

MODEL DEBT SETTLEMENT LAW FOR STATES

Debt settlement services hold out the promise of settling debts for less than the full amount owed. To achieve the touted result of settling debts, however, the consumer first has to save enough to fund settlements of the debts. Multiple debts may be involved, and the process may be designed to 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 debt collection calls, bad reports by creditors to the credit reporting agencies, or even being sued on the debt. Since creditors are not getting paid prior to some uncertain future lump sum settlement, it is not surprising that creditors may get tired of waiting for their money and sue the consumer during the debt settlement program. This can lead to wages being garnished to collect the court judgment obtained by a creditor or by a debt collector.

Debt settlement is sometimes touted as an alternative to bankruptcy or a lower-cost choice than a debt management plan under which creditors get paid in installments over five years. However, debt settlement has had a dismal record of actually eliminating debt for consumers. The industry's own numbers, as submitted to the Federal Trade Commission, showed that three years after starting debt settlement, two thirds (65.6%) of consumers still had a substantial portion of their debt unsettled. Since debt is not repaid during a settlement period, it continues to grow in amount. Most consumers are left with substantial unsettled debts, which have grown during the program period. Any savings can very easily be offset by the combination of the fees paid, the growth in unsettled debt, and taxes due on any settled debt. The two-thirds failure rate was also described in GAO testimony that reported on an industry trade group's study of its larger members.¹ The study showed a 34.4% completion rate, with completion defined as eliminating 75% or more of the debt. The barely over one-third claimed success rate includes 9.8% of consumers who in fact were still saving for not-yet achieved settlements.

The GAO testimony notes that non-industry sources showed even lower rates of debt elimination, at or below 10% of consumers. The GAO also quotes industry trade association representatives as characterizing as "an unrealistic measure" the Better Business Bureau standard that, to avoid its "inherently problematic" category, a debt settlement company should achieve savings of greater than its fee amounts for a majority of its customers.² These poor results make it

¹ U.S. GOV'T ACCOUNTABILITY OFFICE, DEBT SETTLEMENT: FRAUDULENT, ABUSIVE, AND DECEPTIVE PRACTICES POSE RISKS TO CONSUMERS 11 (2010) *available at* <http://www.gao.gov/new.items/d10593t.pdf>.

² *Id.* at 12-13.

particularly important that the consumer not be required to pay fees without results.

Debt settlement companies have long used a business model in which consumers pay significant fees based on the size of the original debt even if none, or only part, of that debt is ever settled. The consumer puts savings into an account each month, and the debt settlement company takes fees each month from those savings. Depending on whether the company is subject to an FTC rule, described below, those fees are generally collected in full during the first half of the debt settlement program whether or not any debt is settled.³ Though the FTC issued a rule forbidding this practice, the rule has a limited scope and is widely evaded.⁴

In the fall of 2010, the FTC amended the Telemarketing Sales Rule⁵ to prohibit debt settlement companies from charging upfront fees before settling any portion of the debts enrolled in a debt settlement program. The FTC rule addresses the timing of the fees and requires that any fees collected be proportional to the amount of the original debt that is actually settled. This essential new protection squarely addresses the key problem of paying in advance for uncertain future results, and where it applies it will protect consumers from paying in advance when no or partial results are achieved. However, because the FTC rule is grounded in its authority to regulate telephone sales, it does not apply to a sale of debt settlement services conducted solely on the Internet. Nor does it apply where “payment is not required until after a face to face meeting.”⁶ In addition, the rule addresses only the timing of the fees and not the size of the fee charged.⁷ The fee might still exceed the savings from the settlement.

However, states can enact the FTC timing protections without the loopholes inherent in the FTC’s Telemarketing Sales Rule approach. States can also add caps on the actual fee amounts, an issue not addressed by the FTC. Some states have already acted to protect their consumers. Illinois⁸ and Maine⁹ have both passed comprehensive laws that are stronger than the FTC’s Telemarketing Sales Rule. Illinois’ law covers all methods of solicitation, not just telemarketing; places restrictions on both amount and timing of fees;

³ An industry-sponsored study of one large debt settlement company showed that the majority of debt settlement customers drop out of the programs within the first six months, after they have paid a large portion of the fees but before their debts are settled. See RICHARD A. BRIESCH, ECONOMIC FACTORS AND THE DEBT MANAGEMENT INDUSTRY (2009), available at <http://www.consumercreditchoice.org/files/ACCC-Dr.%20Briesch%20Study%20Report%20on%20Debt%20Management%20Industry.pdf>.

⁴ Elizabeth Ody, *Debt-Settlement Firms Outfox the Regulators*, BLOOMBERG BUSINESSWEEK, Nov. 3, 2011, available at <http://www.businessweek.com/magazine/debt-settlement-firms-outfox-the-regulators-11032011.html>.

⁵ Telemarketing Sales Rule, 75 Fed. Reg. 48458 (Aug. 10, 2010) (codified at 16 C.F.R. § 310), available at <http://www.gpo.gov/fdsys/pkg/FR-2010-08-10/pdf/2010-19412.pdf>.

⁶ *Id.* at 48468. The rule only applies to telemarketing – i.e., “a plan, program, or campaign which is conducted to induce the purchase of goods or services’ and that involves interstate telephone calls.” *Id.*

⁷ *Id.* at 48488 (“The Commission declines to set fee limits in this proceeding”).

⁸ See 225 ILL. COMP. STAT. 429/1-999 (2011).

⁹ See ME. REV. STAT. ANN tit. 32 §§ 6171-6183 (2010).

requires debt settlement providers to be licensed and bonded; and specifies disclosures and warnings that debt settlement providers must place in contracts.¹⁰ Maine's law requires annual registration and bonding for all debt settlement service providers, and caps fees at no more than 15 percent of the amount by which consumer's debt was reduced through binding settlement.¹¹

States that have an existing limitation on debt settlement to nonprofit providers should keep that law.

States without a restriction to nonprofit providers may take that approach, or may *enact legislation to:*

- **Cap the amount of debt settlement fees based on a percentage of the actual savings to the consumer from a completed settlement.**
- **Restrict the timing of all debt settlement fees until a settlement eliminates the debt on which a fee is to be paid.** States could do this by adopting a state law based on the FTC's rule on the timing of charging debt settlement fees, without the loopholes in the FTC rule for in-person and internet-only sale of debt settlement services.
- **Require debt settlement companies to determine before signing up a customer that the program is suitable for the individual, that the person can meet the savings goals for the debt settlement program, and that the consumer will be better off with debt settlement than without it ("net tangible benefit").**
- **Require debt settlement companies to be licensed and bonded.**
- **Prohibit misleading advertising claims and claims of results.**
- **Require that advertisements include these types of warnings** about the services:
 - Creditors may still try to collect by contacting you, suing you and garnishing your wages or bank account.
 - Not all creditors will agree to accept a balance reduction.
 - Your credit rating and credit score will likely be harmed.
 - The amount you owe is likely to increase while you are waiting for a settlement.
- **Require pre-contract warnings** including the advertising warnings and these:
 - We can't guarantee we will reduce your debt.
 - You should inquire about other means of dealing with debt, including, but not limited to, nonprofit credit counseling and bankruptcy.
 - You remain obligated to make periodic or scheduled payments to creditors while participating in a debt settlement plan, and the debt

¹⁰ 225 ILL. COMP. STAT. 429/1-999 (2011).

