

**Comments of the
Consumer Federation of America and
National Consumer Law Center**

Regarding

Proposed Interim Final Rule on Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies and Approval of Providers of a Personal Financial Management Instructional Course by United States Trustees

**United State Department of Justice
28 CFR Part 58**

**Docket No. EOUST 100
September 5, 2006**

The Consumer Federation of America¹ and National Consumer Law Center,² on behalf of its low income clients, make the following recommendations regarding the proposed Interim Final Rule on procedures for debtor counseling and financial education mandated by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

While the proposal contains a number of laudable and necessary requirements, it does not propose adequate protections to ensure that debtors will be charged reasonable fees for counseling regardless of their ability to pay, as the statute requires. This is a very serious flaw that could undermine the intent of the statute and cause the counseling requirement to become a barrier to bankruptcy for debtors of limited means. In particular, our organizations recommend that the rule be amended to establish uniform fee limits and fair fee reduction guidelines for counseling. We also recommend that the rule ensure that the process of obtaining a fee reduction is not unnecessarily burdensome

¹ **The Consumer Federation of America** is an association of 300 organizations that, since 1968, has focused on consumer education, research and advocacy.

² **The National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal with consumer law problems, including credit counseling issues, and provided extensive oral and written testimony to numerous Congressional committees on these topics. Along with the Consumer Federation of America, NCLC released a report on credit counseling issues in 2003, "Credit Counseling in Crisis", available on-line at: http://www.nclc.org/action_agenda/credit_counseling/content/creditcounselingreport.pdf.

for debtors, as it is at some counseling agencies, and that debtors are informed about the possibility of obtaining a fee reduction when they make first contact with an agency. These and many other recommendations to improve the proposal are offered below.

I. The Rule Should be Amended to Establish Uniform Fee Limits and Fair Fee Reduction Guidelines for Counseling

The statute states that if a fee is charged for counseling services, agencies must charge a reasonable fee, and provide services without regard to ability to pay the fee. [Section 111(c)(2)(B)] However, Section 58.15(e) of this proposed rule does nothing to clarify beyond the statutory language what is a “reasonable” fee or the standards that agencies must use in offering a fee reduction or waiver. Such clarification is absolutely essential to ensuring that counseling does not become a barrier to bankruptcy for debtors of limited means. As our organizations pointed out in comments to the Executive Office of the United States Trustee a year ago, access to credit counseling and bankruptcy will be stymied or delayed if debtors cannot afford the cost of counseling.

The need for formal, uniform rules is especially acute regarding fee reduction or waiver procedures. Unlike the initial fees that are charged by agencies, there still appear to be some significant differences between the agencies in how they determine whether a debtor is eligible for a fee waiver. By not formally mandating the specific standard by which agencies must determine if a debtor is eligible for a fee reduction (as is done for those filing for bankruptcy), the EOUST is turning over discretion on this matter to agencies that have an economic conflict-of-interest. In fact, several agencies and trade associations have publicly expressed concern about the economic viability of agency participation in the bankruptcy counseling program given the fees that they are allowed to charge and their obligation to serve debtors regardless of ability to pay. This is not to say that agencies have acted dishonorably – by all accounts some agencies have been quite liberal in granting waivers – but that the EOUST should not be ceding discretion on this important matter when agencies have a strong economic incentive to charge too much. We understand that agencies incur significant costs to provide this counseling, but the statute is absolutely clear that those who cannot afford to pay should not be required to do so. The first responsibility of the EOUST should be to promulgate regulations that assure that the costs of counseling are not a barrier for debtors.

It is understandable that, in the scramble to implement a statute that took effect only six months after enactment, the EOUST would initially rely on informal communication with agencies to establish fee and waiver guidelines. For example, shortly before the statute took effect last year, the EOUST informed agencies that it had not established a fee cap for counseling, but advised agencies to charge no more than \$50 for counseling services. However, the EOUST’s implicit proposal in this rule to continue to rely on such informal guidance is reckless and inequitable. It is simply not justifiable for debtors of the same financial means to be charged different fees simply because they seek counseling from different agencies. The absence of a formal rulemaking process on the all-important question of fee amounts means that all stakeholders will not have equal opportunity to comment and offer recommendations. It also increases the chances that

some agencies might simply disregard the EOUST's informal recommendations in the future if the EOUST is not able to devote sufficient time and resources to ensuring compliance with this statute.

