NATIONAL CONSUMER LAW CENTER

Consumer Federation of America

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FIRST-EVER STUDY OF CREDIT COUNSELING FINDS HIGH FEES, BAD ADVICE AND OTHER ABUSES BY NEW BREED OF "NON-PROFIT" AGENCIES

--Credit Card Company Practices Have Helped Create Counseling Crisis--

Washington D.C. – As more Americans seek assistance for serious debt problems, the National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) today unveiled *Credit Counseling in Crisis*, a report detailing the severe threat to consumers from a new generation of credit-counseling agencies. The comprehensive study found that, unlike the previous generation of mostly creditor-funded counseling services, these new agencies often harm debtors with improper advice, deceptive practices, excessive fees and abuse of their non-profit status. An estimated nine million Americans have some contact with a consumer credit counseling agency each year.[1]

The report also concluded that creditor practices and funding reductions have caused agencies to cut back on educational services and have led more consumers to drop out of counseling and declare bankruptcy. Another key finding was that poor oversight of credit counseling agencies by the Internal Revenue Service and the states has allowed unscrupulous counseling agencies to grow and prosper.

"The findings of this report show that the credit counseling industry has undergone an alarming transformation in the last decade," said Deanne Loonin, Staff Attorney for the NCLC. "Aggressive firms masquerading as 'non-profit organizations' are gouging consumers. Deceptive practices and outright scams are on the rise," she said. "More consumers are getting bad advice and access to fewer real counseling options. Meanwhile, most state and federal regulators appear to be asleep at the switch."

Major Problems With Credit Counseling

Not all of the new credit counseling agencies are a threat to consumers. Some are above-board and have pioneered consumer-friendly practices, such as flexible hours, electronic payments and easy access by phone and by Internet. However, as the new generation of credit counseling agencies has gained market share, consumer complaints have risen sharply. The Better Business Bureau reported in 2002 that complaints about credit counseling agencies nationwide had increased to 1,480, up from 261 in 1998. Three types of problems are adversely affecting consumers:

- **Deceptive and Misleading Practices.** Complaints and government investigations have focused on agencies that do not make consumers' payments on time, that deceptively claim that fees are

[1] Christopher H. Schmitt with Heather Timmons and John Cady, *A Debt Trap for the Unwary,* Business Week, Oct. 29, 2001.

voluntary, and that do not adequately disclose fees to potential clients. The last two charges are among those cited by the State of Illinois in its lawsuit against AmeriDebt. Inc.

- **Excessive Costs**. In an industry that rarely charged for counseling and other services a decade ago, most agencies now charge fees to set up a Debt Management Program (a debt consolidation plan known as a "DMP") and to maintain it on a monthly basis. Some agencies charge as much as a full month's consolidated payment–usually hundreds of dollars–simply to establish an account.

- **Abuse of Non-Profit Status.** Some "non-profit" credit counseling agencies are increasingly performing like profit-making enterprises. Nearly every agency in the industry has non-profit, tax-exempt status. Nevertheless, some of these agencies function as virtual for-profit businesses, aggressively advertising and selling DMPs and a range of related services, maintaining close ties to for-profit firms, reaping high revenues and paying their executives salaries that are much higher than average for the non-profit sector. A survey of Internal Revenue Service (IRS) tax reports on non-profit organizations found numerous examples of lavish executive compensation and apparent windfall revenues. For example, American Consumer Credit Counseling reported paying its president in 2000 a salary of $462,350 plus just over $130,000 in benefits. In that same year, Cambridge Credit Counseling reported a net financial gain of about $7.3 million. In short, some agencies may be in violation of IRS rules governing eligibility for tax-exempt status. Credit counseling organizations should not qualify as non-profit corporations under IRS rules if they are organized or operated to benefit individuals associated with the corporation or if they are not operated <u>exclusively</u> to accomplish charitable or educational purposes.

- **No Options Other Than Debt Consolidation.** Traditional credit counseling agencies offered a range of services, including financial and budget counseling and community education, as well as DMPs. Newer agencies, in contrast, often funnel consumers only into DMPs, even if they will not benefit. Educational options, such as debt counseling, are disappearing fast.

<u>Creditor Practices Are at the Root of Several Key Problems</u>

Major banks have continued cutting funding to credit counseling agencies, a trend that started in the mid-1990s. Credit card issuers historically paid agencies 15 percent of the debt they recovered from borrowers in DMPs. By 2002, however, one credit counseling trade association (the National Foundation for Credit Counseling) was reporting an average contribution of just 8 percent. More recent data collected for this report indicates that creditors often contribute less than 8 percent, but on a sliding scale, depending on the ability of individual agencies to meet a range of requirements. (See attachment A.) As available revenue has declined, most agencies have curtailed the range of services they offer and have increased the fees they charge to consumers.