¹¹ ME. REV. STAT. ANN tit. 32 §§ 6173, 6174, 6174-A.

settlement provider will not make any periodic or scheduled payments to creditors on your behalf.

- If you stop paying your creditors:
 - Creditors may still contact you or sue you.
 - Wages may be garnished.
 - Your credit rating may be harmed.
 - The amount you owe is likely to increase while you are waiting for a settlement.
- Even if we do reduce your debt, you may still be obligated to pay taxes on the amount forgiven.
- **Create a clear right to cancel** and method to exercise that right to cancel.

Some states already have laws that restrict fees for credit counseling or for debt management, with definitions of those activities broad enough to cover debt settlement. States with strong existing laws that already cap fees at reasonable levels, tied to the savings from completed binding settlements that eliminate debt, should decline to consider any new bills in the area of debt settlement.

Model State Debt Settlement Law - Text

Option One: Restrict Debt Settlement to Non-profit Providers Only

The recommended form of debt settlement regulation limits the provision of debt settlement services to non-profit entities and limits fees to no more than a nominal amount. These restrictions are appropriate for a number of reasons: charging more than a nominal fee can consume any net benefit obtained from a settlement, especially when accounting for any tax liability the debtor may owe on the forgiven debt; charging a fee diverts the debtor's limited funds away from pre-existing creditors and thereby favors the debt settlement provider over businesses that have already rendered services or extended credit to the debtor; and there is a well-documented history of abuse in the for-profit debt settlement industry.¹²

The text of the model law below includes optional provisions for restricting debt settlement to nonprofit entities.

Option Two: Allow For-Profit Debt Settlement but Restrict Fees to 15% of the Savings From the Original Debt Amount, Earned Only When the Debt is Settled in Full; Provide Other Protections.

¹² See U.S. GOV'T ACCOUNTABILITY OFFICE, DEBT SETTLEMENT: FRAUDULENT, ABUSIVE, AND DECEPTIVE PRACTICES POSE RISKS TO CONSUMERS (2010) *available at* <http://www.gao.gov/new.items/d10593t.pdf>; Telemarketing Sales Rule, 75 Fed. Reg. 48458 (Aug. 10, 2010) (notice of final rulemaking and discussion of basis for rule).

MODEL STATE DEBT SETTLEMENT LAW¹³

I. Definitions

- a) "Consumer" means any person who purchases or contracts for the purchase of debt settlement services, or to whom such services are offered or marketed.
- b) "Consumer settlement account" means any account or other means or device in which payments, deposits, or other transfers from a consumer who has contracted for debt settlement services are arranged or transferred by or to a debt settlement provider for the accumulation of the consumer's funds in anticipation of proffering an adjustment or settlement of a debt or obligation of the consumer to a creditor on behalf of the consumer.
- c) "Debt settlement provider" means any person or entity engaging in, or holding itself out as engaging in, the business of providing debt settlement services in exchange for any fee or compensation, or any person who solicits for or acts on behalf of any person or entity engaging in, or holding itself out as engaging in, the business of providing debt settlement service in exchange for any fee or compensation. "Debt settlement provider" does not include:
 - 1) escrow agents, accountants, broker dealers in securities, or investment advisors in securities, when acting in the ordinary practice of their professions and through the entity used in the ordinary practice of their profession;
 - 2) any bank, agent of a bank, trust company, savings and loan association, savings bank, credit union, crop credit association, development credit corporation, industrial development corporation, title insurance company or insurance company operating or organized under the laws of a state or the United States;
 - 3) any person who performs credit services for his or her employer while receiving a regular salary or wage when the employer is not engaged in the business of offering or providing debt settlement service;
 - 4) public officers while acting in their official capacities and persons acting under court order;

¹³ This law is based, with a few variations, upon the Illinois Debt Settlement Consumer Protection Act, 225 ILL. COMP. STAT. 429/1-999 (2011).

- 5) any person while performing services incidental to the dissolution, winding up, or liquidating of a partnership, corporation, or other business enterprise.
- d) "Debt settlement service" means:
- 1) offering to provide advice or service, or acting as an intermediary between or on behalf of a consumer and one or more of a consumer's creditors, where a primary purpose of the advice, service, or action is to obtain a settlement, adjustment, or satisfaction of the consumer's unsecured debt to a creditor in an amount less than the full amount of the principal amount of the debt or in an amount less than the current outstanding balance of the debt; or
 - 2) offering to provide services related to or providing services advising, encouraging, assisting, or counseling a consumer to accumulate funds for the primary purpose of proposing or obtaining or seeking to obtain a settlement, adjustment, or satisfaction of the consumer's unsecured debt to a creditor in an amount less than the full amount of the principal amount of the debt or in an amount less than the current outstanding balance of the debt.
 - 3) The term "debt settlement service" does not include services of an attorney licensed, or otherwise authorized, to practice in [State] when, in the context of an attorney-client relationship:
 - i. negotiating the settlement of pending litigation;
 - ii. negotiating the settlement of a debt that is subject to a *bona fide* dispute regarding its amount or legality;
 - iii. providing information, advice, or legal representation with respect to filing a case or proceeding under title 11 of the United States Code.
- e) "Principal amount of the debt" means the total amount or outstanding balance owed by a consumer to one or more creditors for a debt that is included in a contract for debt settlement service at the time when the consumer enters into a contract for debt settlement service.
- f) "Savings" means the difference between the principal amount of the debt and the amount paid by the debt settlement provider to the creditor or negotiated by the debt settlement provider and paid by the consumer to the creditor pursuant to a settlement negotiated by the debt settlement provider on behalf of the consumer as full and complete satisfaction of the creditor's claim with regard to that debt.
- g) "Secretary" means the Secretary of [*the relevant State department that will oversee the licensing scheme*].

- h) "Settlement fee" means any fee, obligation, or compensation paid or to be paid by the consumer to a debt settlement provider in consideration of or in connection with a binding written agreement for payment of less than the principal amount of the debt in full satisfaction of the creditor's claim against the consumer.