We offer the following additional recommendations regarding fees:

- A. The EOUST should promulgate fee limits and fair standards for the reduction of fees that do not inhibit access to counseling for low and moderate income debtors.** Currently, many agencies are making a decision about whether to grant a waiver of the entire fee based on whether a debtor has an income below 150 percent of the federal poverty level, which is \$9,800 for an individual and \$20,000 for a family of four.³ To the best of our knowledge, the EOUST has not administered any process, either informally or formally, to receive input as to whether this policy fairly fulfills the statutory requirement. In fact, an “all or nothing” standard is not fair to many low income individuals earning an income slightly above the federal poverty level who have to pay the full amount for counseling and will not be receiving a waiver for bankruptcy filing fees. That is why our groups continue to recommend that the EOUST require agencies to offer a sliding scale of fees based on income. Other alternatives to this policy that the EOUST should consider and receive input on include raising the allowable income level significantly to qualify for a complete fee waiver, granting waivers to all individuals receiving means-tested state or federal public assistance, and waiving fees for those receiving pro bono or legal services representation.
- B. The rule should require that the process for obtaining a fee reduction or waiver is not unnecessarily burdensome for debtors and mandate an expedited process for obtaining a reduction or waiver for those in need.** Some agencies have unnecessarily burdensome requirements for obtaining fee waivers, such as requiring debtors to fill out additional income and expense verification forms and provide proof of income and expenses other than by self-certification. In most instances, this information is disclosed to the agencies as part of the counseling process and should not need to be separately provided. Moreover, it is virtually impossible for a debtor in severe financial distress to obtain a waiver (and thus, counseling) in a very short period of time at many agencies because of the additional procedural hurdles, thus ensuring that consumers who have an imminent foreclosure or other emergency must pay for counseling, even if they would be otherwise eligible for a fee waiver. We recommend that the rule stipulate that procedures for obtaining a fee waiver should not be unnecessarily burdensome and that any debtor facing an imminent financial emergency can request and receive an immediate waiver determination.
- C. The rule should require that information about fee schedules and waivers is provided to debtors upon first contact, not just “before services are**

³ 71 Fed. 3848 (Jan. 24, 2006)(2006 Annual Updates to the Department of Health and Human Services Poverty Guidelines.

provided.” [58.15 (e)(3)] It should also require that credit counseling agencies disclose fee and waiver information in a conspicuous manner when promoting or providing information to the public about its bankruptcy counseling services. On November 4, 2005, our organizations wrote to the EOUST with evidence that some agencies were not informing consumers who called them that fee waivers or reductions were available, as required by law. We were concerned that, unless debtors were told of the possibility of a fee reduction or waiver when first contacting the agency, those who genuinely did not have the ability to afford pre-bankruptcy counseling would be needlessly delayed or completely deterred from receiving it, and, ultimately, bankruptcy relief. The proposed rule would continue to allow agencies to refuse to proactively inform consumers about fee reductions at first point of contact, as long as an agency informs consumers of the possibility of a fee waiver or reduction before counseling begins. Under the rule, such disclosure could even be offered as part of a dense package of written information given or emailed to the consumer seconds before counseling begins. Moreover, this requirement does not ensure that information about fee reductions is easily accessible on an agency’s web site. Although all the agency websites that we recently checked do provide information on fee waivers on their web sites, the information is difficult to find in some cases. It is therefore necessary that the rule require that this information be provided in a conspicuous manner.

- D. **The rule should include a specific requirement that agencies comply with all applicable state laws regarding fees.** We commend the EOUST for proposing Section 58.15(c) of the rule, which states that nothing in the rule is intended to preempt any law governing the “conduct or operation” of an agency. As a number of states place limits on fees that can be charged for credit counseling or debt management services, we strongly suggest that this section be clarified to explicitly cover fee limits.
- E. **The rule should prohibit agencies from charging a separate fee for counseling certificates, as required initially by the EOUST.** We commend the EOUST for proposing in Section 58.15(e)(2) that counseling certificates not be withheld because of an inability to pay. However, the EOUST appears to have backed off of an initial requirement that agencies not charge a separate fee for certificates by allowing such fees if they are disclosed to consumers. [58.16(e)(6) and 58.25(j)(6)] We strongly urge the EOUST to reinstate this prohibition. Without it, agencies could be tempted to use a “certificate fee” that is poorly disclosed to skirt fee limits on counseling or to delay issuance of a certificate if a consumer aggressively pursues a fee waiver or reduction. We recommend that section 58.16(e)(6) be amended to prohibit certificate fees in all circumstances. (It should be allowable, however, for agencies to charge a retroactive fee to debtors who are not eligible for a reduction, but only for previous counseling that occurred within 180 days of filing for bankruptcy.) We also recommend that section 58.25(j)(6) prohibit agencies from charging a separate fee for financial education certificates in all instances.

