reach of its consumer education initiatives through public speaking engagements to groups across the country.

Question 6. What is your recommendation for better protecting consumers from these types of abuses moving forward?

Answer. Given the pendency of the rulemaking proceeding, it would be inappropriate for me to express a view as to how to best protect consumers from these types of abuses. Aside from that issue, I fully expect that the agency will continue to expand both its enforcement efforts and its consumer education initiatives and outreach.

Question 7. What is one example of an egregious and fraudulent debt settlement practice the FTC has reviewed or resolved, and in your view, how could it have been avoided?

Answer. As one example, in October 2007 the Commission alleged that four companies and their principals, Robert and Miriam Lovinger, marketed their services through websites that offered a "Debt Meltdown Program," described as "an aggressive method of helping consumers out of the debt trap and away from the bankruptcy path." The FTC's complaint alleged that the defendants told consumers that they would obtain settlements that would substantially reduce the consumers' debt. The defendants allegedly promised to negotiate with creditors and begin making payments to them within several weeks after consumers joined their program, and to provide personalized financial counseling. Defendants also allegedly told consumers to have no further contact with their creditors and to stop paying them immediately, enabling the defendants to negotiate for them. The defendants, however, allegedly failed in many cases to contact each creditor as promised, and consumers continued hearing from creditors about their debts. In addition, the Commission al-

[1] The Spanish-language version of "Debt Collection FAQs" ("Preguntas Frecuentes sobre Cobranza de Deudas: Una Guϕa para Consumidores") is accessible at *www.ftc.gov/bcp/edu/pubs/consumer/credit/scre18.shtm*; "Credit and Your Consumer Rights" ("El Crédito y Sus Derechos como Consumidor") is accessible at *www.ftc.gov/bcp/edu/pubs/consumer/credit/scre01shtm*; and "Knee Deep in Debt" ("Endeudado Hasta el Cuello") is accessible at *www.ftc.gov/bcp/edu/pubs/consumer/credit/scre19.shtm*.

leged that defendants regularly withdrew money from consumers' trust accounts to pay their operating expenses.

In August 2008, the defendants agreed to settle the Commission's charges. The settlement barred the defendants from violating the law again and barred the Lovingers from offering debt settlement services to consumers in the future without first obtaining a $1 million performance bond. The settlement imposed a $7 million judgment on the defendants that was partially suspended based on an inability to pay. The judgment may be imposed in full in the future if the Commission learns that the defendants misrepresented their financial condition during settlement negotiations. The judgment also required the Lovingers to transfer proceeds from the sale of property they owned to be used for possible restitution to injured consumers.

The Commission works to prevent scams like this one from taking advantage of consumers by a combination of aggressive law enforcement (including seeking consumer redress where appropriate), extensive consumer education, guidance to industry as to how to comply with the law, and, where appropriate, promulgating rules.

October 16, 2009

DONALD S. CLARK, Secretary,
Federal Trade Commission,
Washington, DC.

RE: TELEMARKETING SALES RULE—DEBT RELIEF AMENDMENTS—R411001

Dear Secretary Clark:

These comments are being submitted by Consumer Federation of America,[1] Consumers Union,[2] Consumer Action,[3] the National Consumer Law Center on behalf of its low-income clients,[4] the Center for Responsible Lending,[5] the National Association of Consumer Advocates,[6] the National Consumers League,[7] U.S. PIRG,[8] the Privacy Rights Clearinghouse,[9] the Arizona Consumers Council,[10] the Chicago Consumer Coalition,[11] the Consumer Assistance Council,[12] the Community Reinvestment Association of North Carolina,[13] the Consumer Federation of the Southeast,[14]

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[1] Consumer Federation of America is a nonprofit association of some 300 nonprofit consumer organizations across the U.S. CFA advances the consumer interest through research, education and advocacy.

[2] Consumers Union of United States, Inc., publisher of *Consumer Reports,* is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. CU's publications and services carry no outside advertising and receive no commercial support.

[3] Consumer Action is a national non-profit education and advocacy organization that has served consumers since 1971. CA serves consumers nationwide by advancing consumer rights in the fields of credit, banking, housing, privacy, insurance and utilities.

[4] The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states that represent low-income and elderly individuals on consumer issues.

[5] The Center for Responsible Lending is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

[6] The National Association of Consumer Advocates is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[7] The National Consumers League, founded in 1899, is America's pioneer consumer organization. Its mission is to protect and promote social and economic justice for consumers and workers in the United States and abroad.

[8] U.S. PIRG serves as the federation of non-profit, non-partisan state Public Interest Research Groups, which take on powerful interests on behalf of their members. The PIRGs have long advocated for a fair financial consumers marketplace.

[9] The Privacy Rights Clearinghouse is a nonprofit consumer education and advocacy organization, established in 1992 and located in San Diego, CA.

[10] The Arizona Consumers Council has been educating, protecting and advocating on behalf of Arizona consumers since 1966.

[11] The Chicago Consumer Coalition advocates for social and economic justice.

[12] The Consumer Assistance Council, located on Cape Cod, works with the Massachusetts Attorney General's office to provide consumer information and to mediate complaints.

[13] The Community Reinvestment Association of North Carolina is a bank watchdog agency promoting and protecting community wealth.

[14] The Consumer Federation of the Southeast is a not-for-profit consumer advocacy group founded in 2003 and dedicated to consumer advocacy in the Southeastern United States. Its goal is to establish a vigorous, new, pro-consumer agenda built upon public awareness, consumer education, and coalition-building.

Grass Roots Organizing,[15] Jacksonville Area Legal Aid, Inc.,[16] the Maryland Consumer Rights Coalition,[17] Mid-Minnesota Legal Assistance,[18] and the Virginia Citizens Consumer Council.[19]

We applaud the Federal Trade Commission (FTC) for its thorough analysis of the debt relief industry and for the essential amendments that it has proposed to the Telemarketing Sales Rule (TSR) to protect consumers from abusive practices in debt relief, including for-profit debt settlement services, debt counseling services, and debt negotiation services. These amendments are crucial to protecting consumers from deception and ensuring that they do not pay for false promises rather than real results.

Summary of Comments

We strongly support the proposed rule, and in particular these crucial elements:

- *A strong, effective ban on requesting or taking fees in advance of achieving final, documented results for consumers.* We recommend that the results must be based on the consumer's acceptance of the creditor's offer, as documented in writing.
- *Coverage of calls that consumers make in response to advertisements for debt relief services in the general media.* Since for-profit debt counseling, debt settlement, and debt negotiation services are commonly advertised on the Internet, on television, or by other means which are designed to induce consumers to make inbound calls, not covering those calls would create a huge loophole.
- *Prohibitions on specific material misrepresentations.* This provides greater clarity to debt relief service providers regarding the types of claims that the FTC will consider to be deceptive.
- *Specific required disclosures about how the service works and other important information.* We recommend that these disclosures be made before the consumer enrolls for the service, whether they have to pay or not at that point.

In addition, we recommend that the TSR should prohibit debt relief services from these other abusive practices:

- *Changing the addresses on the consumer's accounts so that the debt relief company receives the bills and notices, not the consumer.*
- *Instructing or advising consumers to have no further contact with their creditors.*
- *Instructing or advising consumers not to make any payments to their creditors directly.*
- *Making any representations about the percentage or dollar amount by which debts or interest rates may be reduced, or in the alternative, requiring that any representations about results be based on those which are documented by actual customer experience over the prior 2 years for all of the debt those consumers brought into the program.*
- *Failing to provide a "money-back" cancelation period of at least 90 days in the contract, plus more time if there has been a material breach of the contract or a material violation of law.*

We further recommend that the exemption in TSR for telephone calls in which the sale of goods or services is not completed, and payment or authorization of payment is not required, until after a face-to-face sales presentation should not apply

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[15] Grass Roots Organizing is a 501(c)3 nonprofit organization in Missouri, with a membership of more than 450 households. Founded in 2000, GRO's mission is to create a grassroots voice for economic justice and human rights for all Missourians.

[16] Jacksonville Area Legal Aid, Inc. is a nonprofit law firm that provides free legal services to low income, elderly and working poor individuals in 17 counties in Northeast Florida. JALA's consumer law unit focuses on assisting those who have been victims of predatory lending, unfair collection practices and other illegal business practices.

[17] The Maryland Consumer Rights Coalition was founded in Baltimore, Maryland in 2000 to provide a voice for Maryland consumers. Its mission is to advance and protect the interests of Maryland consumers through education and advocacy and to ensure fairness and safety in the marketplace.

[18] Mid-Minnesota Legal Assistance is one of the network of Legal Aid programs in Minnesota that provides legal advice and representation for low-income clients in a wide range of areas, including consumer law, family law, health law, housing and landlord/tenant law, public benefits law, youth law, disability law, and elder law. Among its services, MMLA, through its Legal Services Advocacy Project, engages in legislative and administrative advocacy, conducting research and policy analysis and providing community education and training.

[19] The Virginia Citizens Consumer Council is a statewide grassroots volunteer consumer education and advocacy organization.

with respect to telemarketing of debt relief services. This exemption could swallow the rule, as well as favor some debt relief providers over others.

In our comments we will address the problems in the debt relief industry and why the proposed amendments to the TSR will help address those problems. We will also explain why specific language changes and additions are needed in order to improve the coverage and workability of the TSR in regard to debt relief services. We believe that strong FTC rules will benefit not only financially distressed consumers but also creditors who are owed money and legitimate debt relief services that truly provide consumers with help for their debt problems.

The Proposed Amendments are Sorely Needed

In its Notice of Proposed Rulemaking (NPR), the FTC has vividly described the pervasive illegal conduct that has occurred as for-profit debt relief services have emerged.

1. Debt settlement services are fraught with problems.

A debt settlement service promises to attempt to settle credit card and other unsecured debts for significantly less than the full amount owed. However, the consumer has to save enough to fund those lump sum settlements to each creditor. Settlement negotiations do not commence until the consumer has saved enough to settle at least one of the debts involved, and there is no likelihood that all of the debt can be eliminated unless the consumer saves a very sizable amount of money. Since multiple debts are often involved, the process may take several years. While the savings period is running, the debts grow in size due to creditor charges for interest and penalty fees. Entering a debt settlement program does not stop the consumer from being called by debt collectors, experiencing negative credit history, being sued for the debt, and having wages garnished after a judgment.

The fee is often calculated on the amount of the consumer's debt or on the projected savings, regardless of whether the debt is ultimately settled or not. As the FTC noted, there are different fee models, but the most common is the "front-end fee" which requires consumers to pay a significant portion of the total amount within the first few months and the balance within a year or less—often well before any negotiations have taken place. Individuals who can't save enough to settle their debts end up paying hundreds, even thousands of dollars but getting no benefit in return. The so-called "flat fee" approach also involves significant fee payments well before any settlement is achieved. For example, the consumer may be charged a set-up fee of from 2 percent to 4 percent, plus additional fees until the fees total from 14 percent to 20 percent of the full amount of the original debt brought into the settlement program, with the entire percentage fee paid over the first half of the program.[20]

Non-completion rates are very high and the rate of successful settlements is very low, as we will discuss further in our comments on the proposed prohibition against advance fees.

Earlier this year, Consumer Federation of America (CFA) testified before Congress that debt settlement firms often mislead consumers about the likelihood of a settlement, cannot guarantee that a creditor will agree to a reduced payment, often mislead consumers about the effect of the settlement process on debt collection and their credit worthiness, and charge such high fees that consumers often don't end up saving enough to make settlement offers that a creditor will accept, causing many consumers to drop out of the program.[21]

The problems consumers face in debt settlement have been much in the news:

- *The New York Times* reports that consumers rarely benefit from debt settlement services. "More often, they say, a settlement company collects a large fee, often 15 percent of the total debt, and accomplishes little or nothing on the consumer's behalf." Debt Settlers Offer Promises But Little Help, *New York Times*, April 19, 2009.[22]

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[20] "Economic Factors and the Debt Management Industry," Richard A. Briesch, PhD, Associate Professor, Southern Methodist University, August 6, 2009, at 12, available at *http://www.consumercreditchoice.org, see also* Keest, *supra*.

[21] Testimony of Travis B. Plunkett on behalf of the Consumer Federation of America, the National Consumer Law Center, and U.S. PIRG before the Committee on Commerce, Science, and Transportation of the U.S. Senate regarding consumer protection and the credit crisis, February 26, 2009, *http://www.consumerfed.org/elements/www.consumerfed.org/File/Plunkett__Testimony__Senate__Commerce__Feb__26(3).pdf*.

[22] *http://www.nytimes.com/2009/04/20/business/20settle.html?__r=1&emc=eta1*.

- The New York Attorney General Andrew Cuomo has called debt settlement a "rogue industry." Cuomo Subpoenas Debt Settlement Firms, *Los Angeles Times*, May 8, 2009.[23]
- Debt settlement was identified in the March 2009 issue of *Consumer Reports* as one of five "financial traps." Financial Traps are Flourishing, Tough Times Have Bred Five Costly Come Ons: High Fee Debt Settlement, *Consumer Reports*, March 2009.[24]
- The CBS Morning News says that complaints to the Federal Trade Commission about debt settlement "more than quadrupled between 2006 and 2007." Debt Settlement Can Hurt More Than Help, May 12, 2009.[25]
- Smart Money reports that using these companies is "fraught with risk, not to mention outrageous fees." Debt Settlement: a Costly Escape, August 6, 2007.[26]

The Better Business Bureau of Los Angeles, Orange, Riverside and San Bernardino Counties offers this caution about debt settlement services:

> Complaints on these companies allege that creditors continue to harass clients, fees and interest continue to accumulate, and that the companies do not contact the creditors. Usually, creditors turn the claims over to collection agencies, file suit and pursue collection of the money owed to them. Debts are seldom settled, customer's credit is ruined, and many people are sued forcing them to seek bankruptcy protection. Typically, it is difficult to obtain refunds from the companies.[27]

The FTC and state agencies have brought many cases against debt settlement companies. The FTC case against Edge Solutions, Inc. provides a good example of the types of problems that consumers have encountered with debt settlement services.[28] The company allegedly promised to reduce consumers' debts to 55 cents on the dollar; told consumers to stop making payments to their creditors, which would place them in a "hardship condition," making negotiations possible; promised that debts would begin to be paid to creditors within several weeks; required consumers to set up direct debits from their bank accounts to an account controlled by the company, from which their fees and debts would be paid; promised one-on-one financial counseling, which in most cases was never provided; buried in the agreement the fact that consumers must pay 45 percent of the total fee upfront before any payments would begin to creditors and that this might take several months; failed to negotiate with and pay creditors as promised; and caused consumers to incur late fees, finance charges, overdraft charges, and negative information on their credit reports, and to face various types of legal action by creditors.

