

**Consumer Federation of America
National Consumer Law Center**

**Comments to Executive Office of the U.S. Trustee on Pre-Filing Counseling Provisions
August 31, 2005**

I. Required Content of Counseling Sessions:

The bankruptcy law gives some guidance on the content of the counseling sessions. Section 106, which includes the counseling mandate, states that approved counseling agencies must outline the opportunities for available credit counseling and assist individuals in performing budget related analysis. A related provision, section 111(c)(2)(E), requires that approved agencies must be capable of providing “adequate counseling with respect to a client’s credit problems that includes an analysis of such client’s current financial condition, factors that caused such financial condition, and how such client can develop a plan to respond to the problems without incurring negative amortization of debt.” Section 111(c)(1) requires that agencies provide adequate counseling with respect to client credit problems.

In the “Instructions for Application as a Nonprofit Budget and Credit Counseling Agency”, the UST does not precisely follow the statutory requirements. Instead, the Trustee states that agencies shall at a minimum provide adequate briefings, budget analysis, and credit counseling services to clients which include consideration of all alternatives to resolve a client’s credit problems, an analysis of the client’s current financial condition, discussion of the factors that caused such financial condition, and how the client can develop a plan to respond to the problems without incurring negative amortization of debt.” §4(1).

All of these factors are derived directly from the statute except for the requirement that agencies consider all alternatives to resolve a client’s credit problems. We are extremely concerned about the UST’s interpretation of the statute in this instance.

A. The UST Should Follow the Statutory Language and Require Agencies to Outline Counseling Options Only

We presume that the UST does not actually want agencies to counsel consumers about ALL alternatives. There are many debt relief alternatives that have been widely discredited and should not be part of any “outlining of alternatives.” Debt termination or debt elimination, for example, has been described by the FRB as “totally bogus” and the OCC has warned against these schemes as well.¹ Debt settlement, as detailed in an NCLC report, is also extremely problematic.² The FTC describes debt settlement programs as “risky” and warns consumers of various abuses.³

¹ See Federal Reserve Board, Division of Banking Supervision and Regulation, SR-04-03 (January 28, 2004), available on-line at <http://www.federalreserve.gov/boarddocs/SRLETTERS/2004/sr0403.htm>; OCC Alert 2003-12 (Oct. 1, 2003), available at www.occ.treas.gov/ftp/alert/2003-12.doc.

² See National Consumer Law Center, “An Investigation of Debt Settlement Companies: An Unsettling Business for Consumers” (March 2005), available on-line at www.nclc.org.

³ See Federal Trade Commission, “Facts For Consumers: Knee Deep in Debt”, available on-line at www.ftc.gov (last visited August 2005).

Rather than listing the alternatives that can be discussed and those that cannot, the UST should follow the statutory language and explicitly limit agencies to advising consumers of counseling options and to performing budget related analyses. (§106(h)(1)...briefings must outline the opportunities for available credit counseling). Non-counseling options such as debt settlement and debt termination would automatically be excluded.

B. The UST Should Explicitly Caution Against Agencies Providing Legal Advice or Bankruptcy Advice

The next set of concerns about the content of the counseling sessions relates to whether the agencies are outlining the counseling options, as required by the law, or going further and recommending or advising against particular debt reduction strategies for individual consumers. The latter is troubling and in many cases illegal.

There is not a single requirement in the Act that agencies provide consumers with substantive advice about whether or not to file bankruptcy, and for good reason. For one thing, agencies that do so might violate state laws against practicing law without a license. The definition of “practice of law” varies greatly by state. In most cases, states will allow nonattorneys to make legal forms available to consumers and to complete those forms at the direction of the consumer but will not permit nonattorneys to give legal advice pertaining to the particular facts of an individual’s case.⁴

Credit counseling agencies already operate close to this line. The agencies rarely have attorneys on staff, yet routinely go beyond basic counseling and advise consumers about strategies to deal with specific debts. This general concern is especially acute in the pre-bankruptcy filing context where inferior or biased advice comparing bankruptcy with other options can severely harm consumers, many of whom have no other viable choice but to file bankruptcy.

The unauthorized practice of law issue is not the only concern. Another problem is that credit counselors typically know very little about the bankruptcy process and even more important have historically been biased against bankruptcy.⁵ After all, credit counseling was created by the credit card industry as an alternative to bankruptcy. These origins, combined with continued reliance on creditor funding, create an institutional bias among many credit counselors that unfortunately leads in many cases to insufficient or misleading advice to consumers. These ties to creditors have been a concern of state and federal regulators, including the I.R.S., which has been clear that organizations are not nonprofit if they rely too heavily on client fees and creditor payments.⁶ This concern is not merely academic. The courts and agencies that have confronted this issue understandably worry that agencies that rely heavily on creditor funding will be reluctant to go against their funders’ interests by recommending bankruptcy to consumers.