II. Requirements in the Rule Ensure that Agencies Can Not Offer Bankruptcy Advice or Information about Potentially Harmful Financial Assistance Alternatives

As our organizations pointed out in comments to the EOUST a year ago, there is a good reason why there is no requirement in the Act that agencies provide consumers with substantive advice about whether or not to file bankruptcy. For one thing, agencies that do so might violate state laws against practicing law without a license. For another, most counselors do not have the knowledge or objectivity to offer unbiased advice about bankruptcy because the credit counseling industry has traditionally had an institutional bias against bankruptcy.

This rule deals effectively with both of these concerns by prohibiting the provision of legal advice [58.15(f)]. It also closely follows statutory requirements in restricting the content of credit counseling briefings to: (1) outlining available counseling opportunities to resolve clients' credit problems, (2) an analysis of clients' current financial condition, and (3) discussion of the factors that caused this condition and assistance in developing a plan to respond clients' problems. [58.15(f)(1)] We commend the EOUST for altering its original instructions to agencies on briefing content, which required agencies to consider "all alternatives" to resolve clients' credit problems. This might have allowed agencies to review alternatives that might be harmful to consumers, such as debt "elimination" or settlement schemes. As written, the proposed rule makes it very clear that agencies may not offer specific bankruptcy advice related to the financial condition of a counseled client.

III. The Regulation Should Require Meaningful DMP Concessions.

A new section of the Bankruptcy Code, section 502(k), allows debtors to attempt to negotiate a reasonable alternative repayment schedule through an approved nonprofit credit counseling agency. If the creditor unreasonably refuses to negotiate such a schedule, a debtor who later files bankruptcy, perhaps as a result of the creditor's unreasonableness, may ask the court to reduce the creditor's claim by 20 percent.

This section is clearly premised on the assumption that creditors must do more to offer viable alternatives to bankruptcy. The problem is that creditors have consistently cut back on the concessions they offer through DMPs over the years. NCLC and CFA have documented these reductions.⁴ Even prior to changes in creditor policies, DMPs did not provide for reductions in principal. As a result, DMPs rarely benefit the most financially distressed consumers.

If the goal is to allow some consumers to repay debts outside of bankruptcy, consumers must be given meaningful options to do so. A 1999 nationwide survey of

⁴ See National Consumer Law Center, Consumer Federation of America, "Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants" (April 2003), available on-line at www.nclc.org.

credit counseling agencies by Visa found that one-third of those who dropped out of DMPs (34.3 percent) said they would have stayed on if creditors had waived or reduced additional interest or fees. Close to half of the clients who dropped off a DMP (41.8 percent) had either filed or were going to file bankruptcy. Nearly half of these consumers said they would have been able to stay out of court with improvements in the DMP process.⁵

Section 502(k) confronts this issue directly, challenging consumers to make reasonable offers to creditors and challenging creditors to accept reasonable offers. By requiring that the offer be made at least 60 days before filing through an approved nonprofit agency, it is clear that Congress intended for consumers to be able to negotiate repayment schedules through approved agencies that involve a compromise of the debt as part of the new credit counseling sessions.

We recommend that the EOUST require that all approved agencies that offer DMPs must at a minimum develop plans that provide for repayment of at least 60 percent of principal over time.

IV. The Rule Should Forbid Agencies from Selling Financial Information about Bankruptcy Counseling Clients

Section 58.15 (h)(2)(viii) appears to allow agencies to sell information about a client to a third party, as long as they receive the client's written permission. We strongly recommend that the rule be amended to prohibit agencies from selling personally identifiable financial information obtained about a client in bankruptcy counseling under all circumstances. Federal law now requires consumers to receive credit counseling prior to filing for bankruptcy protection. These debtors are not seeking counseling of their own volition. Credit counseling agencies should not be allowed to benefit financially from the sale of such sensitive, personal financial information when consumers are being required to seek their services. Moreover, the rule contains no restrictions on how such written permission could be obtained. It would appear to allow agencies to seek written consent by burying it in a request for consent in a lengthy disclosure form with many other items, or in a complicated written contract for services. It would also allow an agency to receive such consent in a negative check-off format, in which a debtor agrees to the sale of their personal financial information if he or she does not take an explicit step to stop it, such as checking a box on a disclosure form. The EOUST should ensure that the highest standards of consumer protection are maintained by prohibiting the sale of personally identifiable information obtained during bankruptcy counseling. If this important step is not taken, at the very least the rule should be amended to require agencies to seek affirmative, written permission on a separate disclosure before they can sell this information.

⁵ "Credit Counseling Debt Management Plan Analysis", Visa U.S.A. Inc., January 1999. A representative sample of 481 consumers who dropped off a DMP was surveyed.