II. Requirement of license.

It shall be unlawful for any person or entity to act as a debt settlement provider except as authorized by this Act and without first having obtained a license under this Act.

[OPTIONAL: No person or entity shall be licensed as a debt settlement provider except for an organization that is described in Section 501(c)(3) and subject to Section 501(q) of Title 26 of the United States Code and exempt from tax under Section 501(a) of Title 26 of the United States Code.]

III. Application for license.

- a) An application for a license to operate as a debt settlement provider in this State shall be made to the Secretary and shall be in writing, under oath, and in the form prescribed by the Secretary. The application form shall contain a statement informing the applicant that a false or dishonest answer to a question may be grounds for denial or subsequent suspension or revocation of the applicant's license. An application for licensure shall be in a form prescribed by the Secretary and at minimum shall include the following:
- 1) The name of each executive officer and director of the applicant and each person that owns or controls, directly or indirectly at least 10 percent or more of the outstanding equity interests of the applicant and any other information necessary for investigation in Section IV; and
 - 2) Disclosure of common ownership by any person owning or controlling, directly or indirectly, 10 percent or more of the outstanding interests or equity securities in the debt settlement services provider with the following persons:
 - i. any person who advertises any service to assist consumers with reducing or eliminating debt;
 - ii. any person who provides banking or similar depository services to consumers of debt settlement services providers;
 - iii. any person, other than individuals employed by the debt settlement services provider, with whom the debt settlement services provider contracts to provide debt settlement services, or parts thereof, to consumers of the debt settlement services provider;
 - iv. a statement describing, to the extent it is known or should be known by the applicant, any civil or criminal judgment

relating to financial fraud or misuse, or relating to consumer protection laws; any disposition of a criminal matter in the nature of a *nolo contendere* plea and any significant civil settlement if either relates to allegations of financial misconduct or fraud or consumer protection laws; and any material administrative or enforcement action by a governmental agency relating to financial fraud or misuse or consumer protection laws in any jurisdiction against the applicant, any of its officers, directors, owners, employees, agents, or predecessor organizations.

- 3) Each applicant, at the time of making such application, shall pay to the Secretary the required fee as set by rule.
- 4) Every applicant shall submit to the Secretary, at the time of the application for a license, a bond to be approved by the Secretary in which the applicant shall be the obligor, in the sum of \$200,000 or an additional amount as required by the Secretary, and in which an insurance company, which is duly authorized by the State to transact the business of fidelity and surety insurance, shall be a surety.
- 5) The bond shall run to the Secretary for the use of the [*relevant State department*] and of any person or persons who may have a cause of action against the obligor in said bond arising out of any violation of this Act or rules by a debt settlement provider.
- 6) Such bond shall be conditioned that the obligor must faithfully conform to and abide by the provisions of this Act and of all rules, regulations, and directions lawfully made by the Secretary and pay to the Secretary or to any person or persons any and all money that may become due or owing to the State or to such person or persons, from the obligor under and by virtue of the provisions of this Act.

IV. Qualifications for license.

Upon the filing of the application and the approval of the bond and the payment of the specified fees, the Secretary may issue a license if he or she finds all of the following:

- a) The financial responsibility, experience, character, and general fitness of the applicant, the managers, if the applicant is a limited liability company, the partners, if the applicant is a partnership, and the officers and directors, if the applicant is a corporation or a nonprofit corporation, and each person who owns or controls, directly or indirectly at least 10 percent or more of the outstanding equity interests of the applicant, are such as to command the confidence of the community and to warrant belief that the

business will be operated fairly, honestly, and efficiently within the purposes of this Act;

- b) The applicant, if an individual, the managers, if the applicant is a limited liability company, the partners, if the applicant is a partnership, and the officers and directors, if the applicant is a corporation or a nonprofit corporation, and each person who owns or controls, directly or indirectly at least 10 percent or more of the outstanding equity interests of the applicant, have not been convicted of a felony or a misdemeanor or disciplined with respect to a license or are not currently the subject of a license disciplinary proceeding concerning allegations involving dishonesty or untrustworthiness;
- c) The person or persons have not had a record of having defaulted in the payment of money collected for others,
- d) The applicant, or any officers, directors, partners, or managers have not previously violated any provision of this Act or any rule lawfully made by the Secretary; and
- e) The applicant has not made any false statement or representation or material omission to the Secretary in applying for a license under this Section.
- f) A license issued under this Act to operate as a debt settlement provider shall be valid for the location specified in the application. The license shall remain in full force and effect until it is surrendered by the debt settlement provider or revoked by the Secretary as provided in this Act; provided, however, that each license shall expire by its terms on January 1 next following its issuance unless it is renewed as provided in this Act.

V. Renewal of license.

Each debt settlement provider under the provisions of this Act may make application to the Secretary for renewal of its license, which application for renewal shall be on the form prescribed by the Secretary and shall be accompanied by a fee of \$1,000 together with a bond or other surety as required, in a minimum amount of \$100,000 or an amount as required by the Secretary based on the amount of disbursements made by the licensee in the previous year. The application must be received by the [*relevant State department*] no later than December 1 of the year preceding the year for which the application applies.

VI. Annual report; debt settlement provider disclosure of statistical information; Secretary to report statistical information.

- a) A debt settlement provider must file an annual report with the Secretary that must include all of the following data:

- 1) for each person:
 - i. the number of accounts enrolled;
 - ii. the principal amount of debt at the time each account was enrolled;
 - iii. the status of each account (for example, active or terminated);
 - iv. whether the account has been settled, and if so, the settlement amount and the corresponding principal amount of debt enrolled for that account;
 - v. the total amount of fees paid to the debt settlement service provider;
 - vi. whether the creditor has filed suit on the account debt;
 - vii. the date the resident is expected to complete the debt settlement program; and
 - viii. the date the resident canceled, terminated, or became inactive in the program, if applicable
 - ix. whether the person is a state resident or non-resident;
- 2) for persons completing the program during the reporting period, the median and mean percentage of savings and the median and mean fees paid to the debt settlement service provider;
- 3) for persons who canceled, became inactive, or terminated the program during the reporting period, the median and mean percentage of the savings and the median and mean fees paid to the debt settlement service provider;
- 4) the percentage of [*State*] residents and non-residents who canceled, terminated, became inactive, or completed the program without the settlement of all of the enrolled debt; and
- 5) the total amount of fees collected from [*State*] residents and non-residents.

The annual report must contain a declaration executed by an official authorized by the debt settlement provider under penalty of perjury that states that the report complies with this Section.

- b) The Secretary may prepare and make available to the public an annual consolidated report of all the data debt settlement providers are required to report pursuant to subsection (a) of this Section.