Most creditors are also becoming increasingly unwilling to reduce interest rates for consumers who enter debt management programs. In the last four years, five of 13 major credit card issuers have increased the interest rate they offer to consumers in DMPs (Bank One/First USA, Discover, Chase Manhattan, Fleet and Wells Fargo). Only two creditors, Providian and Capital One, have lowered rates during the same period, which still leaves Capital One's interest rate at a very high 15.9 percent. Sears, which generally charges interest rates above 20 percent, continues to refuse to negotiate <u>any</u> discount. Bank of America, on the other hand, will completely eliminate interest for consumers in a DMP. Other creditors that charge relatively low rates are Chase Manhattan, at 7 percent, and Providian, at 8 percent. (See attachment B.)

The increasing refusal of creditors to offer significantly lower interest rates causes more consumers to drop out of credit counseling and to declare bankruptcy. According to a survey by VISA USA, one-third of consumers who failed to complete a DMP said they would have stayed on if creditors had further lowered interest rates or waived fees. Moreover, almost half of those who dropped off a DMP had or were going to declare bankruptcy.[2]

"By slashing agency funding and charging credit counseling consumers interest rates that are too high, credit card companies are leaving debt-choked Americans with few options other than bankruptcy," said Travis B. Plunkett, the Legislative Director of CFA. "It is hypocritical for the credit card industry to demand that Congress give them relief by enacting the bankruptcy bill, while closing off credit counseling as an effective alternative to bankruptcy for many consumers."

Creditors have recently made some efforts to stop the trend toward low-quality, high-cost counseling "mills." For example, MBNA will not fund an agency at all unless it meets requirements related to its accreditation status, its financial practices and the amount of fees consumers are charged. However, each creditor applies different requirements to counseling agencies. This has significantly increased the administrative burdens on and costs to agencies.

Bankruptcy Bill and State Laws Could Expose Consumers to Unscrupulous Counselors

Just over 1.5 million Americans declared personal bankruptcy in 2002. Credit counseling mandates proposed in federal bankruptcy legislation (H.R. 975) – and already a part of some state laws – could increase the number of consumers who are served by disreputable credit counselors. The bankruptcy bill would require debtors to receive a credit counseling briefing before filing for personal bankruptcy and to complete a counseling course before being discharged. Although the legislation seeks to insure that agencies meet certain standards of quality, it does not authorize funds to investigate these agencies, their fees, practices or success rates. This will make it harder to prevent shady operators from getting placed on the list of approved agencies maintained by bankruptcy courts and trustees, and to ensure ongoing compliance.

Public Policy Recommendations

1. The Internal Revenue Service should aggressively enforce existing standards for non-profit credit counseling organizations. The IRS should also use its power to impose "intermediate sanctions" when agencies pay unreasonable or excessive compensation to individuals associated with them.

2. Congress and the states should enact laws that would directly address abuses by credit counseling agencies. Among other provisions, the law should:

    - Prohibit false or misleading advertising and referral fees.
    - Require credit counseling agencies to better inform consumers about fees, the sources of agency funding, the unsuitability of DMPs for many consumers, and other options that consumers should consider, such as bankruptcy.
    - Prohibit agencies from receiving a fee for service from a consumer until all of that person's creditors have approved a DMP.

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[2] *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.

- Give consumers three days to cancel an agreement with a credit counseling agency without obligation.
- Cap fees charged by agencies at $50 for enrollment or set-up. Allow only reasonable monthly charges.
- Require agencies to prominently disclose all financial arrangements with lenders or financial service providers.
- Provide consumers with the right to enforce the law in court.

3. Credit counseling trade associations should set strong, public "best practice standards" and provide for vigorous, independent enforcement of these standards. They should also require that all of their members publicly disclose statistics on the number of consumers who fail to complete debt management programs. Trade associations and individual agencies should work to diversify agency funding and decrease agency reliance on creditor funding. This will improve the financial stability of these agencies and decrease the potential conflicts-of-interest that currently exist.

4. Creditors should increase financial support to credit counseling agencies, especially to improve credit counseling options for consumers who are unlikely to benefit from DMPs. Creditors should also reverse the trend of reducing the concessions they offer to consumers who enter DMPs, and immediately stop funding and doing business with agencies that charge high fees, function as virtual for-profit organizations, or employ deceptive or misleading practices.

Advice for Consumers

The report advised consumers to evaluate all of their options before entering credit counseling, including developing a better spending and savings plan, negotiating individually with their creditors and—in very serious situations—declaring bankruptcy. The groups also strongly recommended that consumers shop around for a good credit counseling agency.

"It is virtually impossible to distinguish the honest, caring agencies from the rip-off artists by just looking at a TV ad or making a quick phone call," said Plunkett. "Don't just respond to television or Internet ads. Get referrals from friends or family, find out which agencies have had complaints lodged against them and look at several agencies closely before making a decision."

The report offered consumers a number of tips on how to find quality credit counseling. It also cited seven "red flags" -- reasons to reject an agency and to look elsewhere for assistance:

1. **High Fees.** In general, if the set-up fee for a debt management plan (also known as debt consolidation) is more than $50 and monthly fees are more than $25, look for a better deal. Similarly, if the agency is vague or reluctant to talk about specific fees, go elsewhere.