In its Congressional testimony, CFA concluded that, "The essential promise made by debt settlement firms to the public, that they can settle most debts for significantly less than what is owed, is often fraudulent. There is general consensus that credit counseling, if done well, can provide significant benefits for some financially distressed consumers. No such consensus exists for debt settlement."[29]

2. The proposed amendments wisely cover all types of for-profit debt relief services.

The FTC has taken the correct approach in covering all types of for-profit debt relief services in the proposed amendments to the TSR. While they may operate differently,[30] for-profit debt counseling, debt management, and debt negotiation services share some of the same characteristics as debt settlement services (in fact, sometimes the terms debt settlement and debt negotiation are used interchangeably). These businesses often charge significant fees upfront and make representa-

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[23] *http://articles.latimes.com/2009/may/08/business/fi-debt-relief8.*

[24] *http://www.consumerreports.org/cro/magazine-archive/march–2009/money/scams/high-fee-debtsettlement/scams-high-fee-debt-settlement.htm.*

[25] *http://www.cbsnews.com/stories/2009/05/12/earlyshow/living/money/main5008357.shtml.*

[26] *http://articles.moneycentral.msn.com/SavingandDebt/ManageDebt/DebtSettlementACostlyEscape.aspx.*

[27] *http://www.la.bbb.org/BusinessReport.aspx?CompanyID=100046948.*

[28] See FTC press release at *www.ftc.gov/opa/2008/08/edge.shtm.*

[29] Testimony of Travis B. Plunkett on behalf of the Consumer Federation of America, the National Consumer Law Center, and U.S. PIRG before the Committee on Commerce, Science, and Transportation of the U.S. Senate regarding consumer protection and the credit crisis, February 26, 2009, *http://www.consumerfed.org/elements/www.consumerfed.org/File/Plunkett__Testimony__Senate__Commerce__Feb__26(3).pdf.*

[30] Debt management services offer to make arrangements for consumers to pay their entire debts with reduced interest rates and fees and over longer periods of time; debt negotiation firms offer to make consumers' debts more affordable by obtaining lower interest rates and other concessions from the creditors.

tions that lead consumers to believe that they will get debt relief in return—representations that are sometimes false.

A 2003 report[31] by the National Consumer Law Center (NCLC) and CFA about credit counseling and debt management programs described problems with some debt management services, including: failing to make consumers' debt management program on time, or at all; deceptively claiming that fees are voluntary; not adequately disclosing fees; charging excessive fees; and falsely purporting to be nonprofit organizations. The report also noted that newer entrants in the industry were generally more aggressive in their marketing tactics, particularly with Internet and telemarketing advertising.

The FTC has cited many enforcement actions against debt counseling and debt negotiation services that illustrate the need to protect consumers by bringing these companies under the amendments to the TSR. For instance, in the largest debt management cases ever brought by the FTC, AmeriDebt allegedly misled consumers into believing that it was a nonprofit credit counseling service that would teach them how to handle their debts.[32] Instead, it enrolled them in debt management plans operated by a service provider. Furthermore, contrary to AmeriDebt's claims that there were no upfront fees, it kept consumers' initial payments as fees rather than disbursing them to creditors as promised.

In the case against Debt Solutions, Inc., the FTC alleged that the company charged consumers hundreds of dollars for a "debt elimination program" that, despite its claims, did not greatly reduce interest rates or result in thousands of dollars in savings as represented.[33] Furthermore, consumers were not told that the promised savings would take decades to achieve and that the majority of savings would come from increasingly paying more toward their debts every month, not from reduced interest rates.

To protect consumers from deception and abuse, all types of for-profit debt relief services should be covered by the proposed amendments. If debt counseling and debt negotiation services were not included, some debt settlement companies might try to escape the requirements and prohibitions by claiming to be engaged in those businesses instead. Furthermore, as the FTC has seen, some companies provide a range of debt relief options. For instance, Debt-Set offered a "debt consolidation program" for consumers whose unsecured debts were overdue by 1 month or less and a "debt settlement program" if the debts were overdue by a longer period.[34] The FTC must be careful not to create any loopholes that would allow some businesses to escape the rules that apply to their competitors.

We agree that "product" should be added to the definition of debt relief service so that the rules cannot be evaded by recasting the service as a product. In addition, we suggest adding "or seek to alter" to the definition to avoid creating a loophole for services that might simply claim to attempt to alter the terms of the debt. The revised definition in §310.2 (m) would read:

> *Debt relief service* means any *product or* service represented, directly or by implication, to renegotiate, settle, or in any way alter *or seek to alter* the terms of payment or other terms of the debt between a consumer and one or more unsecured creditors or debt collectors, including, but not limited to, a reduction in the balance, interest rate, or fees owed by a consumer to an unsecured creditor or debt collector.

Key Aspects of the Proposed Amendments

1. Advance fees must be prohibited to prevent substantial consumer injury.

We strongly support the proposed restriction in section 310.4 (a)(5) to ban fees in advance of consumers actually getting the services they are paying for. The FTC has proposed that debt relief services should not request or receive any payment until providing the customer with documentation that the particular debt has been renegotiated, settled, reduced, or otherwise altered. We agree that this is essential to protect consumers from the substantial injury that is caused when they pay fees upfront and little or no services are ever rendered.

Consumers pay significant fees for debt relief services, often before any services are actually provided.

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[31] "Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants," National Consumer Law Center and Consumer Federation of America, April 2003, *http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/credit_counseling_report.pdf*.

[32] See FTC press release at *www.ftc.gov/opa/2008/09/ameridebt.shtm*.

[33] See FTC press release at *www.ftc.gov/opa/2007/05/dsi.shtm*.

[34] See FTC press release at *www.ftc.gov/opa/2008/02/debtreduct.shtm*.

Consumers pay significant amounts of money for debt relief services. For instance, Homeland Financial Services and four other companies charged non-refundable fees of up to 15 percent of consumers' unsecured debts with the promise of reducing those debts by as much as 40 to 60 percent.[35] This seems to be typical of debt settlement companies; whether the fees are based on the total amount of debts or the projected savings, they appear to range from 14 to 20 percent.[36] For instance, for debts totaling $25,000, the consumer would pay $3,500 to $5,000 if the fee was based on the amount of the debt, which seems to be the most common method of calculation. This is a very large amount of money, especially for consumers who are already in financial distress.

Furthermore, as in the case of Homeland Financial Services, negotiations with the creditors usually begin only after the consumer has paid a large percentage of the fees. One company representative at the FTC's September 2008 Public Workshop on "Consumer Protection and the Debt Settlement Industry" indicated that in the front-end fee models consumers could pay 40 percent or more within the first three or 4 months, 65 percent within 6 months, "without any results at that point."[37] We also note the comments at that workshop of the United States Organization for Bankruptcy Alternatives acknowledging that "Some business models call for the fee to be paid up front in its entirety, over the first several months of the program prior to any negotiating with creditors takes (sic) place."[38] The flat fee model, the second most common according to industry representatives at the workshop, works similarly, with the entire amount collected over the first half of the enrollment period.

As we commented previously, debt settlement negotiations cannot start until consumers have saved enough money for the service to make offers to their creditors. That can take years, depending on the amount of the debt, the willingness of various creditors to cooperate, and the consumer's capacity to save. For consumers with multiple debts, negotiations are typically initiated in sequence; when one is settled, the consumer starts saving for the next. This stretches the process out even further. Debt settlement companies typically advertise that they will help consumers become "debt free" within two to 4 years; none claim that they can resolve debt problems in less than 12 months.[39] Part of the reason why the process takes so long is that in addition to saving funds toward a settlement, consumers are paying a substantial portion of the fees upfront.

Meanwhile, the consumers are instructed not to make any payments to their creditors, or even to have any contact with them. Even if a settlement company does not explicitly direct customers not to pay their creditors, such encouragement is implicit. There is simply no way that the vast majority of highly indebted consumers can save enough to make a viable settlement and pay fees without reducing or eliminating the payments they make to creditors. By the time settlement negotiations begin, if at all, consumers' debts have become higher because of interest and penalties, and the amount of money at their disposal has been reduced by the fees they have paid, diminishing the chances that they will be able to make viable offers to their creditors.

For-profit debt negotiation and credit counseling companies also charge significant fees before providing services. Debt Solutions charged $399 to $699 in advance for its debt negotiation "program." Consumers paid $675 upfront to Select Management Solutions, which promised to reduce their credit card interest rates. When the service, which consisted of three-way telephone calls with their credit card companies, did not produce the results that consumers were led to expect, the company allegedly refused to honor its refund policy.[40] National Consumer Council, masquerading as a nonprofit credit counseling service, debited $500 from consumers' banks accounts as an "establishment fee" and $50 per month thereafter from the monthly payments that consumers thought were going to their creditors, without disclosing

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[35] See FTC press release *www.ftc.gov/opa/2006/09/nationwide.shtm*.

[36] See comments to the FTC by The Association of Settlement Companies, December 1, 2008, page 2, *http://www.ftc.gov/os/comments/debtsettlementworkshop/536796–00036.pdf*.

[37] See U.S. Debt Resolve (Johnson), Tr. at 72–74 mentioning that 40 percent or more is collected within the first three or 4 months and the rest in 12 months or less and again at Tr. 108 that 65 percent of the fees will be paid in 6 months "and the client won't have any results at that point in time."

[38] See *http://www.ftc.gov/os/comments/debtsettlementworkshop/536796–00022.pdf*, page 12.

[39] See Debt Consolidation Care at *http://www.debtconsolidationcare.com/debt-settlement.html*, Fidelity Debt Solutions at *http://www.fidelitydebt.net/debt-consolidationlp1.html?s=gaw&kw=Debt%20settlement&gclid=CIayr5ikip0CFQ62sgod9xz32Q*, FixYourDebtProblems.com at *http://www.fixyourdebtproblems.com/debt-relief-help-settlement/*, Debtamerica Relief at *http://www.debtmerica.com/a/debtsettlement_google.html?gclid=CND21LGmip0CFSTFsgodqlEd3g*.

[40] See FTC press release at *www.ftc.gov./opa/2008/08/smsomax.shtm*.

that the company would not start negotiating a payment plan with creditors until 6 months or longer had elapsed.[41]

Disclosures and prohibited misrepresentations, no matter how effective, are inadequate to prevent substantial injury by themselves. Unjustified fees and abusive practices must also be prohibited.

While the disclosure requirements and prohibitions against misrepresentation that the FTC has proposed are helpful, they alone are not sufficient to prevent the substantial injury that the FTC has described. As the FTC has correctly pointed out, when consumers are considering debt relief services, they have no way to know whether the representations being made are true or not; they can only judge that after they have enrolled (sometimes long after), when the programs have either produced results or failed to do so.

Furthermore, consumers who need help with debt problems are often in very stressful situations. A survey CFA recently conducted showed that the fastest growing complaints that state and local consumer protection agencies received last year were about aggressive debt collection practices.[42] As the FTC noted in the NPR, this makes consumers very vulnerable when they respond to solicitations that promise them relief. The required disclosures that the FTC proposes will help consumers understand the total cost of debt relief services, how they work, and what other alternatives may be available. But desperate consumers will tend to focus most on the representations made in the advertisements about how these services can relieve them of their debt worries. We see the required disclosures and prohibited misrepresentations as good complements to, but not substitutes for, the proposed ban on advance fees.

It is abusive to charge fees in advance for services when most consumers do not benefit.

The information that the FTC and state agencies have gleaned from enforcement actions against debt relief companies revealed extremely low success rates. The vast majority of consumers who signed up for those services derived absolutely no benefit in exchange for the fees they paid. For example, in the case against National Consumer Council, the court-appointed receiver found that only 1.4 percent of consumers obtained the promised results.[43] In recent New York cases against debt settlement companies, the state attorney general alleges that only 1 percent and ⅓ percent of consumers received the services they were promised.[44]

The Center for Responsible Lending (CRL) testified in Congress in 2009 that the debt settlement business is inherently problematic because it specifically targets consumers who are least likely to complete their programs. CRL said that the business model which requires consumers to pay between 14 and 20 percent of their debt in fees before they can reach a settlement means that few were likely to benefit and most were likely to drop out because they could not keep up the monthly payment to the debt settlement company and save funds for settlements at the same time.[45]

In case after case against various types of for-profit debt relief services, the FTC has found that very few, if any, consumers got real help with their debt problems after having paid hundreds, even thousands of dollars in fees. We agree with the FTC that it is an abusive practice to charge consumers in advance for debt relief services that they are likely never to receive. Not only do financially distressed consumers lose what little money they have left to the high fees charged by these companies, but they are left worse off than they were before when the promised results are not achieved, facing higher debts, further damage to their credit records, and the possibility of lawsuits and wage garnishment. In this respect, the consumer harm is more severe than in situations involving recovery services, credit repair, and advance fee loans.

Furthermore, even in the minority of situations where the results are achieved, that is often long after the consumer first enrolled. In the meantime, it is not clear what services have been provided for which the firms should be compensated beyond a de minimus amount, as we will discuss later. This situation is very similar to that of credit repair, in which there is little evidence of success and a long lag time be-

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[41] See FTC press release and link to complaint at *http://www.ftc.gov/opa/2004/05/ncc.shtm*.

[42] See press release with link to "2008 Consumer Complaint Survey Report," July 30, 2009, *http://www.consumerfed.org/elements/www.consumerfed.org/File/Consumer%20Complaint%20survey%20Report%20PR%207-30-09.pdf*.

[43] See FTC press release at *http://www2.ftc.gov/opa/2005/03/creditcouncel.shtm*.

[44] See press release at *www.oag.state.ny.us/media_cetner/2009/ma/may19b_09.html*.

[45] Testimony of Kathleen Keest on behalf of CRL, CFA and NCLC before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection, May 12, 2009, *www.responsiblelending.org/credit-cards/policy-legislation/congress/ftc-ccdp-testimony–5–12–2009final.pdf*.

fore results, if any, are achieved. The approach that Congress took in addressing this problem was to enact the Credit Repair Organization Act, which bans advance fees.[46] That is the correct approach here.

Industry has not provided reliable, credible empirical evidence of the value or success of for-profit debt relief services.

There has been no reliable, credible empirical evidence from industry of the value or success of for-profit debt relief services. In researching the debt settlement industry for a 2005 report, NCLC found that it was very difficult to obtain information from companies or industry associations and was forced to conclude that "Unfortunately, it is not easy to determine what the companies actually do to earn these fees."[47] As the FTC has noted, what little information has been provided by the debt settlement industry fails to show the success rate—that is, the number or percentage of consumers who pay for services and fully achieve the promised results.

A recent study[48] released by Americans for Consumer Credit Choice (ACCC) does not provide this evidence. There is no list or other information about the ACCC's members on its website, but it appears to be a debt settlement industry group.[49] The study is based on data of 4,500 customers from only one debt settlement company, which is not identified. The author contends that this is a "very significant sample of consumers in this industry."[50] However, there is no information about what percentage of the company's customers, or of the industry as a whole, this represents to support that contention. There is also no information about the company's fee structure.

The author points to other limitations—for instance, the company does not retain information regarding offers and settlements for consumers who dropped out of the program—and acknowledges that the results from this company may not be applicable to the industry as a whole.