VII. License; display and location of license.

Each license issued shall be kept conspicuously posted in the place of business of the debt settlement provider. The business location may be changed by any debt settlement provider upon 10 days prior written notice to the

Secretary. A debt settlement provider must operate under the name as stated in its original application.

VIII. Denial of license.

- a) Any complete application for a license shall be approved or denied within 90 days after the filing of the complete application with the Secretary.
- b) The Secretary may deny licensure for any of the following:
 - 1) an application that contains any omission or false statement of material fact or is incomplete;
 - 2) the applicant, an officer, director, general partner, member or person owning or controlling, directly or indirectly, 10 percent or more of the outstanding interests or equity securities, or a predecessor organization of the applicant has been convicted of or pleaded *nolo contendere* to a crime; incurred a significant civil settlement; suffered a civil judgment or any administrative judgment by any public agency involving fraud, deceit, dishonesty or financial misconduct or has violated state or federal securities or consumer protection laws, or any regulatory scheme of the State; or has been convicted of any other offense reasonably related to the qualifications, functions, or duties of a person engaged in the business in accordance with the provisions of this division;
 - 3) an applicant or any officer, director, general partner, member or person owning or controlling, directly or indirectly, 10 percent or more of the outstanding interests or equity securities of has made any false statement or representation or material omission to the Secretary;
 - 4) an applicant is or becomes insolvent;
 - 5) an applicant refuses to reasonably comply with an investigation or examination of the debt settlement service provider by the Secretary;
 - 6) an applicant has improperly withheld, misappropriated, or converted funds received in the course of doing business;
 - 7) an applicant has used fraudulent, coercive, deceptive, illegal, or dishonest practices, or demonstrated incompetence regarding debt settlement services, or financial irresponsibility in this state or elsewhere;
 - 8) an applicant has shown to have engaged in a pattern of failing to perform services promised;

9) an applicant or any officer, director, or general partner, member or person owning or controlling, directly or indirectly, 10 percent or more of the outstanding interests or equity securities of the applicant has violated any provision of this division or the rules or any order thereunder or any similar regulatory scheme of the State or a foreign jurisdiction; or

10) for good cause shown.

c) The Secretary shall deny licensure if the application is not accompanied by the fee established by the Secretary.

d) The application shall be considered withdrawn within the meaning of this section if the applicant fails to respond to a written notification of a deficiency in the application within 90 days of the date of the notification.

IX. Revocation or suspension of license.

a) The Secretary may revoke or suspend any license if he or she finds that:

1) any debt settlement provider has failed to pay the annual license fee or to maintain in effect the bond required under the provisions of this Act;

2) the debt settlement provider has violated any provisions of this Act or any rule lawfully made by the Secretary under the authority of this Act;

3) any fact or condition exists that, if it had existed at the time of the original application for a license, would have warranted the Secretary in refusing its issuance; or

4) any applicant has made any false statement or representation to the Secretary in applying for a license under this Act.

b) In every case in which a license is suspended or revoked or an application for a license or renewal of a license is denied, the Secretary shall serve notice of his or her action, including a statement of the reasons for his or her actions, either personally or by certified mail, return receipt requested. Service by mail shall be deemed completed if the notice is deposited in the U.S. Mail.

c) In the case of a denial of an application or renewal of a license, the applicant or debt settlement provider may request, in writing, a hearing within 30 days after the date of service. In the case of a denial of a renewal of a license, the license shall be deemed to continue in force until 30 days after the service of the notice of denial, or if a hearing is requested during that period, until a final administrative order is entered.

- d) An order of revocation or suspension of a license shall take effect upon service of the order unless the debt settlement provider requests, in writing, a hearing within 10 days after the date of service. In the event a hearing is requested, the order shall be stayed until a final administrative order is entered.
- e) If the debt settlement provider requests a hearing, then the Secretary shall schedule the hearing within 30 days after the request for a hearing unless otherwise agreed to by the parties.
- f) The hearing shall be held at the time and place designated by the Secretary. The Secretary and any administrative law judge designated by the Secretary have the power to administer oaths and affirmations, subpoena witnesses and compel their attendance, take evidence, and require the production of books, papers, correspondence, and other records or information that the Secretary considers relevant or material to the injury.
- g) The costs for the administrative hearing shall be set by rule.

X. Contracts, books, records, and contract cancellation.

- a) Each debt settlement provider shall furnish to the Secretary, when requested, a copy of the contract entered into between the debt settlement provider and the debtor. The debt settlement provider shall furnish the debtor with a copy of the written contract at the time of execution, which shall set forth the charges, if any, agreed upon for the services of the debt settlement provider.
- b) Each debt settlement provider shall maintain records and accounts that will enable any debtor contracting with the debt settlement provider, at any reasonable time, to ascertain the status of all the debtor's accounts with the debt settlement service provider, including, but not limited to, the amount of any fees paid by the debtor, amount held in trust (if applicable), settlement offers made and received on each of the debtor's accounts, and legally enforceable settlements reached with the debtor's creditors. A statement showing the total amount received and the total disbursements to each creditor shall be furnished by the debt settlement provider to any individual within seven days after a request thereof by the said debtor. Each debt settlement provider shall issue a receipt for any payment made by the debtor to a debt settlement provider.

XI. Examination of debt settlement provider; duty to disclose a post-license event.

- a) The Secretary, with or without subpoena, at any time, either in person or through an appointed representative, may examine the books, records, condition and affairs of a debt settlement provider.

- b) In connection with any examination, the Secretary may examine on oath any debt settlement provider and any director, officer, employee, customer, manager, partner, member, creditor, or stockholder of a debt settlement provider concerning the affairs and business of the debt settlement provider.
 - 1) The Secretary shall ascertain whether the debt settlement provider transacts its business in the manner prescribed by law and the rules issued thereunder.
 - 2) The debt settlement provider shall pay the cost of the examination as determined by the Secretary by administrative rule. Failure to pay the examination fee within 30 days after receipt of demand from the Secretary may result in the suspension of the license until the fee is paid.
 - 3) The Secretary shall have the right to investigate and examine any person, whether licensed or not, who is engaged in the debt settlement service business.
- c) Each debt settlement provider shall disclose promptly to the Secretary, but in no event more than 30 days after the occurrence of the event, any change in any of the criteria listed in [Section IV] of this Act for the issuance of a license.

XII. Rules

The Secretary shall adopt and enforce all reasonable rules necessary or appropriate for the administration of this Act. The rulemaking shall be subject to the provisions of the [*State administrative procedure act*].