2. **"Voluntary" Fees that Aren't So Voluntary.** Some agencies publicly claim that their fees are voluntary, but don't pass this information on to consumers. Others will tell you that their fees are voluntary, but will put a lot of pressure on you to pay the full fee, even if you can't afford it. Ask all agencies you contact if their fees are voluntary. If the full fee is too much, do not pay the agency more than you can afford.

3. **The Hard Sell.** If the person at the other end of the line is reading from a script and aggressively pushing debt "savings" or the possibility of a future "consolidation" loan, hang up.

4. **Employees Paid by Commission.** Most credit counseling agencies are non-profit organizations that are supposed to consider your best interests when offering you counseling options. Employees that receive commissions for placing consumers in debt management plans are more likely to be focusing on their own wallets than yours.

5. **They Flunk the "Twenty Minute" Test.** Any agency that offers you a debt management plan in less than twenty minutes hasn't spent enough time looking at your finances. An effective counseling session, whether on the phone or in-person, takes a significant amount of time, generally thirty to ninety minutes.

6. **One Size Fits All.** Some agencies are like a shoe store that sells just one type of shoe. The only choice they will offer you is a debt management plan. The agency should talk to you about whether a debt management plan is appropriate for you rather than assume that it is. If the agency doesn't offer any educational options, such as classes or budget counseling, consider one that does.

7. **Aggressive Ads.** Many agencies that advertise treat consumers fairly. However, some are being investigated or sued for deceptive practices. Many others charge unreasonable fees or offer no real counseling. Don't just respond to television and Internet advertising, or telemarketing calls. Get referrals from friends or family, find out which agencies have been subject to complaints and talk to a number of agencies before making a decision.

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National Consumer Law Center is a non-profit organization specializing in consumer issues on behalf of low-income consumers. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations that represent low-income and elderly individuals on consumer issues.

Consumer Federation of America (CFA) is a non-profit association of almost 300 pro-consumer groups, with a combined membership of 50 million, which was founded in 1968 to advance the consumer interest through advocacy and education.

A copy of the report can be found at: http://www.consumerfed.org/ credit_counseling_report.pdf.

ATTACHMENT A:
CREDTOR "FAIR SHARE" CONTRIBUTIONS TO COUNSELING AGENCIES3

Creditor	Current Contribution	Contribution in 1994
Citibank	8%	10%
Bank One Corp/ First USA	0 - 6.8	10
MBNA America	0 – 10	6
Chase Manhattan	6 – 10	10
Bank of America	0 – 9	10
Providian Financial Corp.	8	10
Capital One Financial Corp.	9	10
Fleet Boston Financial Corp.	6 – 9	10
Household Credit	3 – 10	6
Wells Fargo Bank	10	10
Discover	7	10
Sears	4 – 10[5]	10
American Express Optima	8	12

[3] As reported by several credit counseling agencies and confirmed by the Consumer Federation of America, February 2002.
[4] "Large Banks Increase Charges to Americans in Credit Counseling," Consumer Federation of America, July 28, 1999.
[5] The higher the payment volume forwarded by the agency to Sears, the lower the percentage paid to the agency.

ATTACHMENT B:
CREDITOR INTEREST RATES FOR CONSUMERS IN CREDIT COUNSELING6

Creditor	**Current Interest Rate**	**Interest Rate in 1999**[7]	**Change**
Citibank	9.9 %	9.9 %	None
Bank One Corp/First USA	11.0	6.0	Increase
MBNA America	15.9[8]	15.9	None
Chase Manhattan	7.0	6.0	Increase
Bank of America	0.0	0.0	None
Providian Financial Corp.	8.0	12.0	Decrease
Capital One Financial Corp.	15.9[9]	19.8	Decrease
Fleet Boston Financial Corp.	9.99	9.5	Increase
Household Credit	9.0	9.0	None
Wells Fargo Bank	14.0	10.0	Increase
Discover	17.99[10]	9.9	Increase
Sears	No reduction	No reduction	None
American Express Optima	No reduction [11]	21.7	None

[6] As reported by several credit counseling agencies and confirmed by the Consumer Federation of America, February 2002.
[7] "Large Banks Increase Charges to Americans in Credit Counseling," Consumer Federation of America, July 28, 1999.
[8] The rate can be less than 15.9%, depending up an examination of the debtors' finances by MBNA.
[9] If account is opened at a lower rate, that rate is retained.
[10] This is the highest rate that will be assessed. Discover sets different rates for different consumers, but will always set a lower rate than that originally received by the consumer.
[11] American Express will not reduce the interest rate while a consumer is paying off the debt owed to them in a DMP. However, when a consumer completes paying back the entire amount originally owed to American Express, all interest accumulated after the consumer entered the DMP is refunded.