We also note that there is no explanation of how this company was selected for the study, or by whom. While the data cannot be taken as representative of all debt settlement companies, if this is an example of the industry at its best, it reveals some serious shortcomings. For example, a shocking 60 percent of customers canceled their participation in the program before completing it. The author touts this drop-out rate as better than the 80 percent[51] or more that some have described as typical of debt settlement and compares it favorably with the churn rate for subscription services such as mobile phones.

We would not characterize the majority of customers dropping out of a debt settlement program before completing it as a good result, especially when there is no evidence that any of the drop-outs settled even one of their debts through the company's efforts. Furthermore, the comparison to the churn in the wireless phone industry does not fit. Cell phone customers don't usually pay in advance of receiving the service, as debt settlement customers do. And many undoubtedly switch their wireless service provider because another one has offered them a better deal. It's unlikely that debt settlement customers drop out because another debt settlement company has offered them a better deal.

Given the predominant front-loaded fee structure in the debt settlement industry and the fact that the customers of this company who canceled had been in the program for a median of 5 to 6 months (and some for much longer), we can assume that many paid a substantial portion of their fees before dropping out. The report provides explanations for why some customers canceled (13.5 percent of the drop-outs filed for bankruptcy, 6.8 percent were unable to save, 9.2 percent had "buyer's remorse" within the first 2 or 3 months, and 14 percent settled on their own or were going to try to do so), but there is no explanation for why more than half (56 percent) of those who dropped out did so. Some may well have been discouraged after paying fees for months and getting no satisfactory results. It also seems clear that, with such a high cancelation rate, the settlement firm was enrolling customers in the program for whom it was not appropriate in the first place. In fact, it seems

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[46] 15 U.S.C. § 1679 et. seq.

[47] "An Investigation of Debt Settlement Companies: An Unsettling Business for Consumers," National Consumer Law Center, March 2005, *http://www.nclc.org/issues/credit_counseling/content/DebtSettleFINALREPORT.pdf*.

[48] "Economic Factors and the Debt Management Industry," Richard A. Briesch, PhD, Associate Professor, Southern Methodist University, August 6, 2009, available at *http://www.consumercreditchoice.org*.

[49] The August 7, 2009 press release states that "ACCC, with other industry and interested groups" requested the study, see *http://www.consumercreditchoice.org/node/4*.

[50] *Id.* page 15.

[51] "Look Out for That Lifeline, Debt Settlement Firms are Doing a Booming Business—And Drawing the Attention of Prosecutors and Regulators," *BusinessWeek,* March 6, 2008.

likely that this company made little or no effort to determine suitability at all, which we believe should be a requirement for all debt relief services.

Of the 40 percent still in the program, the report does not make clear how many had actually settled even one of their debts. The report provides results only "conditional on" settlement of one debt or receipt of one settlement offer. No statistics are provided in the published report for the people who had no debts settled. CFA asked the author and was told orally that 55.7 percent of those who did not drop out had settled at least one debt. That means that 44.3 percent of those still in the program had not settled any debts at all. And of the total of 4,500 customers in the study, only 22 percent had settled even one debt.

The 40 percent remaining in the program at the time of the study had been in it for at least 12 months; some had been in for 18 months and some for 24. It is possible that more of these customers may eventually settle at least one debt, and that those who have already settled at least one debt may settle more. It is also possible that more customers may drop out without settling any debts.

Since there are no statistics based on customers actually completing the program, which supposedly takes 36 to 48 months, the study does not answer the fundamental question that the FTC has long posited—what is the number or percentage of consumers who pay for debt relief services and fully achieve the promised results of the elimination of debt?

Furthermore, the fact that the rate of offers was higher than the rate of settlements (for those who had settled at least one debt) shows that not all offers are acceptable. Some offers may be for more money than the consumers can afford, and some may be rejected because they are not as good as consumers were led to expect. At any rate, the percentage of offers made, which is highlighted in the report to demonstrate the value of this company's services, cannot be used as a real measure for success.

The author of that study argues that prohibiting any fees until debt relief services have actually been provided is analogous to forbidding insurance companies from collecting premiums until a claim is filed. But when consumers buy insurance they receive a legally binding commitment that the company will pay in the event of specific future events. For-profit debt relief services cannot make similar promises of specific results, even if they attempt in good faith to help consumers. First, creditors are under no obligation to agree to settle debts, reduce interest or enter into payment plans. Indeed, as some creditors say they choose not to deal with for-profit debt relief services at all.[52] Second, these services have no control over whether their customers will be willing or able to accept and fund any offers that creditors may make.

Nonprofit credit counseling services have ongoing relationships with creditors and understand what their payment requirements are. They determine in advance if consumers can afford acceptable payment plans and, if not, provide advice about other alternatives such as bankruptcy. There may be a modest consultation fee or set-up fee, but the charges for administering debt management programs are usually assessed on a "pay as you go" basis for the services provided. From the information available about for-profit debt relief services, it appears that they charge significant fees early on in the programs without any reasonable assurance that they can help consumers and without providing real educational or other services. There is no reliable, credible evidence that even a majority of their customers get the relief they have paid for.

The advance fee ban must not be weakened by preconditioning its application on guaranteeing or representing a high likelihood of success.

The FTC's questions ask whether there is another formulation of the advance fee ban that would be more appropriate than a ban conditioned on the provision of the promised goods or services. The answer is no.

Limiting the ban only to instances of a guarantee or representation of a high likelihood of success has been made would create numerous opportunities for evasion. First, an impression or expectation of future success could be created by the lead generator, rather than the representations of the direct seller or telemarketer. Once an impression of likely success has been created, it could be very hard to dispel. Furthermore, and most fundamentally, the very reason that a consumer would use a debt relief service is to get their debt problems resolved. A rational consumer

[52] See comments made at the FTC's September 2008 public workshop on debt settlement by American Express (Flores), Tr. 142–43, and the ABA (O'Neill), Tr. at 96–97; see also comments by Bank of America in "Look Out for that Lifeline, Debt-Settlement Firms are Doing a Booming Business—and Drawing the Attention of Prosecutors and Regulators," *BusinessWeek*, March 6, 2008.

would not sign up without the expectation of a high likelihood that he or she would get satisfactory results.

In essence, the expectation of a high likelihood of success is inherent in the customer's acceptance of a debt relief service. A representation of success should not have to be shown as a separate requirement for application of an advance fee ban. Such a limitation would very significantly undercut the value of a ban. In fact, we believe that representations of success should not be allowed at all, for reasons that we will explain later.

The FTC also asks whether there are alternatives to an advance fee ban that would sufficiently address the problem of low success rates in the debt settlement industry. There are not.

A small initial fee may be acceptable in limited circumstances.

Some claim that for-profit debt relief services are entitled to front-loaded fees because of they provide assistance to the customer or provide value at the onset. This is not supported by the facts. There is no evidence that these companies provide meaningful consumer education, and even if they did, that would not justify charging hundreds, let alone thousands of dollars. Until satisfactory outcomes for customers are actually accomplished—setting up a debt management plan, settling the debts, or negotiating changes to the debts—the basic service that is promised is not rendered even if some minor preliminary steps to provide a possible future agreement have been taken. The concerns expressed by some companies about how to get customers to pay their fees are somewhat ironic—how can they represent with confidence that customers will be able to pay off their debts through their programs when they are not confident that the customers will have sufficient funds to pay them? At any rate, those concerns are outweighed by the concerns about substantial injury to consumers when they pay in advance for debt relief services that may never be provided.

A small initial fee could be reasonable when a debt relief service performs substantial work at the onset such as conducting a real, individualized financial analysis to determine if the program is suitable for and will result in a tangible net benefit to that consumer. Such a fee should be capped at $50, to avoid reintroducing the market incentive to sign up people who are unlikely to benefit from the service. Several states have enacted laws that limit the set-up fee that debt settlement services can charge to $50 or less.[53] Set-up or enrollment fees for debt counseling services are also limited in some states; for instance, Arizona caps them at $39.[54]

Adequate proof of results must be provided before fees may be requested or paid.

It is essential that consumers be provided with adequate documentation that their debts have been renegotiated, settled, reduced, or otherwise altered before payment can be requested or received. The FTC's proposal describes the types of documentation that would be acceptable but does not specify the form in which it should be provided. This portion of the proposed rule should be clarified to specify that the documentation be provided to the consumer *in writing* and be *from and binding on the creditor.*

Furthermore, for debt settlements, it is extremely important that the documentation show that debt has been fully settled for a specific dollar amount. A fully executed debt settlement agreement is the preferred document. Other documents should be considered only if they are equally binding. This is particularly important in order to avoid any confusion about what can trigger an allowable fee—actual settlements, not unaccepted offers to settle, and not preliminary conversations between a debt settlement service and a creditor.

Finally, we are concerned that debt relief services may assert that they should be able to charge fees if they have obtained offers from consumers' creditors, even if the consumers do not accept them. As the ACCC study of one debt settlement company illustrated, not all offers are accepted. Allowing fees to be collected based on offers could provide incentives to negotiate offers that do not reduce or alter the debt in any significant way and that do not benefit consumers. We do not believe that this is what the FTC intended and the amendment should make clear that the fee payments are contingent upon, and payable no earlier than, on consumers having accepted binding settlement offers made by creditors.

Fees should not be disproportionate to the results achieved.

The proposed ban on advance fees for debt relief services would mean that fee payments could no longer be disproportionate to the results that are actually achieved in terms of the elimination of the debts. For instance, if a consumer asked a debt settlement company for help with three debts, a fee would be paid for each

[53] Florida, Oregon, Iowa, North Carolina, and Kansas.

[54] National Consumer Law Center, Fair Debt Collection, section 12.3, 6th edition 2008 and Supp.

debt as it is settled; the consumer could not be asked to pay a fee based on the total amount of all three debts when only one has been settled and the other two are still outstanding.

In the case of debt management plans, payments to creditors are not made in a lump sum but are spread out in monthly installments. If we understand the FTC's intentions correctly, under the proposed amendment the debt management company would take a portion of the fee each month when it makes the payments to the consumer's creditors. However, the language in the proposed amendment does not make this clear. We are concerned that consumers could be required to pay the entire amount or a significant portion of their fees at the time that they are enrolled in a debt management plan, giving them no protection if the service stopped forwarding their payments to their creditors.

To address this and other issues we have raised, we suggest that proposed § 310.4 (5) be revised to read:

> Requesting or receiving payment of any fee or consideration from a person for any debt relief service until *the customer has agreed to the creditor's offer* and the seller has provided the customer with *written* documentation in the form of a settlement agreement, debt management plan, or other such valid contractual agreement, *from and binding on the creditor*, that the particular debt has, in fact, been renegotiated, settled, reduced, or otherwise altered *and that shows the specific dollar amount, interest rate, or other terms as applicable, and in the case of debt settlement, that shows that the debt has been settled and released. With respect to a debt management plan that calls for making payments over time to a creditor, no fee may be received earlier than the proportional amount of progress made toward reducing the debt.*

The advance fee ban as structured will not prohibit consumers from using legitimate escrow services.

We agree that the ban on advance fees will not prohibit consumers from using legitimate escrow services that they control in order to save money in anticipation of a settlement, including money that may eventually be used to pay a debt service provider. However, it is crucial that no fees can be deducted by or on behalf of the debt relief company until the services have been provided and consumer has been given the required documentation. We are concerned about business models in which the consumers open accounts with third-party services and give the debt settlement services a power of attorney to remove the fees from those accounts. This arrangement is described in some detail in a California case involving Nationwide Asset Services.[55]

Any escrow arrangement must give the consumer, and only the consumer, the right to withdraw the funds at any time. Furthermore, the consumer should be able to choose the escrow service and not be obliged to use one that assesses higher fees than other bank accounts of the same type.[56]

2. Other abusive practices should be prohibited.

In addition to banning fees in advance of actually providing debt relief services, there are other abusive practices that should be addressed by the TSR in order to provide adequate protection for consumers.

Changing the addresses on consumers' accounts so that the debt relief company receives the bills and notices, not the consumer, should be prohibited.

This prevents consumers from receiving notices about penalties, referral to collection, and other impending actions—information consumers need in order to protect their interests pending any reduction, settlement or other negotiated resolution of the debt.

Instructing or advising consumers to have no further contact with their creditors should be prohibited.

This prevents consumers from responding to notices and offers for direct negotiations from their creditors and could worsen their situations by prolonging their debt problems and increasing the fees that they must pay to the debt relief services and the likelihood of lawsuits and other adverse actions. It may also prevent the con-

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[55] California Department of Corporations vs. Nationwide Asset Services, Inc., No. 38300, 4–5, August 4, 2006, *http://www.corp.ca.gov/OLP/pdf/oah/N2005120755.pdf*.

[56] Taking a power of attorney over any bank account held in the name of the consumer or held by any third-party should be determined to be an unfair business practice. It is inherently deceptive to encourage the consumer to open a bank account and then take the right to remove funds directly out of that bank account by a power of attorney. If the consumer wishes to authorize an electronic debit from his or her bank account, the Federal Electronic Fund Transfer Act provides the framework for that transaction, including a right to cancel an authorization for preauthorized periodic payments.

sumer from receiving information about how high the debt has grown during the delay for debt settlement/negotiations.

Instructing or advising consumers not to make any payments to their creditors directly should be prohibited.

This prevents consumers from making even minimum payments to their creditors in order to forestall or reduce the risk of penalties, damage to their credit reports, lawsuits, and other adverse actions while they are waiting for the debt relief services to be rendered.

Making any representations about the percentage or dollar amount by which debts or interest rates may be reduced should be prohibited.

This is inherently misleading because each person's debts and capacity to pay them is different. Furthermore, there are varying levels of cooperation among creditors; some will not even deal with for-profit debt relief services at all. Even if a debt relief service has a high rate of success overall, the success rate does not guaranty that every customer will achieve the same results. Moreover, fine-print disclaimers do little to dampen the expectations created by such claims.

Representations of results are also misleading when they are not regularly achieved for *all of the debts* for a significant majority of the customers. For example, suppose that a debt settlement company regularly settles half of the debts for half of the initial debt amount—an assumption which we believe is very optimistic in light of high drop out rates. If half of the debts are settled, that means that the debt settlement company's customers still owe the full amount, plus new creditor interest charges, on the remaining unsettled half of their debts. It would be very misleading to claim: "We settle debts for 50 cents on the dollar," in this circumstance. A consumer who had started debt settlement with two debts of $12,000 each and had one debt settled for $6,000 would have paid the $6,000 settlement and still owe $12,000—that consumer would be on the hook for 75 cents on the dollar in remaining debt and the payment for the settlement, not even counting the amount of the debt settlement company's fees.

We believe that a prohibition against making any representations about the percentage or dollar amount by which debts or interest rates may be reduced is the best way to protect consumers from expectations that may not be fulfilled. If this recommendation is not adopted, we suggest as an alternative a ban on *making any representation about the percentage or dollar amount at which a debt may be reduced or the amount a consumer may save unless the provider maintains evidence that the represented result was achieved for all debt enrolled in the program for at least 80 percent of the clients who began the service in the most recent two calendar years.* Evidence supporting claims of results should be verified by an independent audit.