XIII. Penalties.

- a) Any person who operates as a debt settlement provider without a license shall be guilty of a [*state law*] felony.
- b) Any contract of debt settlement service as defined in this Act made by an unlicensed person shall be null and void and of no legal effect.
- c) The Secretary may, after 10 days notice by registered mail to the debt settlement service provider at the address on the license or unlicensed entity engaging in the debt settlement service business, stating the contemplated action and in general the grounds therefore, fine such debt settlement service provider or unlicensed entity an amount not exceeding \$10,000 per violation, and revoke or suspend any license issued hereunder if he or she finds that:
 - 1) The debt settlement service provider has failed to comply with any provision of this Act or any order, decision, finding, rule, regulation

- 2) If any fact or condition comes into existence which, if it had existed at the time of the original application for the license, clearly would have warranted the Secretary in refusing to issue the license.

XIV. Additional liability for unlicensed activity.

Any person who, without the required license, engages in conduct requiring a license under this Act without the required license shall be liable to the Department in an amount equal to the greater of (1) \$5,000 or (2) an amount equal to four times the amount of consumer debt enrolled. The Department shall cause any funds so recovered to be deposited in the Debt Settlement Consumer Protection Fund.

XV. Injunction and other relief.

- a) To engage in debt settlement service, render financial service, or accept debtors' funds, as defined in this Act, without a valid license to do so, is hereby declared to be inimical to the public welfare and to constitute a public nuisance. The Secretary may, in the name of the people of the [State], through the Attorney General of the [State], bring a civil action for injunctive relief, and may include in the action any claim for restitution, disgorgement, or damages on behalf of the consumers injured by the act or practice constituting the subject matter of the action. The Attorney General may include in any action authorized by this section a claim for costs, including reasonable attorney's fees and expenses, and the court shall have jurisdiction to award such relief and any other additional relief.
- b) Any debt settlement service provider who violates any provision of this Act shall be deemed to have violated the licensing provisions of this Act.

XVI. Review.

All final administrative decisions of the Secretary under this Act shall be subject to judicial review pursuant to the provisions of the [State administrative review law], including all amendments, modifications, and adopted rules.

XVII. Cease and desist orders.

- a) The Secretary may issue a cease and desist order to any debt settlement provider or other person doing business without the required license when, in the opinion of the Secretary, the debt settlement provider or other person is violating or is about to violate any provision of the Act or any rule or condition imposed in writing by the Department.
- b) The Secretary may issue a cease and desist order prior to a hearing.

- c) The Secretary shall serve notice of his or her action, including a statement of the reasons for his or her action either personally or by certified mail, return receipt requested. Service by mail shall be deemed completed if the notice is deposited in the U.S. Mail.
- d) Within 10 days after service of the cease and desist order, the licensee or other person may request a hearing in writing.
- e) The Secretary shall schedule a hearing within 30 days after the request for a hearing unless otherwise agreed to by the parties.
- f) If it is determined that the Secretary had the authority to issue the cease and desist order, then he or she may issue such orders as may be reasonably necessary to correct, eliminate, or remedy that conduct.
- g) The powers vested in the Secretary by this Section are additional to any and all other powers and remedies vested in the Secretary by law, and nothing in this Section shall be construed as requiring that the Secretary shall employ the power conferred in this Section instead of or as a condition precedent to the exercise of any other power or remedy vested in the Secretary.
- h) The cost for the administrative hearing shall be set by rule.

XIX. Advertising and marketing practices.

- a) [*Preferred*]: A debt settlement provider shall not make any representation about the results that may be achieved by debt settlement, including about the percentage of dollar amount by which debt may be reduced or the amount a consumer may save, or the experience of its customers with respect to debt reduction.
- a) [*Alternative*]: A debt settlement provider shall not represent, expressly or by implication, any results or outcomes of its debt settlement services in any advertising, marketing, or other communication to consumers unless the debt settlement provider possesses substantiation for such representation at the time such representation is made, and retains such substantiation for at least seven years from the last date on which the representation was made.
- b) A debt settlement provider shall not, expressly or by implication, make any unfair or deceptive representations, or any omissions of material fact, in any of its advertising, marketing, or other communications with individuals, concerning debt settlement services.
- c) All advertising and marketing communications concerning debt settlement services shall disclose the following material information clearly, conspicuously, and, for written materials, in a minimum of 12-point font:

"Debt settlement services are not appropriate for everyone. Failure to pay your monthly bills in a timely manner will result in increased balances and will harm your credit rating. Not all creditors will agree to reduce principal balance, and they may pursue collection, including lawsuits. You may owe taxes on any debt that is forgiven."

XX. Individualized financial analysis.

- a) Prior to entering into a written contract with a consumer, a debt settlement provider shall prepare, provide to the consumer in writing and retain a copy of:
 - 1) an individualized financial analysis, including the individual's income, expenses, and debts; and
 - 2) a statement containing a good faith estimate of the length of time it will take to complete the debt settlement program, the total amount of debt owed to each creditor included in the debt settlement program, the total savings estimated to be necessary to complete the debt settlement program, and the monthly targeted savings amount estimated to be necessary to complete the debt settlement program.
- b) A debt settlement provider shall not enter into a written contract with a consumer unless it makes, provides a copy to the consumer, and retains on file, written determinations, supported by the financial analysis, that:
 - 1) the consumer can reasonably meet the requirements of the proposed debt settlement program, including the fees and the periodic savings amounts set forth in the savings goals;
 - 2) the debt settlement program is suitable for the consumer at the time the contract is to be signed; and
 - 3) the consumer is reasonably expected to receive a net tangible benefit from the program.
- c) A debt settlement provider shall retain any items required under this section for one year if no debt settlement contract is entered into, and for five years after the expiration of a contract for debt settlement services, for the consumer to whom they relate.

XXI. Required pre-sale consumer disclosures and warnings.

- a) Before the consumer signs a contract, the debt settlement provider shall provide an oral and written notice to the consumer that clearly and conspicuously discloses all of the following:
 - 1) Debt settlement services may not be suitable for all consumers;