V. The Rule Should Include Additional Standards to Help Prevent Abuse of Non-Profit Status

Section 111(c)(2)(A) of the Act requires that approved nonprofit agencies at a minimum have a board of directors, the majority of whom are not employed by the agency and will not directly or indirectly benefit financially from the outcome of the counseling services provided by such agency. The proposed rule repeats this requirement. [58.15(d)(3)(i) and (ii)] The proposal also states that the agency may not engage in any conduct or transactions that generates or creates the appearance of generating a private benefit for any individual or group. [58.15(d)(5)]

The proposal should go further in articulating minimum standards for approved non-profit agencies, especially because some agencies approved by the EOUST to offer counseling are not qualified under not §501(c)(3) of the Internal Revenue Service (IRS) code. At a minimum, certain standards from that section of the IRS code should be explicitly listed in the rule. In this way, non-501(c)(3) approved agencies will be required to meet the same critical, minimum standards as the 501(c)(3) agencies.

For example, at a minimum, all agencies should be required to have a primarily charitable or educational mission, regardless of whether they have 501(c)(3) status. In addition, the UST should explicitly state that approved agencies must be prohibited from paying owners, directors, and staff excessive compensation. Standards for excessive compensation can be found in the I.R.S. Code. Nonprofit organizations that pay compensation that is far higher than that paid by comparable organizations in the same geographical area for directors or others who are performing comparable services may be paying unreasonable or excessive compensation in violation of §4598 of the Internal Revenue Code.⁶ Payment of excess compensation is just one kind of excess benefit transaction that may subject an offending organization to sanctions. This is often referred to as the “intermediate sanctions” rule.

VI. The Rule Should Require the Disclosure of Key Counseling Information to Clients and The Public

Section 111(c)(2)(D) of the Bankruptcy Code requires that agencies provide full disclosures to a client, including funding sources, counselor qualifications, possible impact on credit reports, and any costs of such program that will be paid by such client and how such costs will be paid. The list is illustrative, not exhaustive. The proposed rule tracks this requirement [58.15(e)(9)] but does not require a few key consumer disclosures that we have previously recommended. Two very important additional disclosures that we would recommend are the percentage of all counseling consumers who are placed in Debt Management Programs (DMPs) and the percentage of these consumers who complete these DMPs (as the data becomes available.) As we mentioned in our comments of a year ago, we do not believe that extensive disclosures are particularly helpful for consumers. However, this information will provide debtors with crucial comparative data about how many consumers use the DMP alternative to

⁶ 26 U.S.C. §4958.

bankruptcy at particular agencies, and how many of those consumers successfully complete payment on their DMP debts.

We also strongly recommend that the EOUST collect from agencies and make conspicuously available on its web site crucial information that consumers can use to comparative shop. This information should not only include the list of approved agencies, but their disciplinary history with the EOUST, the fees each agency charges and fee waiver policies it uses, the number of clients who were counseled in the last year, the number of clients who entered DMPs, and the number who successfully completed DMPs (and/ or have been retained in DMPs for particular periods of time.)

Although in practice many consumers will be referred to counselors through their attorneys, it is important for the EOUST to provide information that allows consumers the ability to shop around and compare various agencies. This will also help creditors, consumer organizations, Congress, and other outside observers assess the practices and performance of these agencies.

In addition, we strongly recommend that Sections 58.16(h)(4) and 58.26(i)(4) of the proposed rule require agencies to inform the EOUST immediately if they are the subject of any legal action initiated under 11 USC 111 (g) (2) of the Code. The agency administering this credit counseling law should certainly be formally informed of any significant private enforcement efforts under the statute. This would allow the EOUST to insure that it is aware of the most current information about problems that may exist at any agency and pursue an investigation of these concerns.

VII. More Analysis of the Effectiveness of Debtor Education Courses is Necessary

Section 58.25 proposes requirements for post-discharge debtor education courses that are required under sections 727(a)(11) and 1328(g) of the Bankruptcy Code. To the extent that our organizations have offered recommendations in these comments on requirements in this section that are identical to those in 58.15, we ask that these recommendations receive consideration under this section as well.

Credit counseling requirements under the Act have received a great deal more attention than those that mandate pre-discharge debtor education -- from Congress, the media, consumer organizations, creditors and debtor's attorneys. As a result, far more analysis needs to be conducted on the strengths, weaknesses, and overall effectiveness of debtor education courses that are being offered. We strongly urge the EOUST to carefully monitor the effectiveness of all of the courses that are being offered and to base the final rule it issues on these course largely on a thorough analysis of debtor education pilot projects that are mandated by the Act.