However, if any representations about the percentage or dollar amount by which debts or interest rates may be reduced are allowed, there should also be a required disclosure that those results cannot be guaranteed for each individual customer. Furthermore, debt relief companies should be required to submit their audits to the FTC so that the information is publicly available.

Failing to provide a "money-back" cancelation period of at least 90 days in the contract, plus more time if there has been a material breach of the contract or a material violation of law should be prohibited.

A cancelation period gives consumers time to assess whether a product or service is right for them. In the case of debt relief services, a minimum of 90 days to cancel with return of all monies paid except for payments that have already been made to creditors would enable consumers to make that assessment and provide a disincentive for debt relief services to market to and contract with consumers who are not likely to benefit from the services.

We also suggest that consumers should have the right to cancel in the event of a material violation of law or breach of contract by the seller. This would protect consumers from the worst actors and give a competitive advantage to sellers who honor the law and comply with their contractual promises.

3. Inbound calls for debt relief services must be covered by the rule.

We strongly support the extension of the existing telemarketing sales rule's disclosure and misrepresentation provisions to inbound calls to debt relief services. Limiting the coverage only to outbound calls would ignore the marketing realities and allow a very large loophole in the TSR to continue. For-profit debt counseling, debt settlement, and debt negotiation services are commonly advertised on the Internet, on television, and by other means which are designed to induce the consumer to make an inbound call. Protecting the consumer from misrepresentation and requiring disclosure of key information only for those potential debt relief customers who receive a phone call, rather than also for those who are induced by an advertisement

to make a phone call, would make no policy sense, leave a large loophole in place, encourage evasion of the rules, and give a competitive advantage to those who use advertising to induce inbound calls.

An additional reason that inbound calls must be covered is the role of lead generators. For example, National Consumer Council used pre-recorded messages left on consumers' answering machines as well as direct mail to induce consumers to call in order to generate leads for several other companies. Both the representations used to induce calls from consumers and those made during the calls should be covered. The TSR should make clear that it applies to lead generators. Furthermore, we believe that the debt relief providers who accept those leads to should be held responsible for the representations made to generate them, including those made during inbound calls.

4. We support the disclosures required in the proposed amendments.

Consumers must be told the truth about the debt relief services. It is very important that the current general disclosure requirements under the TSR apply to inbound calls for debt services as well as outbound calls, as the FTC has proposed. We also agree that the additional disclosures pertaining to debt relief services are needed. They will help consumers understand exactly how these services work, what to expect from them, and whether they are likely to serve their needs. Combined with the advance fee ban, the disclosures would provide strong consumer protection.

The disclosures will also help consumers understand their own obligations and the impact that the services may have on them. For example, it is crucial for consumers to know that contracting with a debt relief service will not necessarily prevent their creditors from taking collection action, that their credit ratings may be affected, and that the savings they may realize may be considered taxable income, and that the debt balance increases when payments are not being made.

We understand that payments for debt relief services are often debited from consumers' bank accounts within a few days after they have enrolled in the programs. However, if the disclosures are designed to help consumers make informed decisions about whether to sign up or not, they need the information *before* making the contractual commitment even if the payment will be later. Therefore, we suggest that § 310.3 (a)(1) could be improved to provide greater protection to consumers, not just for debt relief services but in other types of telemarketing sales as well, if it required the disclosures to be made before the earlier of payment or an *obligation* to pay. The revised subsection would read:

Before *the earlier of payment or an obligation to pay for goods or services offered*, and before any services are rendered, failing to disclose truthfully, in a clear and conspicuous manner, the following material information:

5. Prohibitions against specific misrepresentations are useful.

We agree with the FTC that it is useful to add a specific prohibition in § 310.3 (a)(2)(x) against misrepresenting any material aspect of a debt relief service, such as the amount of money or percentage of debt that consumers must accumulate before negotiations with their creditors are initiated, the effect of the service on collection efforts, how many consumers attain certain results, and whether the service is nonprofit. This provides greater clarity to debt relief service providers about what they can and cannot do.

6. The exemption for transactions that are not concluded until after a face-to-face sales presentation should not apply to debt relief services.

We believe that the exemption under § 310.6 (a)(3) should not apply to debt relief services. Even if the exemption may have made sense for certain types of telemarketing sales, in the sale of services to be delivered in the future such as debt relief, the fact of a face-to-face meeting simply does not create a sufficient safeguard. It would be far too easy for the real sales process to occur by phone or other remote means and then a simple signing meeting to be used to escape all application of the rule.

Furthermore, a face-to-face exemption could create the anti-competitive result in which industry players who deal with potential customers only via the Internet or phone must adhere to standards of disclosure, non-misrepresentation, and the very important advance fee restriction, while those who arrange for a face-to-face meeting do not.

Conclusion

The "police the marketplace" approach taken by the FTC will protect not only consumers but any legitimate debt relief services that actually provide real benefits to consumers. Those debt relief services will be entitled to fees, and should have a bet-

ter chance of succeeding in the marketplace when their competitors are stopped from taking significant fees without achieving real debt relief.

We agree with the FTC that additional measures must be taken to address America's debt problem, including continued enforcement, consumer education, and more flexibility in the options that creditors provide to consumers. There should also be obligations for debt relief services that may go beyond the scope of the TSR. For example, debt relief providers should be required to conduct an individual financial analysis for all potential customers to determine whether the service is suitable for and will provide a tangible net benefit to them before enrolling them.

Furthermore, there should be similar rules to protect debt relief customers when the use of the telephone is not involved in the transaction, such as when they are solicited for and enroll in debt relief services entirely through the Internet.

The FTC has not included mortgage foreclosure rescue and modification services in the proposed amendments to the TSR because it has received authority from Congress to promulgate separate rules in that regard. However, the issues are very much the same and the FTC should address them with equally strong rules.

We believe that the proposed amendments to the TSR are a good and necessary step to protect debt relief customers from false promises and financial injury. We appreciate the opportunity to provide our comments and will be happy to answer any questions that the FTC may have in regard to our views and suggestions.

Submitted by:

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On behalf of:

Consumer Federation of America
Consumers Union
Consumer Action
The National Consumer Law Center on behalf of its low income clients
The Center for Responsible Lending
The National Association of Consumer Advocates
The National Consumers League
U.S. PIRG
The Privacy Rights Clearinghouse
The Arizona Consumers Council
The Chicago Consumer Coalition
The Consumer Assistance Council
The Community Reinvestment Association of North Carolina
The Consumer Federation of the Southeast
Grassroots Organizing
Jacksonville Area Legal Aid, Inc.
The Maryland Consumer Rights Coalition
Mid-Minnesota Legal Assistance
The Virginia Citizens Consumer Council

ECONOMIC FACTORS AND THE DEBT MANAGEMENT INDUSTRY

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August 6, 2009

Executive Summary

The current economic climate makes the need for debt management programs even more acute. More consumers are finding themselves in financial hardship due to high unemployment, low home equity rates, lack of access to bankruptcy protection, and the "credit crunch" so well documented in the press and by legislators. This economic climate implies that many consumers are one emergency away from financial hardship. There is no question that the multitude of people currently in financial distress need programs that reduce the principal of their debt to stave off bankruptcy (Manning 2009, Plunkett 2009).

Debt management programs (DMPs) come in several forms, but their basic structure is similar: they require some sort of consumer education if they are accredited by national trade associations (Keating 2008, USOBA 2008), consumer participation is voluntary (Hunt 2005, Plunkett 2009) and a plan is set up to make the consumer debt-free in two to 5 years. The key differences in the organizations are the mechanisms they use to finance the organization and to help consumers pay off their debt (Hunt 2005, Plunkett 2009). In this paper, I refer to organizations that help con-

sumers pay off their debt by reducing interest rates as consumer credit counseling services (CCCSs) and organizations that help consumers pay off their debt by reducing principal as Debt Settlement Programs (DSPs). The efficacy of these different approaches has been discussed by a variety of authors, but these discussions have lacked a clear and detailed consumer welfare analysis, which is provided in this research.

One of the most important findings of this research is that the different approaches (CCCS or DSP) help consumers by increasing their economic welfare as compared to paying off the debt under the original conditions. However, the consumer welfare analysis suggests that DSPs create the greatest consumer welfare of any approach. In fact, consumer welfare is higher under DSPs than under the 60-60 rule (repay 60 percent of the debt principal in 60 months) suggested in the literature (see *e.g.,* Keating 2008, Manning 2009). If consumers are allowed to repay their debt over 3 years, the affordability of the DSPs (as measured by monthly payments) is similar to the affordability of a program based upon the 60-60 rule. Additionally, creditors are helped by both CCCSs and DSPs as their losses are lower when consumers use DMPs as opposed to other alternatives.

This research empirically examines the efficacy of one DSP company in this industry. Key findings, which are consistent with the observation that programs which reduce the principal of the debt may be the only means to keep a growing number of consumers out of bankruptcy, include:

1. Accurate measures of consumer completion and cancellation cannot be calculated from the data, as almost 30 percent of the cancellations are due to the consumers either directly paying off the debt or being forced into bankruptcy. Further, the cancellation data does not contain information regarding offers received or debt repaid, so it does not accurately reflect value generated by the company. That said, the raw cancellation rate (60 percent over 2 years) is much less than speculated (85 percent within 1 year) and is similar to or better than other subscription-based service industries (*e.g.,* mobile telephone and cable television companies) that have Better Business Bureau certified members.

2. Conditional on the consumer receiving an offer or settlement, the firm had mean, median and mode settlement offers at or below 50 percent of the original debt. This number beats the 60-60 rule and suggests that the firm is generating significant consumer benefits.

3. The debt settlement company generates tremendous value to its clients, as more than 57 percent of the clients have offers to settle at least 70 percent of their original debt, and the most common situation (almost 30 percent of the clients) having settlement offers for at least 90 percent of their original debt.

4. The debt settlement company has an increasingly higher value to customers with higher account balances and higher total debt, but lower number of accounts.

5. Once "fair share" payments are taken into account, CCCS fees and payments for a consumer account can exceed 29 percent of the consumer debt, levels which Plunkett (2009) calls "exorbitant." This finding suggests that regulation is required to ensure transparent reporting of all fees and payments is required for all companies offering Debt Management Programs.

6. Reasonable upfront fees by DSPs (before settlement) should be allowed because DSPs generate value for consumers and incur expenses generating this value. This fee structure is similar in nature to the one used by CCCSs, attorneys and other service-providing firms.

These findings suggest that a "common sense" approach should be used with the DMP industry. A common sense approach implies that regulatory and other consumer advocacy groups focus on ensuring that there is sufficient regulation to be able to identify and, if necessary, prosecute bad actors without harming economic competition which increases consumer welfare. The industry analysis also suggests several regulatory recommendations which could further benefit consumers:

1. Focus on making alternatives transparent so consumers can make better decisions: disclose total fees including "fair share" and all other consumer fees, success metrics of offers received, settlements accepted and percent of debt settled. This disclosure has the additional benefit of allowing interested third parties, *e.g.,* consumer advocacy groups and government agencies, to calculate the economic impact of this industry on consumers and other industries.

2. Provide guidance for handling of client monies in "fiduciary" accounts, especially in terms of timing between audits, what happens if a consumer cancels service, appropriate interest rates, and whether or not (and under what cir-

cumstances) companies can make payments on behalf of consumers. The regulators should allow DSPs to establish trust accounts with their clients, which would include:

a. Requiring consumers to save money every month as one condition of making "satisfactory progress" in the program. DSPs should have the ability to monitor, but not control (or make disbursements from) these funds.

b. Proving regulatory protection for consumers from litigation and creditor calls while consumers are making "satisfactory progress." Other protections to ensure that consumers are protected from cancellation fees paid to DSPs and unethical business practices, *e.g.,* ensure that the financial institutions holding the funds are independent of the DSPs and no fees are disbursed from the accounts without full disclosure and regulatory oversight and approval.

c. Allowing disbursements from these accounts only with consumer and DSP approval and for payment to creditors, approved fees, and to the consumer if they cancel the program or for new financial hardships.

3. Require financial education of consumer, and require specific metrics in terms of meeting short-term and long-term education and outcomes (see, *e.g.,* Clancy and Carroll 2007, Keating 2008, Staten and Barron 2006).

Introduction

While the current economic climate (discussed below) provides strong support for programs which help consumers get out of debt, the strongest arguments for programs which take the approach of reducing the principal comes from organizations and individuals who are either antagonistic or agnostic to this approach. For instance, the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (or BAPCPA) suggests a "60-60" standard for debt repayment outside of bankruptcy, where the 60-60 refers to the consumer entering into an agreement with their creditors 60 days prior to bankruptcy to repay 60 percent of their debt within a "reasonable" timeframe. Additionally, both Plunkett (2009) and Keating (2008), who use pretty strong rhetoric in denouncing companies using this approach, support a 60-60 rule that allows consumers to repay 60 percent of their debt within 60 months and acknowledge that a growing number of consumers may be forced into bankruptcy without access to ethical and proconsumer companies offering this alternative. For the remainder of this document, the term "60-60 rule" refers to repaying 60 percent of the debt within 60 months, not the BAPCPA plans.

Within the debt management industry, firms have taken two different approaches in their debt management programs (DMPs). The first approach, called Consumer Credit Counseling Services (or CCCSs), helps consumers by reducing the interest payments and, potentially, fees on the debt, but still has consumers pay 100 percent of the principal. The second approach, called Debt Settlement Programs (or DSPs), helps consumers by reducing the principal on the debt (Hunt 2005, Plunkett 2009). These approaches also differ in how the firms are funded and their taxable status. CCCSs are generally nonprofit firms and are funded by both account maintenance fees from consumers as well as "donations" from creditors which may take the form of "fair share" payments and/or direct grants (Boas *et al.,* 2003, Plunkett 2009). DSPs, on the other hand, are generally for-profit firms, and are funded through fees charged directly to consumers without any payments from the creditors (Hunt 2005).

Before proceeding further, I acknowledge that both types of organizations have had firms which have taken advantage of vulnerable consumers (US Senate Hearings 2005, Clancy and Carroll 2007, Plunkett 2009), so some of the heated rhetoric directed at different approaches by organizations with vested interests is not only self-serving, but is also counterproductive. The focus of legislative efforts should be to protect consumer welfare by ensuring that the goals of the industry (consumer education and debt relief) are met, to ensure that organizations act in ethical and transparent ways and to impose appropriate sanctions on any company that willfully take advantage of consumers, *i.e.,* "bad actors."

One of the reasons that I argue that the heated rhetoric and trying to use regulation to eliminate other approaches are counterproductive is based on the notion that competition produces efficiencies, which, in turn, increase consumer welfare and economic growth. A fundamental principal of the Federal Trade Commission is that competition benefits consumers through lower prices and increased variety. This philosophy is summarized as:

> Competition in America is about price, selection and service. It benefits consumers by keeping prices low and the quality and choice of goods and services high (FTC 2009a).