Credit counseling agency web sites and promotional materials abound with dire warnings about bankruptcy:

⁴ See generally National Consumer Law Center, *Unfair and Deceptive Acts and Practice* §5.12.2.4 (6th ed. 2004).

⁵ See generally Lea Krivinskas, “Don’t File! Rehabilitating Unauthorized Practice of Law-Based Policies in the Credit Counseling Industry”, *Amer. Bankruptcy L.J.* (Winter 2005).

⁶ See generally David Lander and Deanne Loonin, “Restoring ‘Nonprofitness’ And ‘Quality’ to the Credit Counseling Industry”, *Norton Bankruptcy Law Adviser* (April 2005).

For example:

- One of the larger credit counseling agencies, Consolidated Credit Counseling, states on its web site that bankruptcy is not the “quick fix” it is advertised to be. This might be a fair statement. But the site goes on to say that “The limitations and embarrassment caused by declaring bankruptcy is rarely worth it.”⁷
- Consumer Credit Counseling Services of Atlanta includes an article on its web site titled “Avoiding Bankruptcy.” Although the article acknowledges that bankruptcy is appropriate in some circumstances, it also informs consumers that they “...pay a heavy price [if they file bankruptcy] for what essentially amounts to breaking a promise.”⁸

Bankruptcy is hardly ever an option that consumers choose without difficulty. A consumer’s decision whether to file bankruptcy is complex. Describing bankruptcy merely as a “last resort”, as many agencies do, is overly simplistic and often misleading. Bankruptcy may in fact be the best option for some consumers compared to the “heavy price” they will pay financially and personally if they are unable to file. Clearly it is an option that has significant consequences that should be carefully considered, but counseling agency staff are not knowledgeable enough to discuss these consequences and as noted above, are not sufficiently objective to compare bankruptcy against other options in a non-biased way.

There is still a lot of confusion in this area as evidenced by a July 2005 NFCC press release which states that “...the new bankruptcy law includes a provision that consumers be fully informed about the bankruptcy process, alternatives to bankruptcy and the potential consequences of filing for bankruptcy.”⁹

The law says no such thing. As discussed above, there is not a single requirement in the Act that agencies provide consumers with substantive advice about whether or not to file bankruptcy or even that they be “fully informed” by counselors of the bankruptcy process. The fact that a reputable trade association has misinterpreted the required content of the counseling sessions to this extent underscores the need for the UST to clarify this issue.

We recommend that the UST:

1. Delete the language in the forms requiring counselors to conduct briefings that consider all alternatives to resolve a client’s credit problems. This language should be replaced with language closer to the statutory language, requiring that the briefings include information about the opportunities for counseling as well as the other factors in the list.
2. Issue a clear statement that counselors must not give bankruptcy advice or engage in the unauthorized practice of law in any other way.

II. The UST 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

⁷ See <http://www.consolidatedcredit.org> (last visited August 2005).

⁸ See <http://www.cccsatl.org> (last visited August 2005).

⁹ NFCC Press Release, July 7, 2005, available on-line at nfcc.org.

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.¹⁰ 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 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.¹¹

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 that involve a compromise of the debt as part of the new credit counseling sessions.

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

III. The UST Should Set Reasonable Fee Limits and Mandate Sliding Fee Scales

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)). In addition, agencies must abide by any state law fee limits. §3(3). The application forms state that fees must be reasonable and that the Agency will provide services without regard to a client's ability to pay and will not withhold a certificate because of an inability to pay. The UST has explained that it has not yet set a dollar amount, but that counseling services generally should be available for a fee ranging from free to \$50.

We urge the UST to clarify this standard by formally setting outside limits on fees that can be charged for counseling and DMPs and by requiring agencies to charge fees to all consumers on a sliding scale. There are many reasons why such clarification is essential, including the fact that many of the abuses that have occurred in the credit counseling industry have involved overcharging.

In developing this structure, the UST should not assume that most debtors have much, if any "ability to pay." On the contrary, studies have consistently shown that the average income of Chapter 7 filers hovers around \$20,000 a year, well below the national median. Chapter 13 filers have slightly

¹⁰ 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.