- 2) Using a debt settlement service likely will harm the consumer's credit history and credit score;
 - 3) Using a debt settlement service does not stop creditor collection activity, including creditor lawsuits and garnishments;
 - 4) Not all creditors will accept a reduction in the balance, interest rate, or fees a consumer owes;
 - 5) The consumer should inquire about other means of dealing with debt, including, but not limited to, nonprofit credit counseling and bankruptcy;
 - 6) The consumer remains obligated to make periodic or scheduled payments to creditors while participating in a debt settlement plan, and that the debt settlement provider will not make any periodic or scheduled payments to creditors on behalf of the consumer;
 - 7) The failure to make periodic or scheduled payments to a creditor is likely to:
 - i. harm the consumer's credit history, credit rating, or credit score;
 - ii. lead the creditor to increase lawful collection activity, including litigation, garnishment of the consumer's wages, and judgment liens on the consumer's property; and
 - iii. lead to the imposition by the creditor of interest charges, late fees, and other penalty fees, increasing the principal amount of the debt;
 - 8) The amount of time estimated to be necessary to achieve the represented results;
 - 9) The estimated amount of money, expressed in dollars using numerals, that the consumer must accumulate before a settlement offer will be made to each of the consumer's creditors.
 - 10) The estimated fee, expressed in dollars using numerals, for a settlement arranged in the time and for the amount described in paragraphs 8 and 9; and
 - 11) The consumer may be required to pay taxes on forgiven debt.
- b) The requirements of this Section are satisfied if the provider provides the following warning verbatim, both orally and in writing, with the caption "CONSUMER NOTICE AND RIGHTS FORM" in at least 28-point font and the remaining portion in at least 14-point font, in bold, underlined, and capital letters where indicated, to a consumer before the consumer signs a contract for the debt settlement provider's services:

"CONSUMER NOTICE & RIGHTS FORM

CAUTION

We CANNOT GUARANTEE that you will reduce or eliminate your debt.

We estimate that it will take _____ months to settle all of your debts.

You must save \$ _____ before we will make a settlement offer to your creditors.

We will charge you \$ _____ if your creditors agree to settle for that amount. The actual charge may be more or less, depending on the final settlement.

You are still required to pay your bills, unless your creditors say otherwise.

If you stop paying your creditors, the following are likely to happen:

- **Creditors may still contact you and try to collect.**
- **Creditors may still sue you for the money you owe.**
- **Your wages or bank account may still be garnished.**
- **Your credit rating and credit score likely will be harmed.**
- **Not all creditors will agree to accept a balance reduction.**
- **Consider all your options, including credit counseling and bankruptcy.**
- **The amount of money you owe may increase due to creditor imposition of interest charges, late fees, and other penalty fees.**
- **You may be required to pay taxes on any debt forgiven.**

YOUR RIGHT TO CANCEL

If you sign a contract with a Debt Settlement Provider, you have the **right to cancel at any time** and receive a full refund of all unearned fees you have paid to the provider and all funds placed in your settlement fund that have not been paid to any creditors.

IF YOU ARE DISSATISFIED OR YOU HAVE QUESTIONS

If you are dissatisfied with a debt settlement provider or have any questions, please bring it to the attention of the [State] Attorney General's Office or [Relevant State Agency/Department].

[Include Contact information for the State AG and/or relevant State Agency/Department].

I, the debtor, have received from the debt settlement provider a copy of the form entitled Consumer Notice and Rights Form.”

XXII. Debt settlement contract.

- a) A debt settlement provider shall not provide debt settlement service to a consumer without a written contract signed and dated by both the consumer and the debt settlement provider.
- b) Any contract for the provision of debt settlement service entered into in violation of the provisions of [Sections XX or XXI] is void.
- c) A contract between a debt settlement provider and a consumer for the provision of debt settlement service shall disclose all of the following clearly and conspicuously:
 - 1) The name and address of the consumer;
 - 2) The date of execution of the contract;
 - 3) The legal name of the debt settlement provider, including any other business names used by the debt settlement provider;
 - 4) The corporate address and regular business address, including a street address, of the debt settlement provider;
 - 5) The telephone number at which the consumer may speak with a representative of the debt settlement provider during normal business hours;
 - 6) A complete list of the consumer's accounts, debts, and obligations to be included in the provision of debt settlement service, including the name of each creditor and principal amount of each debt;
 - 7) A description of the services to be provided by the debt settlement provider, including the expected time frame for settlement for each account, debt, or obligation included in item (6) of this subsection;
 - 8) An itemized list of all fees to be paid by the consumer to the debt settlement provider, and the date, approximate date, or circumstances under which each fee will become due;
 - 9) A good faith estimate of the total amount of all fees and compensation, not to exceed the amounts specified in [Section XXIII of this Act] to be collected by the debt settlement provider from the consumer for the provision of debt settlement service contemplated by the contract;

- 10) A statement of the proposed savings goals for the consumer, stating the amount to be saved per month or other period, time period over which savings goal extends, and the total amount of the savings expected to be paid by the consumer pursuant to the terms of the contract;
 - 11) The amount of money and the percentage of debt the consumer must accumulate before a settlement offer will be made to each of the consumer's creditors;
 - 12) The written individualized financial analysis required by [*Section XX of this Act*];
 - 13) The contents of the "Consumer Notice and Rights Form" provided in [*Section XXI*];
 - 14) A written notice to the consumer that the consumer may cancel the contract at any time until after the debt settlement provider has fully performed each service the debt settlement provider contracted to perform or represented he or she would perform, and upon that event:
 - i. the consumer shall be entitled to a full refund of all unearned fees and compensation paid by the consumer to the debt settlement provider, and a full refund of all funds provided by the consumer to the debt settlement provider for a consumer settlement account, except for funds actually paid to a creditor on behalf of the consumer, under the terms of the contract for debt settlement service;
 - ii. all powers of attorney granted to the debt settlement provider by the consumer shall be considered revoked and voided; and
 - 15) A form the consumer may use to cancel the contract pursuant to the provisions of [*Section XXV of this Act*]. The form shall include the name and mailing address of the debt settlement provider and shall disclose clearly and conspicuously how the consumer can cancel the contract, including applicable addresses, telephone numbers, facsimile numbers, and electronic mail addresses the consumer can use to cancel the contract.
- d) If a debt settlement provider communicates with a consumer primarily in a language other than English, then the debt settlement provider shall furnish to the consumer a translation of all the disclosures and documents required by this Act in that other language.

XXIII. Fees.

- a) A debt settlement provider shall not charge fees of any type or receive compensation from a consumer in a type, amount, or timing other than fees or compensation permitted in this Section.
- b) A debt settlement provider may charge a settlement fee, which shall not exceed

[ALTERNATIVE IF LIMITING DEBT SETTLEMENT TO NON-PROFIT ENTITIES: \$50 dollars, adjusted annually for inflation]

[ALTERNATIVE IF ALLOWING FOR-PROFIT DEBT SETTLEMENT: an amount greater than 15% of the savings from a completed settlement.]

If the amount paid by the debt settlement provider to the creditor or negotiated by the debt settlement provider and paid by the consumer to the creditor pursuant to a settlement negotiated by the debt settlement provider on behalf of the consumer as full and complete satisfaction of the creditor's claim with regard to that debt is equal to or greater than the principal amount of the debt, then the debt settlement provider shall not be entitled to any settlement fee.¹⁴

- c) A debt settlement provider shall not collect any settlement fee from a consumer until a creditor enters into a legally enforceable agreement to accept funds in a specific dollar amount as full and complete satisfaction of the creditor's claim with regard to that debt and those funds are provided by the debt settlement provider on behalf of the consumer or are provided directly by the consumer to the creditor pursuant to a settlement negotiated by the debt settlement provider.