Therefore, rather than take the position of being an advocate for a specific approach to helping consumers to get out of their situation, this research is focused on understanding the different approaches and calculating the consumer benefits associated with each approach. The benefits are measured in terms of both total consumer welfare (*i.e.,* how much will consumers pay in total for different approaches) consumer affordability (how much must the consumer pay each month), and how much are firms collecting as a percentage of the original debt from the consumers and creditors. It is important to include payments from creditors to the firms, as they represent indirect fees charged to consumers because the creditors should be indifferent between giving consumers a discount of the same amount that they pay the firms in "fair share" payments or any other way the firm is compensated.

Probably the most important finding of this research is that both CCCSs and DSPs increase consumer welfare over the alternative of the consumer paying off their debt using a fixed payment of 2 percent of their original debt every month (the recommended minimum payment). However, DSPs increase consumer welfare much more than CCCSs and have similar affordability to CCCSs when the payments can be made over 3 years (instead of 5 years for CCCSs). Given the findings in the extant literature that creditors are also better off when consumers use DMPs, it appears that DMPs are a "win-win" for both consumers and creditors, so regulators should be encouraged to use a common sense approach to this industry: protect the vulnerable consumers while supporting competition among the different approaches to getting rid of consumer debt. This competition is consistent with the Federal Trade Commission's approach to other industries and would result in increased consumer welfare over the long term.

Some of the key recommendations for regulatory agencies include: (1) protecting consumers from litigation and calls/threats from creditors while they are making "satisfactory progress" in accredited DMPs. Satisfactory progress needs to have measurements related to educational goals as well as financial goals (*i.e.,* being current on payments for CCCSs and saving enough for DSPs); (2) providing DSPs with the ability to set up trust accounts for their clients that have very specific limitations on disbursements (*i.e.,* approved payments to creditors, approved fees to DSPs, payments to consumers for cancellation or new hardships, etc.); (3) require full disclosure of all fees consumers directly or indirectly (*e.g.,* "fair share" payments, grants from creditors, etc.) pay; and (4) provide guidance of how companies can accurately measure program effectiveness, *e.g.,* does receiving offers for all enrolled debt constitute program completion?

The remainder of this document is organized as follows. In the next section, the economic factors which are increasing the necessity of this industry are briefly reviewed. Next, the different alternatives are provided with an eye toward understanding the economics and limitations of the alternatives. In section three, the performance of a specific DSP is analyzed. This firm provided a significant dataset, the details of 4,500 randomly selected clients. In analyzing the clients, we use a stratified sampling approach, also called a "strata approach." The clients are combined into different groups, based upon their debt levels. These different stratums are then analyzed to see if consumer behavior or firm performance differs between the groups. As far as we know, this type of analysis of the efficacy of Debt Settlement Programs has not been published.

In the next section, the economics (both for consumers and the firms) of the debt management programs is analyzed in more detail. Specifically, consumer welfare is estimated and compared under a variety of assumptions. This paper concludes with public policy and industry recommendations.

Current Economic Climate

The importance of the consumer debt management industry has become increasingly important as the U.S. economic recession continues. *Table 1* shows the seasonally adjusted unemployment rate in the United States, which has reached 9.4 percent as of May 2009.

Table 1—U.S. Unemployment Rate

Year	Month	Percent
2008	May	5.5
	Jun	5.6
	Jul	5.8
	Aug	6.2
	Sep	6.2
	Oct	6.6
	Nov	6.8
	Dec	7.2
2009	Jan	7.6
	Feb	8.1
	Mar	8.5
	Apr	8.9
	May	9.4

Source: U.S. Bureau of Labor Statistics (*http://www.bls.gov/opub/ted/*).

Even worse, the long-term unemployment rate (those unemployed more than 27 weeks), rose in May by 268,000 to 3.9 million U.S. Households, roughly triple the number at the start of the recession (U.S. Bureau of Labor Statistics 2009). Note that employment is generally a lagging indicator (*e.g.,* it improves after the economy improves), an uptick in the U.S. economy will not provide immediate relief for these households.

The high unemployment rate coupled with the fact that the average credit card balance at the end of 2008 was more than $10,000 for approximately 91 million households (158 million individuals or 78 percent of all households) who have credit cards (Woolsey and Schulz 2009). A silver lining is that in April of 2009, seasonally adjusted total consumer debt was decreasing at a 7.5 percent annual rate (Federal Reserve 2009). However, household leverage (total debt to disposable income), while decreasing, still remains at 130 percent from a high of 133 percent in 2007. This number can be contrasted to the 55 percent leverage in the 1960s and 65 percent leverage in 1980s (Zuckerman and Todd 2009).

An implication of these statistics is that many consumers are barely able to pay their debts and are one emergency away from financial hardship—a recent study found that medical bills were a contributing factor in more than 60 percent of all bankruptcy filings (Himmelstein *et al.,* 2007). From this hypothesis, one would then expect consumer credit card and personal loan default rates to be increasing. *Figure 1* confirms this belief, as consumer default rates on credit cards stands at 7.49 percent in the first quarter of 2009, and consumer defaults on personal loans stand at 2.93 percent in the same period. If anything, these numbers understate the problems consumers are having. In a report prepared for the National Foundation for Credit Counseling, Harris Interactive (2009) found:

- 26 percent of households admitted to not paying their bills on time. Minorities may be more severely impacted, with this number rising to 51 percent for African American households.
- In the last 12 months, 15 percent of individuals were late paying a credit card and 8 percent admitted to missing at least one payment, and 6 percent have their debts in collection.
- 32 percent admit that they have no savings, and only 23 percent state that they were saving more than a year ago.
- 57 percent of households do not have a budget, and 41 percent give themselves a grade of C, D, or F in their financial knowledge.

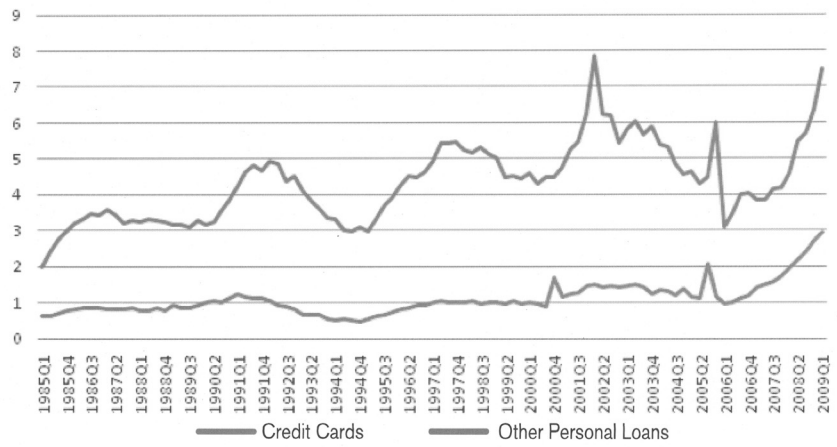
One may conclude that given the financial turmoil in this market, credit card companies may be hurt as well. However, a recent study found that since the bankruptcy law was reformed in October 2005 (2005 Bankruptcy Abuse Prevention and Consumer Protection Act or BAPCPA), the credit card industry has recorded record profits, although more factors (*e.g.,* interest rate spreads, increased fees, etc.) enter into this profitability than simply the increased difficulty of entering into bankruptcy (Simkovic 2009).

A recent study estimated that as many as 800,000 households have been precluded from entering bankruptcy due to BAPCPA (Lawless *et al.,* 2008). Therefore, the need for a service which helps consumers manage and pay down their debts and to work with the credit card companies is more acute than ever. In fact, recent legislation requires credit card companies to recommend credit counseling education and debt management programs to consumers in financial trouble (Reddy 2009). So what are consumers' alternatives when they find themselves in financial hardship? Their alternatives are grouped into four broad categories (Hunt 2005) that vary in terms

of a continuum of how much of the debt can the consumers afford to repay (all, partial or nothing):

1. Bankruptcy—either chapter 7 or chapter 13.
2. Debt Management Programs—This includes any service which tries to help the consumers pay off their debts (outside of bankruptcy) either through reduction in interest rates, debt reduction or other means.
3. Other financing—This includes raising money through sales or refinancing of current assets (*e.g.,* home equity loan).
4. Repayments on original terms.

Figure 1—Bank Charge Off Percentages



Source: U.S. Federal Reserve Bank.

Overview of Consumer Alternatives

This section provides an overview of the different alternatives that are available to consumers who are in financial hardship. Before discussing the alternatives, a brief discussion of the process or stages involved is provided (based on Mojica 2009).[*]

1. Financial Hardship

First, consumers have some financial hardship which limits a family's ability to continue paying their debts. For instance, Himmelstein *et al.* (2007) found that medical bills were a contributing factor in more than 60 percent of all bankruptcy filings and that medical portion of the debt was more than $5,000 or 10 percent of family income. A creditors willingness to work with a consumer, *e.g.,* give grace periods, reduce interest rates and/or debts, is directly linked to the consumer's ability to demonstrate that a true hardship was the cause of the household's financial crisis (Dash 2009).

2. 30 Days

Once the consumer is at least 30 days late in payment, and for every 30 days thereafter, a notice is sent to credit bureaus indicating delinquency. At this point the consumer usually starts receiving calls from the creditors requesting payment. Eventually, credit cards and other revolving credit are canceled for the consumer. Once the account is delinquent, credit card fees may be dramatically increased, although new Federal legislation has put curbs on credit card companies in terms of fees and interest rate changes (Reddy 2009). Reddy did cite a consumer whose interest rate jumped from 12 percent to 24 percent due to late payments even though the credit card company did agree to work with the consumer.

In the current economic crisis, credit cards are willing to extend the grace periods for consumers who have true hardships, even reducing the total debt amount. How-

[*] Sources: Bank of America 2008 10K; page 127—Table 15, page 128—Table 16, page 172—Table 37; American Express 10K; page 50, page 56; Chase 2008 10K; page 155, page 81, page 128; CapitalOne 2008 10K; page 73—Table C, page 76—Table F.

ever, these deals come at a price—a consumer's credit score may drop 70 to 130 points as a result (Dash 2009).

3. Six Months

The creditor writes off the debt. At this point, the account may be sold, sent to a collections agency or a law firm. Generally, the amount of debt collected by these agencies varies, but examination of 10K reports from various creditors indicates that credit card companies are receiving about 10 percent of the outstanding debt when it is sold.

More recently, credit cards have become more willing to negotiate terms with consumers, but they generally require that consumers be at least 90 days delinquent and are accepting "dimes if not pennies on the dollar" (Dash 2009). Given the relatively low recovery rate, it suggests that other alternatives (*e.g.,* lawsuits, selling debts to collection agencies) provide even lower returns for the creditors.

4. Lawsuit as Option

Creditors may sue consumers to collect bills. From a consumer standpoint, this option adds legal fees to the debt they already cannot afford. Assuming that the creditor gets a judgment, it may be enforced by garnishing wages, sales of assets, etc.

From a consumer standpoint, there is a mine field waiting for them once they get into financial trouble. Generally, the creditors will not work with a consumer until they are at least 90 days delinquent, and they may increase interest rates or fees simply because the consumer contacts the creditor for help (Dash 2009). Further, creditors are more likely to help consumers who do not have a history of financial troubles, so they are less likely to help those most in need (Dash 2009). Under a practice known a "global default", creditors can move an account that is current into default because the consumer is delinquent to a different creditor, (see, *e.g.,* testimony U.S. Committee on Financial Services 2007). Once the credit card is in default, legislation limiting harassing calls really does not apply to the original creditors, only third party collectors. One would expect very high dropout or cancellation rates for the first 6 months a consumer is enrolled in a program, until the regulatory protections take effect. Therefore, some sort of protection for consumers who want to settle their debt and have enrolled in certified debt management programs is required. Ironically, studies have found that credit card losses are 32 percent lower for the clients who enter DMPs before fair share payments are included (Hunt 2005), so it is against the creditors own best interests to force the consumer into litigation. England has solved this problem for their consumers in financial difficulty using the insolvency act of 1986. In this act, if enough creditors (generally 75 percent) agree to the debt reduction plan, the other creditors are legally bound by the repayment plan even if they did not agree to the plan.

Bankruptcy*

Both Chapter 7 and Chapter 13 bankruptcy are legal means of settling debts. Chapter 7 is a liquidation of assets, and the reform act of 2005 (2005 Bankruptcy Abuse Prevention and Consumer Protection Act or BAPCPA) placed many hurdles for consumers to use Chapter 7 (and instead force them to use Chapter 13). These hurdles includes means testing, higher fees and increased costs and risks for those assisting consumers filing Chapter 7 (Simkovic 2009). Once a consumer uses chapter 7, they cannot file again for 8 years and are limited in filing for other legal remedies for several years. Additionally, the filing stays on their credit report for 10 years (Hunt 2005). One unfortunate side effect of filing bankruptcy is that many employers check potential employee credit history, so this may have an effect on future income and job prospects.

Chapter 13 filings on the other hand are considered "wage earner plans" where the debt amount is reduced based on the consumer's ability to pay, and a plan is set up so that consumers pay their debts in three to 5 years (Hunt 2005). Hunt (2005) suggests that attorney and trustee fees amount to approximately 14 percent of the debt, and creditors' average about 35 percent recovery of the debt. However, he also suggests that only 33 percent of consumers finish the program, less than the average for voluntary debt management programs. In a white paper, the United States Organization for Bankruptcy Alternatives suggests that the completion rate is much lower, only 20 percent to 25 percent (USOBA 2008). As with Chapter 7,

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* Source: Fair Debt Collections Practices Act (FDCPA) at *http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre27.pdf.* See *http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/uk/insolvencyact.pdf*, for a description of the insolvency act of 1986 which established this system.

Chapter 13 filings go on a consumer's credit report (although for a shorter period of time), and their ability to file in later years is limited.

Bankruptcy as an alternative for most consumers has become much more limited since BAPCPA was passed in 2005 (Lawless *et al.,* 2008). They estimate that as many as 800,000 U.S. households have been prevented from filing bankruptcy in the last few years.

However, this does not mean that total bankruptcy filings are down, only that consumers are being moved from Chapter 7 (liquidation) to Chapter 13 (partial payment) to move this option away from paying nothing toward paying something. When these settlements are sold on the open market, they generally receive only 18–21 cents on the dollar (Manning 2009). Given the above estimates that the judgments only return 35 cents on the dollar, the net effect to the creditors is that they only receive pennies on the dollar through this route. One would expect that creditors would attempt to stay away from this alternative.

However, once there is more than one creditor, they face a classic "prisoner's dilemma" (Poundstone 1992). The basic idea is that even though all of the creditors are better off by avoiding bankruptcy and legal judgments, each individual creditor is better off by cheating (*e.g.,* initiating legal judgments to be the first one in line). This problem has also been called the creditor's dilemma (Bainbridge 1986). Therefore, some regulatory guidance is required beyond BAPCPA, which suggests the 60-60 (pay off 60 percent of debt in 60 months) as a standard, and would limit creditors to 80 percent of the debt principal if they do not reach an agreement (Manning 2009). Assuming that they collect on the judgment, this 80 percent rule provides the wrong incentive to the creditors, as they are better off using litigation. Therefore this 80 percent standard should be lowered to 60 percent to match the 60-60 rule.