¹¹ "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.

higher incomes but still earn less than \$30,000 yearly.¹²

The reality is that most consumers required to seek counseling will have little or no ability to pay fees. The best way to address this reality is to require agencies to establish sliding fee scales tied to a consumer's present household income and assets. Many agencies already use these types of systems. If this is not required, agencies will accept a small quota of consumers who cannot pay and refer others to other agencies. In essence, they will "cherry pick" customers. Consumers who truly cannot pay may not be able to find agencies to help them.

In addition, we recommend that the UST act quickly to set caps on fees. In making these determinations and overseeing this process, the Trustee should take careful note of the fee limits already set in many states. In most of these states, agencies are prohibited from charging any fees at all for counseling or education in cases where they enroll clients in debt management plans. This general principle should be applied in the bankruptcy counseling standards as well so that consumers who end up enrolling in a DMP after the pre-filing briefing are not charged separately for the counseling session. In addition, consumers that enter a DMP after going to an agency for pre-filing counseling should be eligible for a certificate if they later drop out of the DMP within six months of the initial counseling.

In developing the fee limits, we request that the UST consult not only with agencies, but also with consumers and consumer advocates. Agencies generally focus on their bottom lines. However, the I.R.S. has been clear that credit counseling agencies do not merit tax-exempt, non-profit status if they rely too heavily on creditor payments and consumer fees for funding. A prerequisite for a non-profit is diversification of funding, including funds from individual donations, private and government grants. The courts and agencies that have confronted this issue understandably worry that agencies that rely heavily on creditor funding will be reluctant to go against their funders' interests by recommending bankruptcy to consumers. Agencies must, therefore, be raising funds from sources that support their charitable mission so that costs can be subsidized and not routinely passed on to consumers. Allowing agencies to tie fees solely to actual costs may encourage agencies to violate their non-profit-related obligations and foster the types of abuses that have been rampant in the industry in recent years.

IV. The UST Must Ensure That Adequate Capacity of Quality Counseling Exists

It is not at all clear that adequate capacity of quality counseling exists to meet the requirements of the law. We urge the UST to publicly explain how it will determine whether adequate capacity exists. Section 106(h)(2) gives the UST the authority to determine whether approved agencies in a district are reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the pre-filing requirements.

The UST should find that such capacity does not exist unless an individual in that district has access to all three types of counseling, in-person, telephone or Internet. Debtors should have a meaningful choice about how they want to receive counseling, not be forced to talk to a counselor by phone or over the Internet because no in-person services are available. In addition, consumers must have reasonable access to services in their own language.

V. The UST Should Adopt Additional Standards to Help Prevent Abuse of Non-Profit Status

¹² John M. Barron, Michael E. Staten, "Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay, Monograph #33", Credit Research Center, Georgetown School of Business, Georgetown University, 1997, p. 16.

Section 111(c)(2)(A) requires that approved nonprofit agencies at a minimum have a board of directors the majority of which i) are not employed by such agency; and ii) will not directly or indirectly benefit financially from the outcome of the counseling services provided by such agency. The forms at §2(1) repeat this requirement. The forms also state that the agency may not engage in any conduct or transactions that generate or create the appearance of generating a private benefit for any individual or group.

The UST should go further in articulating minimum standards for approved non-profit agencies. At a minimum, certain standards from §501(c)(3) of the I.R.S. code should be explicitly listed in the forms. 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, regardless of whether they have 501(c)(3) statuses should be required to have a primarily charitable or educational mission. 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.¹³ 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 UST Should Require Key Data Disclosures to Clients and The Public

Section 111(c)(2)(D) 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 statutory language is illustrative, not exhaustive.

Although we do not believe that extensive disclosures are particularly helpful for consumers, we do recommend that additional, targeted disclosures be required that cite the percentage of all consumers that the agency places in DMPs and as the data becomes available, percentage of pre-filing customers placed in DMPs. In addition, consumers should be given information on the percentage of consumers that complete the DMPs.

Even if the UST decides not to require this type of disclosure to consumers at the time they seek assistance from the agency, this information should at a minimum be available to consumers, their attorneys, other advocates, and the public through a public web site. This web site should include not only a list of approved agencies, but also provide basic information about agency funding sources, board of directors, staff, and basic DMP performance information as discussed above.

Although in practice many consumers will be referred to counselors through their attorneys, it is important for the UST to provide information that allows consumers the ability to shop around and compare various agencies. This will also help advocates and others assess the performance of these agencies.

¹³ 26 U.S.C. §4958.