XXIV. Consumer settlement accounts and monthly accounting.

- a) A debt settlement provider who receives funds from a consumer shall place all funds received for a consumer settlement account in a properly designated trust account in a federally insured depository institution in the name of the consumer. The funds shall remain the property of the consumer until the debt settlement provider disburses the funds to a creditor on behalf of the consumer as full or partial satisfaction of the consumer's debt to the creditor or the creditor's claim against the consumer. Any interest earned on such account shall be credited to the consumer.
- b) A debt settlement provider shall not be named on a consumer's bank account, take a power of attorney in a consumer's bank account, create a demand draft on a consumer's bank account, or exercise any control over any bank account held by or on behalf of the consumer.

¹⁴ The Illinois state law, from which this model is based, was passed prior to the FTC's Telemarketing Sales Rule. The Illinois law permitted companies to charge a \$50 enrollment fee before settling any debt, in addition to the capped settlement fee. An enrollment fee is not permitted by the federal law and so is not included in this model state legislation.

- c) A debt settlement provider shall, no less than monthly, provide each consumer with which it has a contract for the provision of debt settlement service a statement of account balances, fees paid, settlements completed, and remaining debts.

XXV. Cancellation of contract and right to fee and settlement fund refunds.

- a) A consumer may cancel a contract with a debt settlement provider at any time before the debt settlement provider has fully performed each service the debt settlement provider contracted to perform or represented it would perform.
- b) If a consumer cancels a contract with a debt settlement provider, or at any time upon a material violation of this Act on the part of the debt settlement provider, then the debt settlement provider shall ensure that the consumer receives a refund of all fees and compensation, with the exception of any earned settlement fee, as well as all funds paid by the consumer to the debt settlement provider that have accumulated in a consumer settlement account and that the debt settlement provider has not disbursed to creditors. Any direct debit authorizations granted to the settlement provider by the consumer shall be considered revoked and voided upon cancellation.
- c) A debt settlement provider shall ensure that the consumer receives any refund required under this Section within five business days after the notice of cancellation, and shall include with the refund a full statement of account showing fees received, fees refunded, savings held, payments to creditors, settlement fees earned if any, and savings refunded.
- d) Upon the cancellation of a contract under this Section, the debt settlement provider shall provide timely notice of the cancellation of the contract to each of the creditors with whom the debt settlement provider has had any prior communication on behalf of the consumer in connection with the provision of any debt settlement service.

XXVI. Obligation of good faith.

A debt settlement provider shall act in good faith in all matters under this Act.

XXVII. Prohibited practices.

A debt settlement provider shall not do any of the following:

- a) Charge or collect from a consumer any fee not permitted by, in an amount in excess of the maximum amount permitted by, or at a time earlier than permitted by Section XXIII of this Act;

- b) Advise or represent, expressly or by implication, that consumers should stop making payments to their creditors;
- c) Advise or represent, expressly or by implication, that consumers should stop communicating with their creditors;
- d) Change the mailing address on any of a consumer's creditor's statements;
- e) Make loans or offer credit or solicit or accept any note, mortgage, or negotiable instrument other than a check signed by the consumer and dated no later than the date of signature;
- f) Take any confession of judgment or power of attorney to confess judgment against the consumer or appear as the consumer or on behalf of the consumer in any judicial proceedings;
- g) Take any release or waiver of any obligation to be performed on the part of the debt settlement provider or any right of the consumer;
- h) Advertise, display, distribute, broadcast, or televise services or permit services to be displayed, advertised, distributed, broadcasted, or televised, in any manner whatsoever, that contains any false, misleading, or deceptive statements or representations with regard to any matter, including services to be performed, the fees to be charged by the debt settlement provider, or the effect those services will have on a consumer's credit rating or on creditor collection efforts;
- i) Receive any cash, fee, gift, bonus, premium, reward, or other compensation from any person other than the consumer explicitly for the provision of debt settlement service to that consumer;
- j) Offer or provide gifts or bonuses to consumers for signing a debt settlement service contract or for referring another potential customer or customer;
- k) Disclose to anyone the name or any personal information of a consumer for whom the debt settlement provider has provided or is providing debt settlement service other than to a consumer's own creditors or the debt settlement provider's agents, affiliates, or contractors for the purpose of providing debt settlement service without the prior consent of the consumer;
- l) Enter into a contract with a consumer without first providing the disclosures and financial analysis and making the determinations required by this Section;
- m) Misrepresent any material fact, make a material omission, or make a false promise directed to one or more consumers in connection with the solicitation, offering, contracting, or provision of debt settlement service;

- n) Violate the provisions of applicable do not call statutes;
- o) Purchase debts or engage in the practice or business of debt collection;
- p) Include in a debt settlement agreement any secured debt;
- q) Employ an unfair, unconscionable, or deceptive act or practice, including the knowing omission of any material information;
- r) Engage in any practice that prohibits or limits the consumer or any creditor from communication directly with one another; or
- s) Represent or imply to a person participating in or considering debt settlement that purchase of any ancillary goods or services is required.

XXVIII. Noncompliance with the Act.

- a) Any waiver by any consumer of any protection provided by or any right of the consumer under this Act:
 - 1) shall be treated as void; and
 - 2) may not be enforced by any federal or State court or any other person.
- b) Any attempt by any person to obtain a waiver from any consumer of any protection provided by or any right or protection of the consumer or any obligation or requirement of the debt settlement provider under this Act shall be a violation of this Act.
- c) Any contract for debt settlement service that does not comply with the applicable provisions of this Act:
 - 1) shall be treated as void; and
 - 2) may not be enforced by any federal or State court or any other person; and
 - 3) Upon notice of a void contract, a refund by the debt settlement provider to the consumer shall be made as if the contract had been canceled as provided in [*Section XXV of this Act*].

Section XXIX. Civil remedies.

- a) A violation of this Act constitutes an unlawful practice under the [*State's Unfair and Deceptive Acts and Practices Act*].

- b) A consumer who suffers loss by reason of a violation of this Act may bring a civil action to enforce that provision. A consumer who brings a civil action may recover the following from a debt settlement provider and any person that caused the violation:
- 1) Statutory damages in an amount to be determined by the court of no less than \$1,000 and no more than \$5,000 per violation. The consumer need not establish any losses in fact in order to recover statutory damages;
 - 2) Compensatory damages from any injuries caused by the violation; and
 - 3) Reasonable attorney's fees and costs.
- c) An action brought under this division shall be commenced within four years after the latest of the following dates:
- 1) The last transmission of money to a provider by or on behalf of the consumer; or
 - 2) The date on which the consumer discovered or reasonably should have discovered the facts giving rise to the consumer's claim.
- d) The period prescribed in paragraph (2) of subdivision (c) shall be tolled during any period during which the provider or, if different, the defendant has materially misrepresented information required by this division to be disclosed to the consumer, if the information so misrepresented is material to the establishment of the liability of the defendant under this division.