Consumers must also go through counseling services (regardless of whether or not they enroll in debt management programs) prior to filing for bankruptcy. The National Foundation for Credit Counseling estimated that their members provided 1.26 million education sessions for bankruptcy in 2007 (Keating 2008). Some recent research has suggested that the educational component may be important for consumers (Staten and Barron 2006). Staten and Barron find that consumers who enter counseling are significantly less likely to file for bankruptcy in later years, and have significantly lower risk scores than consumers who choose to not enter counseling.

A nagging concern is whether the reason for the good outcomes is self-selection (*e.g.,* motivation of consumers) or efficacy of the program (Clancy and Carroll 2007; Hunt 2005). That said, academic arguments over the source of the outcomes of these programs miss the key point. Regardless of the underlying cause, if consumers are more successful once they enter the programs, shouldn't those programs be encouraged and protections for consumers who are making satisfactory progress enacted, so that their chance of finishing the programs and gaining their benefits are enhanced? This is a classical agency problem where the credit card companies (and public policy) should not care about why clients are more successful, only that they are more successful once they enter into the educational programs. While it may be difficult to determine measures of the program outcomes, an approach similar to that used in Stanten and Barron (2006) where consumers are surveyed years after exiting the programs to determine financial health through risk scores, credit scores, bankruptcy rates and other measures would seem to be a good start and should be required for all organizations offering counseling services.

Refinance

Refinancing the debt using assets is a viable alternative for only a few consumers, as it requires consumers to receive appropriate interest rates and to have sufficient equity in their home or other assets to pay down the debt. The second criteria can be a very high hurdle given that the median household filing bankruptcy has a negative $25,000 net worth (Lawless *et al.,* 2008) and that household home equity is at historic lows—below 50 percent—and economists expect this trend to continue (AP 2008, Keating 2008).

The other problem is that some consumers may have already used this option to pay off debts or to get needed cash for ongoing expenses, even education (Chu and Achohido 2008). Given the current crisis in getting loans, declining home values and variable interest rate mortgages that are getting ready to reset, this option is becoming less viable for most consumers (Manning 2009).

The problem is that the credit cards use risk assessment to set interest rates, implying that consumer interest rates increase once delinquencies are noted on their credit reports (Chu and Achohido 2008, Plunkett 2009). A clear consequence is that consumers may not receive good interest rates, even on a home equity loan due to the credit problems. In addition, by refinancing, a consumer can lose their assets

(*e.g.,* their homes and cars) if they default on the loan as they have converted unsecured debt into secured debt.

Debt Management Programs

Debt management programs (DMPs) come in several forms, but their basic structure is similar: they require some sort of consumer education if they are accredited by national trade associations (Keating 2008, USOBA 2008), consumer participation is voluntary (Hunt 2005, Plunkett 2009) and a plan is set up to make the consumer debt-free in two to 5 years. The key differences in the organizations are the mechanisms they use to finance the organization (consumer fees vs. "fair share" payments from credit card companies) and to pay off consumer debt (reduce interest rates and fees vs. reduce debt principal) (Hunt 2005, Plunkett 2009). In this paper, I refer to organizations that reduce interest rates as consumer credit counseling services (CCCSs) and organizations which reduce principal as Debt Settlement Programs (DSPs). It should be noted that neither of these organizations can force the creditors to accept their terms. It is the case that some creditors do not work with DMPs (of either type) or only make very small concessions (Hunt 2005). Given the national organization's call for debt principal reduction as part of DMPs, it appears that, over time, the distinction between these two types of organizations may blur (Keating 2008), making a stronger case for the strong value of DSPs to consumers.

The importance of full disclosure of the funding sources cannot be overstated. Because the CCCSs receive some of their funding from the creditors (Keating (2008) estimates that about 50 percent of the funding for CCCSs come from creditors), there is a conflict of interest for these organizations, especially when the funding is tied to the amount of debt under management (Boas *et al.,* 2003, Hunt 2005, Manning 2004). Second, because the CCCSs receive some of their fees indirectly, there may be an impression that they are less expensive than DSPs. However, the economic welfare of the creditors is unchanged if they give these fees to consumers as a reduction in the debt principal instead of to the CCCSs in the form of grants or "fair share" payments. Therefore, consumers are paying increased and undisclosed fees in their monthly payments. Further, the FTC recommends consumers ask about the funding sources as part of their consumer protection program (FTC 2009c). I believe that stronger action should be taken, requiring disclosure of the fees, as information is the basis of education, and education is the first line of defense against fraud and deception, it can help you make well-informed decisions before you spend your money (FTC 2009b).

Consumer Credit Counseling Services (CCCSs)

CCCSs generally try to get rid of a consumer's debt over 5 years and generally receive the majority of their funding from credit card companies (Boas *et al.,* 2003, Hunt 2005), although the terms of the agreements have been evolving over time. Hunt states that the average account set up fee is $25 and monthly maintenance fee is $15. Over 5 years, this translates into $910 paid directly to the CCCS. Additionally, he notes the firms receive "fair share" payments (or even grants) from the credit card companies which average 6 percent of the amount that the credit card receives—which is more than 6 percent of the debt. For instance, assuming equal payments over 5 years and a 10-percent interest rate, a consumer with $10,000 in debt will pay $12,748.23 to the credit card company, which implies that the consolidator would receive another $764.89 in fees (for a total of 16.7 percent of the debt). The levels of the fees in this example appear to be similar to those in Chapter 13 bankruptcy noted above.

It should be noted that CCCSs collect the money from the consumers and distribute the money to the creditors (Boas *et al.,* 2003), which implies a fiduciary duty is accepted by these organizations. However, they implicitly assume that consumers will pay back 100 percent of the debt, only at a reduced interest rate and potential reduction of some or all of the fees.

Therefore, not only do they not conform to the 60-60 rule noted above, but this alternative may not be viable for some consumers who could pay back the debt under the 60-60 rule, forcing them into litigation and/or bankruptcy (Manning 2009).

From a consumer welfare standpoint, the key drivers of consumer welfare are the terms of the agreement: how much are the interest rates reduced, and how many payments are required? Plunkett (2009) suggests that these terms vary widely by creditor and by CCCS, so one area of needed disclosure are median terms negotiated by the CCCS for each creditor, as well as median consumer fees and "fair share" payments and/or grants from creditors. Clearly, the CCCS would need to disclose to their customers if a creditor did not accept the terms presented and would need to adjust the required payments.

In terms of calculating efficacy of the programs, both measures and approaches for the educational component are discussed above, so I focus on the debt reduction portion of the business. One set of measurements relate to the terms negotiated with the creditors. For instance, in the settlement offers and final settlements, how much is the original debt amount reduced? And how much of the original debt receives settlement offers? A second set of measurements are the successful completion rates of the program, although without some regulatory protection of consumers enrolled in these programs, these are not accurate measurements of firm performance because consumers can always be forced out of the programs through litigation by one or more creditors.

Debt Settlement Programs (DSPs)

For DSPs, the general idea is to have the consumers save money and pay the creditors in one or a few payments (depending upon the size of the debt) with the goal of paying off the debt in two to 4 years. Instead of focusing on interest rates, DSPs negotiate to reduce the principal of the debt, which implies one set of metrics is their ability to meet or beat the 60-60 rule noted above. Details of the size of the principal reduction are missing in the literature (although they are examined in the next section for one company), but companies claim to be able to reduce up to 50 percent of the principal. Instead of taking money from the credit card companies, these organizations generally receive their fees from consumers. Plunkett (2009) writes that these fees average somewhere between 14 and 20 percent, and Manning (2004) claims that these fees can include a set up fee ranging from 2–4 percent, and service fees range from 15–25 percent.

Without defending the veracity of the assumptions, if we take the same consumer above, who has $10,000 in debt, receives a 20 percent reduction in the debt principal and pays a lump sum at the end of 2 years? The consumer would end up paying $8,000 to the Credit Card Company or $4,748 less than they would have under the CCCS example above. Whether or not the consumer is better off would then depend upon the fees charged—the consumer would be indifferent (*i.e.,* pay the same amount) if the fees were $4,748+$910 or $5,658 (56.6 percent of the original debt).

As with the CCCSs, consumer welfare is strongly influenced by the key assumptions of the model, *i.e.,* number of years before lump-sum payment, interest rate and the principal reduction amount. This example also shows where some confusion may enter into marketing and other communications: the consumer received a 20 percent reduction from the initial debt, but did they still have to pay interest on the debt while saving for the payment (note the results are the same as making payments for 2 years). So, a consistent method of communicating the principal reductions is required, where the amount of the final payment in relation to the initial debt is reported. Similar to CCCSs, transparency implies that median settlements for different creditors and credit status (*e.g.,* in litigation) would have different principal reductions and would need to be disclosed.

This model has some unique difficulties as well as common problems with the CCCSs. A key difference would be that consumers (or clients) are not required to accept settlement offers from the creditors. Therefore, any metric which attempts to only look at settlements would tend to underestimate (*i.e.,* bias) the effectiveness of DSPs, meaning that a second set of metrics related to offers received from creditors would also be required.

A second problem for DSPs is whether or not they should put client money into fiduciary accounts. In the data provided by the DSP analyzed in the next section, 6.8 percent of the cancellations gave the inability to save as the reason that they canceled the service. On one hand, one could argue that the consumer must learn how to handle their savings to really get out of the cycle of debt, so no fiduciary accounts should be necessary. However, one could use the analogy of learning to crawl before learning to walk to analyze this situation. The end goal of the program is to have consumers self-sufficient, but they may need to learn how to save, and how to not dip into these savings for luxury items while paying off their debt. Therefore, it seems, at least at the beginning, the companies should at least monitor the savings of their clients to ensure that they are making progress.

In a similar vein, one could argue that the companies should establish fiduciary accounts for their clients to ensure that they can actually pay off the offers once they are received. Otherwise, what should the company do with their clients who are not saving? However, the extant literature is ripe with examples of abuses for these accounts (see, *e.g.,* Plunkett 2009). Therefore, guidance from regulatory, consumer advocacy and industry groups would be helpful in this area.

My recommendation in this area is to strike a balance from the different approaches. First, allow DSPs to set up "trust" accounts where monies can only be released to pay creditors (with a signed letter from the creditor and consumer), to pay

agreed upon reasonable program fees (agreed upon on the creation of the account) or refunded to the client upon termination of the program or upon demonstration of a new financial hardship (*e.g.,* medical bills). Second, the DSPs should be allowed to monitor these accounts to ensure that their client is saving, and consumer saving being one condition of making "satisfactory progress" in program. If the protections noted above were in place for consumers making "satisfactory progress," the effect of not saving would remove their protections from creditors and litigation, creating a very strong incentive to save. It would be an interesting area for future research to investigate the savings rates for consumers who are enrolled in programs which have trust funds as an aspect of their programs.

Finally, both CCCSs and DSPs suffer from the same problem where the original creditors (but not third parties) can continue calling them after they have signed up for a program and have asked (or the DMP has asked) for the creditors to stop calling (source: Fair Debt Collections Practices Act or FDCPA). Even worse, even though the consumer is trying to avoid bankruptcy and litigation, it can be forced upon the consumer by only one out of many creditors. This phenomenon has been called the "creditor's dilemma" (Bainbridge 1986). In conversations with the DSP analyzed below fully 20.5 percent of the consumers who canceled the service gave bankruptcy as the reason for canceling the program, and another 19.3 percent who canceled the service gave a reason that was categorized as an "outside influence."

The problem is that consumers may be acting in good faith and trying to climb out of debt, the DMP may be acting in good faith to help the consumer and most of the creditors can be acting in good faith working with the DMP and the consumer, but one creditor can force failure of the entire process. To be honest, I can't see a way out of this problem without regulatory action, as similar problems (called "prisoner's dilemmas") have been extensively studied and the solutions generally require modifying incentives of the actors (Poundstone 1992). The clear implication is that consumers need regulatory protection from litigation and harassing calls while they are making satisfactory progress in these programs.

Timing of Fees

Throughout the above discussion, the issue of when DMPs should receive fees has not been addressed, so this issue is addressed in this section. This issue is one of the most contentious for DSPs where Plunkett (2009) and others have suggested that other than small account set up fees, DSPs should not receive any fees until the debt is settled. A general response to this recommendation is that this requirement is analogous to forbidding insurance companies from collecting premiums until a claim is filed, or forbidding attorneys from collecting fees until the matter is settled or forbidding doctors or hospitals from collecting fees until the patient is healthy.

The recommendation also ignores when value is created for the customers and when expenses are incurred by the DSPs in creating the value. DSPs create value for their clients in multiple ways. First, they offer financial education, budgeting, etc. as part of the program. Given that CCCSs charge consumers for this education (and receive Federal funding to support the education) (Keating 2008), there can be no argument that this provides value to the customers. Also, DSPs create value for the customers (and incur expense) when offers are received from creditors to reduce their debt (see empirical section below for quantification of this value) whether or not the consumers actually accept the offers. As shown in the next section, offers are received on some accounts within 2 months of enrollment in the program.

This recommendation is also inconsistent with the way that CCCSs receive their fees. An analogous situation would require that CCCSs receive no fees (including grants and "fair share" payments from creditors and monthly account maintenance fees) until the debt is paid off (generally in 5 years), which would make the business economically unviable without massive government funding. Given the current Federal and state deficits, this funding is unlikely.

Finally, the fact that consumers have to make payments, in and of itself, is educational. It forces consumers to get in the habit of saving and making payments. If the DSP has a "trust" account or is otherwise monitoring the savings of the client, similar expenses to those of CCCSs are incurred.

Therefore, DSPs should be allowed to charge consumers fees prior to the final settlement because value is generated for the clients and expenses are incurred by the DSP to generate that value. That said, to help protect consumers, any fees before settlement should reflect actual value generated and expenses incurred. As noted above, full disclosure of fees is required for consumers to make good choices.

Repayment on Original Terms

The problem with this alternative is that consumers are already delinquent and cannot afford the payments. The delinquency may be temporary, but even under the new credit card rules, consumers would still have 6 months of increased interest rate payments due to the late payment (Reddy 2009).

Analysis of Debt Settlement Program

In this section, we analyze data from a DSP firm. The purpose of this section is to analyze specific performance metrics for the firm to establish as a basis for estimating consumer welfare in the next section. Given that the firm has not tracked education and financial health after a consumer leaves the program, these metrics are not analyzed. The remainder of this section is organized as follows: the next part provides a brief description of the data. Next, specific performance metrics are analyzed taking care to control for when a consumer enters the program.

Description of Data

The firm† provided three cohorts of random, stratified samples of their data. The data was stratified into the lowest quartile, middle 50 percent and top quartile in terms of total indebtedness of the client with a random sample of 500 clients drawn from each stratum. Three cohorts were also drawn from the data: clients entering 24 months, 18 months and 12 months prior to the date of the data being accessed. Therefore, the database contains 4500 clients—a very significant sample of consumers in this industry. The client confidentiality is maintained through no identifying information (*e.g.,* demographics, names, credit card account numbers, etc.). One limitation of this data is that once a consumer cancels their account, no information is retained regarding offers, settlements, etc. That said, the sampling methods imply that the results can be applied to the entire database of clients for this firm. While the results may not be applicable to the industry as a whole without some strong assumptions, they are likely applicable to similar firms in industry and allow several conjectures to be examined in detail.

All creditor accounts, offers to settle (whether or not the client accepted the offer), offer amounts, date of the offer, whether or not the offer was accepted and if/when the client canceled the account are included in the data. In addition, the original creditor was provided so the question of whether or not there are differences in settlement offers due to the volume of accounts could also be tested. *Table 2* provides simple descriptive statistics for the data.

Table 2—Descriptive Statistics for Strata

	Stratum 1 (Lowest 25%)			Stratum 2 (Middle 50%)			Stratum 3 (Top 25%)		
	Mean	Median	Std Dev	Mean	Median	Std Dev	Mean	Median	Std Dev
Total Debt	7,927	8,000	1,223	16,966	16,138	6,788	47,404	40,201	21,884
Num Accts	3.7	3.0	1.7	4.6	4.0	3.3	6.3	6.0	3.3
Weeks in Program	49.9	49.0	33.4	49.4	50.0	46.1	46.9	46.0	32.4
Pct Cancelled	59.1			58.1			64.5		

Several points are obvious in the table. First, the median weeks are similar for the three stratums. Therefore, from a time in program standpoint, it appears the strata are identical. Second, as expected, the number of accounts increases as the total debt increases. Finally, the cancellation percentages are roughly similar across the different stratums. However, the top stratum appears to cancel at a much higher rate. We can calculate the weighted average cancellation rate to be approximately 60 percent, this rate is comparable to cell phone companies that average 2–3 percent monthly churn, or cancellation, rates (Mozer *et al.,* 2000). Clearly, this rate is high, but it does compare very favorably with the 84 percent yearly churn rate (Plunkett 2009). However, further analysis of the reasons for cancellation point to the difficulty in calculating accurate cancellation and/or completion rates.

The reasons for cancellation for the customers in the database are summarized in the five reasons provided in *Table 3.* There are several striking results from this table. First, if the outcome of paying off debts is considered a success, then the cancellation rate is overstated because 14 percent of the consumers included as cancellations actually paid off their debt.

† Credit Solutions.

Table 3—Reasons for Cancellations

Reason	Percentage
Bankruptcy (Chapter 7 or 13)	13.5%
Can't Save	6.8%
Buyer's Remorse [a]	9.2%
Settle/try to settle on own	14.0%
Other	56.5%

Note: [a] Buyers remorse is limited to those customers who cancel within 30 days of the initial payment to the DSP, which can be 30–60 days from the initial enrollment date.

Second, a significant portion of the consumers (13.5 percent) are being forced out of the program due to litigation. Therefore, protection of consumers from litigation is required for those consumers making satisfactory progress in the program. Third, a significant amount of the cancellations (6.8 percent) are due to consumers not being able to save. Because the DSP does not monitor/require savings, a significant portion of the cancellations could have been prevented by significant incentives for the consumers to save.

Therefore, the aggregate cancellation rate is a poor measure of the quality of the service provided. To help put the cancellation rate into context, *Table 4* provides yearly and monthly churn rates across a variety of industries, companies and time periods (selected sample from Kohs 2006) and shows that the churn rate is lower than or comparable to some companies and subscription-based industries which also have Better Business Bureau (BBB) certified members.

Table 4—Churn rates in other industries

Annual Churn	Monthly Churn	Company	Industry	Data Year
7.20%	0.62%	Sirius	Satellite Radio	2006
10.00%	0.88%		Web Hosting	2003
10.00%	0.88%	Western Wireless	Wireless	2001
11.00%	0.97%	Alamosa PCS	Wireless	2001
15.00%	1.35%	Nascar.com (premium subscribers)	Sports Media	2004
16.00%	1.45%	Nextel	Wireless	2005
17.00%	1.55%	Colorado teachers in "excellent" schools	Education	2004
17.00%	1.55%	Schnader Harrison (lawyers)	Legal	2003
17.00%	1.55%		DBS TV	2002
18.00%	1.65%	DirecTV	DBS TV	2003
19.00%	1.76%	Alltel	Wireless	2005
22.00%	2.07%	Analog cable subscribers	Cable TV	2002
23.00%	2.18%	Cingular	Wireless	2005
23.00%	2.18%	Colorado teachers in "unsatisfactory" schools	Education	2004
26.00%	2.51%	Sprint	Wireless	2005
26.00%	2.51%	Subscribers	Cable TV	2002
31.00%	3.09%		Pagers	1998
34.80%	3.56%	T-Mobile	Wireless	2005
35.00%	3.59%	Maricopa County (anglers)	Recreation	2002
45.00%	4.98%		E-mail addresses	2004
46.00%	5.13%		Prepaid Calling Cards	2004
46.00%	5.13%	Digital cable subscribers	Cable TV	2002
51.00%	5.94%	Globe	Prepaid Wireless	2004
52.00%	6.12%	Florence (AL) Times Daily (readers)	Newspapers	2005
58.00%	7.23%	Snowball.com	E-mail newsletter	2000
78.00%	12.62%	Touch Mobile	Prepaid Wireless	2004
93.00%	22.16%	VOOM	HD TV	2004
93.00%	22.16%	Runoff at time of sale	Home Mortgage	2002

Analysis of Data

In this section, different performance metrics are examined for the firm at the client-level.

The first set of metrics in *Table 5* provides performance metrics that can be used to calculate consumer welfare. The first column represents the conditioning of the metric: Settle—did the client settle at least one account, Offer—did the client receive at least one offer on the account, Cancel—did the client cancel all of their accounts. Note that the company did not retain offer and settlement information once the accounts were canceled.

Table 5—Consumer welfare metrics

Condition	Metric	Stratum 1 (Lowest 25%)			Stratum 2 (Middle 50%)			Stratum 3 (Top 25%)		
		Mean	Median	Std Dev	Mean	Median	Std Dev	Mean	Median	Std Dev
Settle	% Debt	51.0	48.8	0.19	48.5	46.7	0.27	49.2	47.5	0.19
	% Total Debt	54.7	50.7	0.30	54.1	50.6	0.45	53.1	49.4	0.32
	% Accounts	52.0	50.0	0.27	51.5	50.0	0.39	53.0	50.0	0.29
	Days first settlement	211 [a]	189	116	196 [a,b]	177	154	183 [b]	163	99
Offer	% Debt	62.2	64.2	0.29	56.6	52.2	0.39	56.8	55.7	0.17
	% Total Debt	56.5 [b]	51.5	0.18	63.7 [a,b]	67.8	0.43	67.7 [a]	72.1	0.29
	% Accounts	57.3 [b]	50.0	0.28	59.6 [b]	50.0	0.40	64.7 [a]	66.7	0.28
	Days first offer	210 [a]	188	126	186 [b]	172	148	168 [c]	148	95
Cancel	Days Cancel	196	168	145	197	163	207	202	171	155

Notes: Superscript a>b>c with probability less than or equal to 5 percent than they are the same. Values with same letter are not significantly different.

The second column represents the metric and the remaining columns report the mean, median and standard deviations for the metrics. Medians are included as a second measure of central tendency. The percent debt metric measures what percentage of the original debt the consumer paid when the account was settled. There are not significant differences between the strata, although the results indicate that the median is less than 48 percent, or that the households received an average discount more than 50 percent. The percent of total metric indicates the percentage of the original debt that has a settlement (conditional on the client settling at least one account). Once again there are no significant differences between the strata, but the median across the three stratums is around 50 percent. The percent of accounts settled is not different between the strata, and hovers around 50 percent. This indicates that the size of the debt is not a driving factor in getting the account settled. Interestingly, the only significant effect conditional on settling one account is the number of days until the first settlement, where the smaller accounts take longer than the other two. However, the medians for all three strata hover around 6 months. Note that, conditional on settlement, this organization beats the 60-60 rule noted above.

But when the offers are examined, they suggest a slightly different story. First, there are no significant differences in the average amount offered (% Debt) for the three strata. However, the median offer is around 56 percent, much higher than the 48 percent settlement, although both numbers beat the 60 percent of debt rule noted in the introduction. Hence, it can be concluded that the negotiations work for the clients. In terms of the percent of the original enrolled total debt (% total debt) that receives an offer, the highest quartile (median 72%) is significantly different than the lowest quartile (median 51.5%), but neither quartile is significantly different from the middle 50 percent (median 67.8%). This result (as well as the differences between means and medians) suggests high variance in the percent of debt settled, and that the significance on this metric may be spurious. If it is not spurious, it then appears that the creditors are more willing to make offers on higher debts, which is consistent with the analysis of Dash (2009). The results for the percent of accounts and days until the first offer support this hypothesis, where the highest quartile receives their first offer sooner than the lowest quartile and median strata, and the highest quartile has a larger percentage of accounts receiving offers than the other two strata.

Figure 2 provides a histogram of the percent of total debt that has either been settled or offered combining all three strata. There are a couple of striking elements to this figure. First, the most frequent value (also called the "modal value") for both settlements and offers is between 90 and 100 percent, indicating that the firm is generating value for their customers. Second, the distribution for both appears to be uniformly distributed (ignoring the mode). This seems to imply that consumers are progressing through the program; otherwise I would expect to find another mode where the clients get "stuck" in their progress. That said, the firm should strive to have 100 percent of the debt with offers. This figure also points to the difficulty in calculating a completion rate. Given that consumers are receiving offers on their debt but not accepting all of the offers, how should the accounts be counted?

Figure 2—Histogram of Percent of Debt Settled and Offered

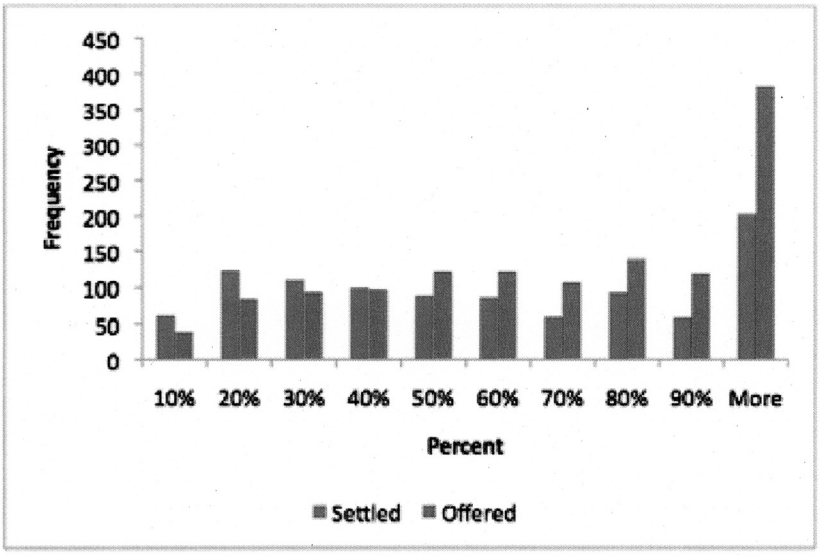
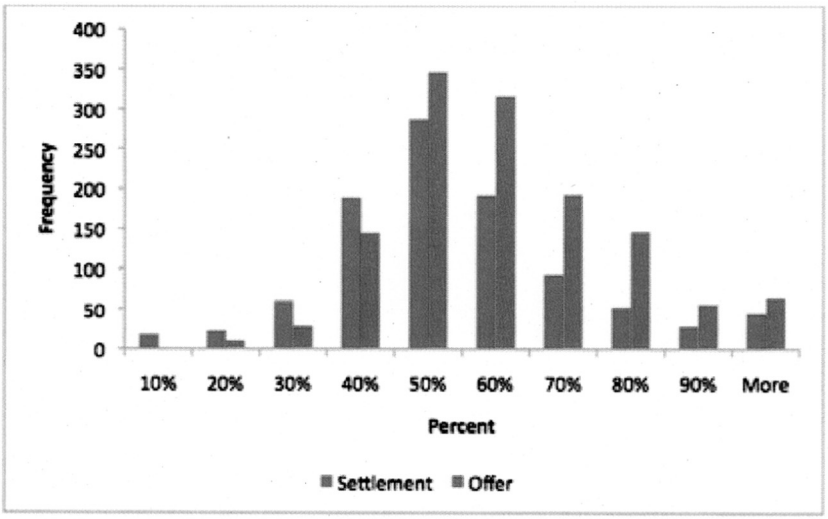


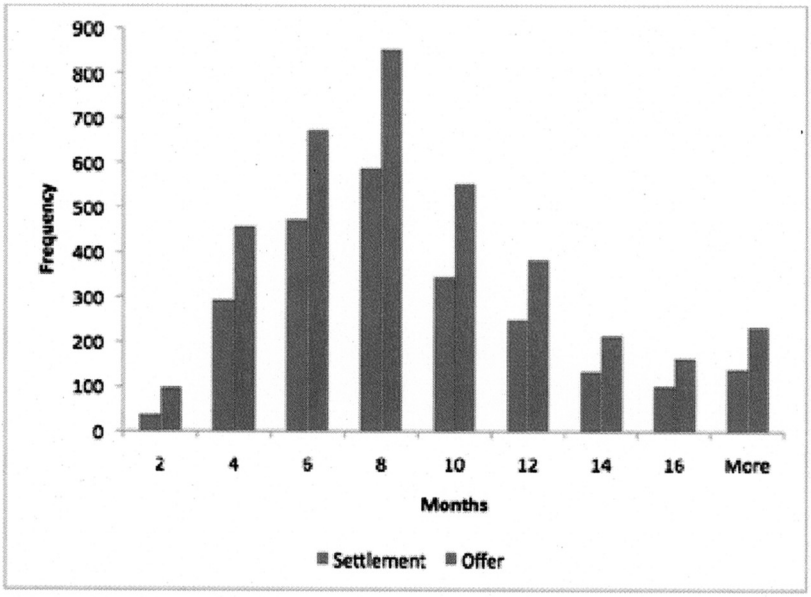
Figure 3 provides a histogram of the percent of the enrolled debt (*i.e.,* original debt amount) that was either paid during settlement or had a settlement offer, conditional on settlement or receiving an offer. The settlement data appears to be normally distributed with the mean, mode and median slightly less than 50 percent, much better than that 60-60 rule noted above. A striking feature is that the average offers are almost normally distributed, but have a positive skew. This positive skew implies that the creditors tend to make more offers above the mode than below the mode. Given the distribution of the settlements is more balanced; it implies that the firm does a good job in negotiating better terms for their clients. Specifically, we see that the absolute frequency (not just percentage) is much higher for settlements below the mode than for offers. Similarly, the frequency for offers above the mode (and median) is much higher for offers than for settlements. The mean, median and mode (all measures of central tendency) appear to be the same, suggesting that the firm generates value to their clients by beating the 60-60 rule. However, to manage client expectations about possible benefits from the program, the firm should be transparent about the median and 75 percent quartile (*i.e.,* 25 percent quartile in terms of discount) when calculating savings for the consumer. Given the convergence of mean, median and modes, a standard deviation should also be reported.