Prepared By:

Financial Services Campaign Team, Consumers Union of U.S., Inc.

Updated January 2012 by Consumers Union and National Consumer Law Center® on behalf of its low-income clients

APPENDIX A

RECENT DATA ON DEBT SETTLEMENT

Most consumers don't get rid of all of their debt with debt settlement

- The Florida Attorney General sued Nationwide Asset Services, Inc., and others, in the Fall of 2009, alleging that 227 Floridians had enrolled over six years, but only 30 of those consumers completed the program, which is a completion rate of less than 13.5%. The same case cited a complaint by the New York Attorney General alleging that of 1981 who signed up over three years, only 64 completed the program, at rate of just over 3%.
- The Colorado Attorney General analyzed information from annual reports to it by debt settlement companies in October 2009, and found that for Colorado consumers using debt settlement in 2008, less than 1% of consumers had all debt eliminated by debt settlement [0.84%].

Source: Colorado Attorney General, Oct. 23, 2009, comments to the FTC proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services

<http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00189.pdf>. This is the first independent evidence about the actual completed settlement results for all consumers for *all* of the debt that they bring into a debt settlement program. These numbers appear to include people who started debt settlement in 2008 and those who had been in debt settlement for one, two, or three years.

- Debt settlement companies provided fraudulent information and deceptive practices to lure vulnerable customers with claims of unusually high success rates. The GAO reported that industry surveys show far a lower rate of completion of debt settlement programs – 34.4%, even when the industry defined “completion.”

Source: United States Government Accountability Office, Testimony Before the Committee on Commerce, Science, and Transportation, U.S. Senate, Debt Settlement: Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers, Statement of Gregory D. Kutz, Managing Director Forensic Audits and Special Investigations, GAO-10-593-T April 22, 2010. pp. 10-11. <http://www.gao.gov/new.items/d10593t.pdf>.

Debt settlement has a high drop out rate

- In a sample of 4,500 debt settlement customers of one company, 60% canceled the debt settlement service, and the median time for cancellation was between five and six months after starting debt settlement.

Source: R. Briesch, *Economic Factors and the Debt Management Industry*, August 6, 2009, posted at: <http://www.consumercreditchoice.org/files/ACCC-Dr.%20Briesch%20Study%20Report%20on%20Debt%20Management%20Industry.pdf>. This study was issued by a pro-industry group called Americans for Consumer Credit Choice.

Even the industry's own statistics show that debt settlement does not regularly eliminate all of the debt for most consumers

- An industry trade association survey shows most consumers do not eliminate all of their debt in debt settlement.
- Only 34.4% of consumers who started debt settlement three years earlier had either “substantially completed” their debt settlement plans or were still actively saving for settlements. Only 24.6% had eliminated at least 75% of their debt; while 9.8% were still trying to get rid of their debts through settlement three years after starting debt settlement.
- The industry's own statistics showed that 65.6% of consumers still owed 25% or more of their original debts three years after starting debt settlement. Some of those consumers must have owed much more, because the industry survey also showed that for those consumers whose debt settlement plans were terminated without being completed, only 34.8% of the terminating consumers had even one debt settled before termination.

Source: The Association of Settlement Companies (TASC), October 26, 2009, comments to the FTC on the proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services, p. 9-11. <http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00202.pdf>
See also the GAO discussion of this information, United States Government Accountability Office, Testimony Before the Committee on Commerce, Science, and Transportation, U.S. Senate, Debt Settlement: Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers, Statement of Gregory D. Kutz, Managing Director Forensic Audits and Special Investigations, GAO-10-593-T April 22, 2010. pp. 10-11, <http://www.gao.gov/new.items/d10593t.pdf>.

Debt settlement doesn't deliver on its promises

- The Better Business Bureau (BBB) designated debt settlement as an “inherently problematic” type of business because of the nature and the volume of consumer complaints. The BBB developed criteria for a debt settlement company to demonstrate that it did not fall under the “inherently problematic” category, such as substantiation for advertising claims, procedures to screen out consumers who are inappropriate candidates for debt settlement, and a threshold that at least half of the customers receive significant debt reduction in an amount exceeding the fees charged.

However, no debt settlement company “had yet successfully demonstrated that it met these criteria.” The GAO quoted officials for two leading debt settlement trade associations who characterized the BBB 50% success rate criteria as an “unrealistic measure.”

- The GAO also testified that “Allegations of fraud, abuse, and deception in the debt settlement industry are widespread.”

Source: United States Government Accountability Office, Testimony Before the Committee on Commerce, Science, and Transportation, U.S. Senate, Debt Settlement: Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers, Statement of Gregory D. Kutz, Managing Director Forensic Audits and Special Investigations, GAO-10-593-T April 22, 2010. pp. 11-13. <http://www.gao.gov/new.items/d10593t.pdf>

Over the past five years, 21 states have brought 128 enforcement actions against 84 debt relief companies for unfair or deceptive trade practices. Most of these cases have been about debt settlement. States enforcement actions have alleged:

- Unsubstantiated claims of consumer savings.
- Deceptive representations about the length of time needed to complete a debt relief program.
- Misleading or failing to adequately inform consumers about the risk of debt collection efforts, lawsuits and increased debt balances while enrolled in debt relief programs.
- Deceptive disparagement of credit counseling and bankruptcy as alternatives for debtors.
- Failure to conduct individualized financial analyses to determine whether the debt relief is suitable for the consumer.
- Collection of substantial up-front fees even when the debt relief company fails to provide services to the consumer.
- Basing savings claims and settlement fees on the debt including the amount by which the debt has grown during debt settlement, rather than on the original debt amount that the consumer had upon entering the program.

Source: National Association of Attorneys General (NAAG) comments to the FTC on proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services, October 23, 2009, <http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00192.pdf>.

Note: The FTC’s Telemarketing Sales Rule now provides some restrictions on the timing of fees, but it has significant loopholes. It prohibits upfront fees before settling any portion of the debts enrolled in a debt settlement program. The FTC rule requires that fees be collected no earlier than proportionally to the amount of the original debt that is actually settled. However, its protections do not apply to contracts which were entered into after a face to face sales presentation. The

FTC rule addresses the timing of fees, but does not cap the fees. That can only occur with additional state or federal action.

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