Figure 3—Histogram of Percent of Debt Paid for in Settlements and Offers



Next, we look at the cancellation data. There are no significant differences between the three strata. However, the median time to cancel hovers between five and 6 months. Even though there is no data on the offers and settlements for these clients, I find it highly unlikely that this group received no offers in this time, as the median time approximates the median time for offers and settlements. It is much more likely that other, unobserved factors were more influential in this decision. *Figure 4* combines the data from the three strata, and provides a histogram of the time it takes an account to be settled or the time it takes for an account to receive the first offer. For both settlements and offers, a negative skew is observed for the distribution.

Figure 4—Histogram of Time for Settlement or Offer to be Received



Interestingly, this implies that the creditors are generally very interested in settling the account, with the modal offer time being between 6 and 8 months. The firm can clearly improve in their performance by reducing the right tail of the offer distribution, *i.e.,* ensuring that all accounts receive offers in a timely manner. This graph also depicts how the firm generates value for their customers in the negotiations. By receiving many offers quickly, they can make the creditors compete against each other for the lump sum payment from the consumer. This competition is in the form of reducing the principal of the debt.

A problem with this distribution is that, without some sort of regulatory protection, the spurned creditors (*i.e.,* those who do not offer good enough discounts on the debt, so they are not selected for the lump sum payment) can initiate litigation that would drive the consumer into bankruptcy, creating unnecessary cancellations for the firm. A second challenge for this firm is that the savings plan ought to require their clients to save enough in the first 6–8 months to pay off one of their creditors, potentially the creditor with the smallest balance. This finding supports the call for protection of consumers making "satisfactory progress" in paying their debts through Debt Management Programs.

In summary, this analysis has several key findings:

1. Creditors seem to make lower offers sooner to consumers with higher balances,

2. The median cancellation time is between 5 and 6 months, implying (due to a lack of data) that the clients likely received offers, as the median is not very different than the median offer time. However, it is very difficult to calculate accurate cancellation rates (often used as a measure of "failure" of the programs) due to the fact that almost 30 percent of the clients cancel due to paying off their debts or going into bankruptcy.

3. Both the median offer (approximately 56 percent of debt) and median settlement (48 percent) are better than the proposed 60 percent rule, so the firm is offering value vis-á-vis the proposed 60-60 rule. Further, the difference between the settlement and offer percentages implies differences between households (potentially due to hardship) and that some households receive tremendous value from the negotiations and relationships of the firm.

4. Conditional on a client settling at least one account, the client seems to settle more than 50 percent of their debt and 50 percent of their accounts. This statistic is impressive as the program lasts 36–48 months, whereas the data only

captures the first 12–24 months for the client. One would expect that at the end of the program, the settlement rate would increase.

5. Conditional on receiving at least one offer, clients seem to receive offers for more than 67 percent of their accounts and debts.

6. The figures seem to indicate that clients are progressing and paying off their debt, as the mode for the number of offers and settlements is between 90 and 100 percent of the enrolled debt. However, the firm does have room for improvement, as the optimal graph would have 100 percent of the debt with offers.

Calculation of Consumer Welfare

In this section, the empirical results are used to calculate consumer welfare under a variety of assumptions and conditions.

Table 6 provides the initial base-line estimates for consumer welfare. We use assumptions of 18 percent annual interest rate and minimum fixed monthly payments of 2 percent and 3 percent for debts of $4,000 and $10,000 (for similar assumptions, see, *e.g.,* Warnick 2005). The fixed monthly payment of 2 percent is similar to current minimum monthly payments as noted in Warnick (2005). Affordability is measured using monthly payments, and consumer welfare is measured by the length of time required to pay off the debt and total amount paid by the consumer. By doubling their payment, consumers are able to cut the time to repay the loan in half and increase their total welfare by paying less to the credit card company.

Table 6—Baseline Consumer Affordability and Welfare Calculations

Payment	2%	3%	2%	3%
Debt Level	$4,000	$4,000	$10,000	$10,000
Annual Interest Rate	18%	18%	18%	18%
Fixed Monthly Payment	$80	$120	$200	$300
Years to Pay	7.8	3.9	7.8	3.9
Total Payments	$7,488	$5,616	$18,720	$14,040
Percent of Original Debt	187%	140%	187%	140%

The first scenario examined is when the same consumer receives help from a CCCS, and the firm is able to cut the interest rate to 10 percent from 18 percent, and has 5 years to repay (this may be an optimistic assumption, as Plunkett (2009) says that creditors are becoming less willing to reduce interest rates). The results of the consumer welfare calculations are provided in *Table 7.* In order to calculate total payments (to credit card and the firm), we assume the industry average of $15 per month and a fair share payment of 5 percent of the payments to the credit card company (Hunt 2005).

Table 7—Consumer Affordability and Welfare Calculations for hypothetical CCCS

Debt Level	$4,000	$10,000
Annual Interest Rate	10%	10%
Years to Pay	5	5
Fixed Monthly Payment	$85	$212
Monthly Account Fee	$15	$15
Total Monthly Payments	$100	$227
% Baseline Payments	125%	114%
Total Payments	$5,999	$13,648
Percent of Original Debt	150%	136%
Percent of Baseline	80%	73%
Firm Fees	$900	$900
% Fair Share	5%	5%
Fair Share Fees	$255	$637
Total Revenue to firm	$1,155	$1,537
% Original Debt	29%	15%

In terms of affordability, both cases are less affordable, *i.e.,* have higher monthly payments than the base case of paying off the debt using with fixed monthly payments of 2 percent of the original debt. However, consumers are better off with this solution as they end up paying much less overall (range from 73 percent to 80 percent of the base case payments), even when the monthly account fees are included. We can conclude that this alternative does help consumer welfare, but it is a generally less affordable solution. If we examine total fees paid, they range from 15 percent to 29 percent of the total debt. Given Plunkett's (2009) description of 30 percent fees as exorbitant, his standard suggests that the CCCS charges exorbitant fees to lower debt consumers. Additionally, if it is assumed that lower income consumers

have lower debt then CCCS charges higher fees as a percentage of the debt to lower income consumers than to higher-income individuals. In fairness, they can argue that cost of education is the same, regardless of the debt level, but it does not change the fact that they have a regressive fee structure.

The 60-60 rule is analyzed in the next scenario.

In this case, we assume 40 percent reduction in the debt principal, the interest rate remains at 18 percent and the firm has varying fees of 15 percent and 20 percent of the original debt balance. *Table 8* provides the results of this analysis. This scenario is more affordable than both the base case and the hypothetical CCCS firm. Further, consumer welfare is highest where the consumer is paying 57–60 percent of the original base case scenario, even though the consumer ends up paying more than the original debt. The fees are now neutral in terms of percentages versus debt and/or income levels, and are progressive in terms of the total fees with respect to debt/income.

Table 8—Consumer Affordability and Welfare Calculations for hypothetical 60-60 rule

Debt Level	$4,000	$4,000	$10,000	$10,000
Annual Interest Rate	18%	18%	18%	18%
Reduction	40%	40%	40%	40%
Years to Pay	5	5	5	5
Fees as percent of Debt	15%	20%	15%	20%
Monthly Credit Payment	$61	$61	$152	$152
Monthly Fee	$10	$13	$25	$33
Total Monthly Payment	$71	$74	$177	$186
Total Payments	$4,257	$4,457	$10,642	$11,142
Percent of Original Debt	106%	111%	106%	111%
Versus baseline	57%	60%	57%	60%
Fee Payments	$600	$800	$1,500	$2,000

The next scenario is a simplified version of the DSP analyzed in the empirical section above. It is assumed that the fees on the account are 15 percent of the total debt, debt is reduced to 40, 50 or 60 percent of the original debt amount and the household makes a balloon payment at the end of 1 year (much shorter than normal estimates of 3 years). *Table 9* provides the results of this analysis. First, this option creates the highest amount of consumer welfare among all of the different options: it is the only option where the consumer pays less than the original debt amount. It is also the least affordable of the options, with monthly payments three times the base case scenario. Therefore, we can conclude that the firm should carefully screen consumers for their ability to save and make this payment within 1 year. However, this finding is highly dependent upon the assumption that the consumer will repay the debt in 1 year, much less than the above scenarios.

Table 9—Consumer Affordability and Welfare Calculations for hypothetical DSP

Debt Level	$4,000	$4,000	$4,000	$10,000	$10,000	$10,000
Reduction	40%	50%	60%	40%	50%	60%
Years to Pay	1	1	1	1	1	1
Fees as percent of Debt	15%	15%	15%	15%	15%	15%
Monthly Credit Payment	$200	$167	$133	$500	$417	$333
Monthly Fee	$50	$50	$50	$125	$125	$125
Total Monthly Payment	$250	$217	$183	$625	$542	$458
% Baseline Payments	313%	271%	229%	313%	271%	229%
Total Payments	$3,000	$2,600	$2,200	$7,500	$6,500	$5,500
Percent of Original Debt	75%	65%	55%	75%	65%	55%
Versus baseline	40%	35%	29%	40%	35%	29%

Therefore, we analyze a scenario with a more reasonable time-frame of 3 years, consistent with Manning's (2009) assumptions, but still shorter than the CCCS or the 60-60 rule. *Table 10* provides the results of this final scenario where the only change from the previous scenario is that the time to repay the debt is increased from one to 3 years. Not surprisingly, consumer welfare has not changed from the previous scenario.

However, the affordability has increased to the point where it is comparable or better than the base-case and 60-60 rule scenarios, even though the consumers pay their debt in 3 years instead of 5 years. This result once again suggests that it would increase consumer welfare if they have protection from creditors and litigation while they are making satisfactory progress in a DSP. It also suggests that DSPs need a mechanism in their program to monitor client savings to demonstrate

to the creditors that clients are making progress toward being able to afford settlements.

Conclusions and Discussion

Similar to most studies, this research has several limitations. First, the empirical analysis only examines a single company over a single time period and does not contain educational measurements or other behavioral measurements after the clients exit the program. Therefore, it is unclear whether or not the findings can be generalized beyond this firm to the industry as a whole. Second, the data does not include information on settlement offers for canceled accounts, so it is very difficult to determine if value was generated for these customers. However, given that the median cancellation time is similar to the median time until the first offer, I find it unlikely that all of these clients received no offers if they stayed in the program long enough.

Probably the most important empirical finding is that this firm adds significant value to their customers where the median and modal settlement offers are less than 50 percent of the original debt, much better than the 60-60 rule. This finding confirms the assumptions in Manning (2009) and calls for programs which reduce the debt principal as an effective means of helping consumers (Plunkett 2009). Given the high rate of cancellations due to bankruptcy (13.5 percent), this finding also suggests that consumers need regulatory protection from creditors (*i.e.,* the "creditor's dilemma") while they are making satisfactory progress in the program.

A second important empirical finding is that the upper bound for the cancellation rate is much lower than speculated (Plunkett 2009). However, accurate cancellation and completion rates cannot be calculated from the data, as consumers who cancel due to paying off their debt and who cancel due to entering bankruptcy are included in the cancellation rates. Further, completion of the program requires consumers to accept the offers. The data indicate that many more accounts have offers than are settled, with the modal client having more than 90 percent of their debt with offers. Even without adjusting the cancellation rate for these factors, the rate is comparable to or lower than other subscription-based businesses which have BBB-certified members. Therefore, excessive cancellation rates cannot be used as a rationale for excluding DSPs from certification.

Finally, a large portion of the consumers who cancel (6.8 percent) indicate that they are not able to save enough. This implies that the DSPs need to monitor consumer savings as part of their program. One effective means for doing this would be to establish third-party trust accounts that have consumer protections in place:

1. Require periodic audits of the accounts,
2. Require arms-length relationship with the DSPs,
3. Only allow disbursements to creditors (with signed letter from creditor and consumer), to DSPs (for pre-approved fees), to consumers who cancel the program or encounter new financial hardships.

If appropriate savings are pre-conditions for consumer protection from litigation and harassment from creditors, consumers will have very strong incentives to save and pay off their debts. The policy simulations have strong implications as well. First, both CCCSs and DSPs increase consumer welfare versus the consumer paying off their debt. However, DSPs are the only option where consumers end up paying off less than 100 percent of their debt, so they create the greatest amount of consumer welfare of any option considered. Not surprisingly, the affordability of the DSP is dependent upon the length of time the consumer has to save to pay off their debt. If a three-year period is used, the DSP is comparable in affordability to the 60-60 rule and can be more affordable than CCCSs. This finding adds support to the recommendation of protecting consumers in the programs to ensure that they have enough time to build their savings to pay off their debts. This finding also supports the regulatory recommendation of establishing fiduciary accounts that can be monitored by the DSPs to ensure that consumers are saving enough.

The policy simulations also suggest that CCCSs may be overcharging some of their clients, where CCCSs receive 29 percent or more of the original debt amount in consumer fees and "fair share" payments. Even worse, their fee structure is regressive: where lower debt (and income) clients pay a larger percentage of the original debt amount in fees than higher debt (and income) clients. This finding suggests regulatory action to require CCCSs to disclose all fees, including fair share payments to consumers, is required to ensure transparency and that consumers can make good decisions. This finding also suggests that DMPs need to ensure that their fee structures are at least neutral or progressive in terms of the percentage and amount of the original debt amount to ensure lower income consumers are not paying unnecessarily large fees.

While not discussed in the empirical or policy sections, the extant literature suggests that education should be required to be provided as part of any certified DMP due to the positive outcomes. However, "satisfactory progress" in DMPs should also include satisfactory progress in the educational programs, which implies firms need to monitor and measure educational attainment. Technologies for this already exist, where consumers can already take driving educational courses over the Internet.

Finally, we find that charging consumers reasonable "up-front fees," *i.e.,* fees before settlement, is consistent with practices in other industries, *e.g.,* legal industry, and can be justified based on value provided to consumers as well as expenses incurred generating this value. Any attempt to ban these fees would have a chilling effect on the industry and is inappropriate for this industry.

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Appendix A: Definition of Acronyms

BAPCPA—Bankruptcy Abuse Prevention and Consumer Protection Act

CCCS—Consumer Credit Counseling Service.

DMP—Debt management program—this term refers to a program that is intended to help a consumer pay off their debt, so it refers to both CCCSs and DSPs.

DSP—Debt Settlement Program.

Settlement—refers to when the consumer and creditor agree to terms (may be one or more payments, could be all or only some of the principal, fees and interest) to repay the debt.

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