



**Credit Counseling in Crisis Update:
Poor Compliance and Weak Enforcement
Undermine Laws Governing Credit
Counseling Agencies**

*A Report Published by The National Consumer Law Center
November 2004*

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Written by:

Deanne Loonin, Staff Attorney, National Consumer Law Center

Researcher: Heather Packard, Research Assistant, National Consumer Law Center

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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.

**National Consumer Law Center
77 Summer Street, 10th Floor
Boston, MA 02110-1006
(617) 542-8010
www.nclc.org**

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FINDINGS AND EXECUTIVE SUMMARY

- The most comprehensive legislative efforts to address credit counseling abuses have occurred at the state level. About half of the states have enacted some type of registration or licensing requirement for credit counselors that do business in their states. **A survey of twenty-five credit counseling companies and enforcement efforts in eight states found that almost half (48%) of the companies offered to perform services for prospective customers in states where the companies were not licensed.**
- Industry compliance varied significantly based on trade association affiliation. All eight companies affiliated with the National Foundation for Credit Counseling (NFCC) refused to serve test customers who said they were calling from states where the companies were not licensed. Just five of eight (62.5%) of the companies affiliated with the Association of Independent Consumer Credit Counseling Agencies (AICCCA) refused such business. Worst of all was the fact that all nine agencies not affiliated with either of those trade groups failed to comply with state licensing laws. This is particularly troubling since estimates show that about 80% of the credit counseling companies now operating are not members of NFCC or AICCCA.
- Despite the findings of widespread non-compliance in their states, most state enforcement agencies surveyed have taken little or no enforcement action. **Of the state enforcement agencies surveyed, seven of eight (87.5%) reported no enforcement actions against credit counseling companies since their licensing laws went into effect.**
- The survey found that many states are not rigorously scrutinizing credit counseling licensing applications. **Six of eight (75%) of the states in the survey had not rejected any applications for licensing or registration. The others rejected just a few.**
- Federal and state law enforcement agencies have begun to address problems in the credit counseling industry. However, enforcement to date has targeted mainly just a few companies even though problems in the industry are widespread.

RECOMMENDATIONS

Ensuring that consumers are protected from unscrupulous credit counseling companies requires a four-step action plan, including:

1. **Passage of strong consumer legislation.** Strong legislation includes not only rigorous licensing requirements, but also substantive provisions such as fee limits and bond requirements that target key problems in the industry and help ensure that consumers have access to quality services.
2. **Industry compliance with public laws.** It cannot be assumed that the industry will police itself. Although strong industry best practices standards may complement public regulation, they are never a substitute for effective public legislation, industry compliance, and rigorous public and private enforcement.
3. **Public and private oversight and enforcement.** States must allocate sufficient resources to state enforcement agencies to allow them to effectively monitor credit counseling practices and bring enforcement actions against violators. The poor public enforcement record to date underscores the need for private enforcement rights as well as greater enforcement by public agencies.
4. **Creditor action.** Creditors that continue to work with credit counseling companies must take more aggressive steps to ensure that they affiliate only with companies that comply with state laws and meet other minimum quality standards.

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INTRODUCTION

In April 2003, the National Consumer Law Center and Consumer Federation of America released, “Credit Counseling in Crisis” a report that documented serious abuses in the “non-profit” credit counseling industry.¹ We reported on the alarming transformation in the credit counseling industry in the last decade. During this time, consumer demand for credit counseling has increased, funding to credit counseling companies has been sharply reduced, and an aggressive new class of companies has emerged. As this new generation of credit counseling companies has gained market share, complaints about deceptive practices, improper advice, excessive fees and abuse of non-profit status have grown. These abuses were also detailed in a March 2004 report by the U.S. Senate Subcommittee on Permanent Investigations.²

At the time the NCLC/CFA report was released, state and federal enforcement agencies had not done much to address problems in the industry. Fortunately for consumers, this situation has begun to change. At the federal level, the Federal Trade Commission has sued a few of the largest credit counseling companies, including AmeriDebt and affiliates. In addition, a number of state Attorneys General have filed lawsuits against a few of the largest and allegedly most unscrupulous companies. However, enforcement to date by states and the federal government has targeted mainly just a small number of companies.

The most comprehensive legislative efforts to address credit counseling abuses have occurred at the state level. Particularly over the last few years, many states have strengthened existing debt management laws or enacted wholly new laws. To help guide these efforts, NCLC and CFA released a model law in February 2004.³

¹ The report is available on-line at:
http://www.nclc.org/initiatives/credit_counseling/content/creditcounselingreport.pdf.

² U.S. Senate Permanent Subcommittee on Investigations, “Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling”, March 24, 2004. Available on-line at: http://govt-aff.senate.gov/_files/032404psistaffreport_creditcounsel.pdf.

³ The model law is available on-line at:
http://www.nclc.org/initiatives/credit_counseling/content/Model_consdebt.pdf. The National Conference of Commissioners on Uniform State Laws (NCCUSL) also established a committee to draft a uniform law.

Most of the new or newly strengthened state laws require credit counseling companies to obtain registrations or licenses in order to operate in those states.⁴ These laws explicitly or implicitly apply to all credit counseling companies doing business in the state regardless of where the company is physically located. This is critical in the current climate of aggressive internet, television and other interstate advertising.

As of September 2004, 26 states had enacted some type of registration or licensing requirements for credit counselors. Many of these licensing provisions have been passed during the past five years, in some cases amending previous laws.

The states with credit counseling licensing or registration laws include:

1. ARIZONA
2. CALIFORNIA
3. CONNECTICUT
4. IDAHO
5. ILLINOIS
6. INDIANA
7. IOWA
8. KANSAS
9. LOUISIANA
10. MAINE
11. MARYLAND
12. MICHIGAN
13. MINNESOTA
14. MISSISSIPPI
15. NEBRASKA
16. NEVADA
17. NEW HAMPSHIRE
18. NEW JERSEY
19. NEW YORK
20. OHIO
21. OREGON
22. RHODE ISLAND
23. SOUTH CAROLINA (** Only licensed attorneys may perform debt adjusting).

However, the current working draft of this committee is worse for consumers than nearly all of the recent state credit counseling/debt management laws.

⁴ Some of the laws limit eligible applicants to non-profit organizations. This restriction should trigger an additional layer of enforcement because credit counseling companies must meet I.R.S. and state tax-exemption/non-profit standards. However, because I.R.S. and state enforcement has been lax, many companies that have been granted non-profit status are in reality for-profit businesses in disguise. The Internal Revenue Service (I.R.S.) has begun to take this problem very seriously. As of March 2004, the agency reported that it had over fifty organizations selected for examination, representing about 50% of the total revenues of credit counseling organizations. See Statement of the Honorable Mark W. Everson, Senate Committee on Governmental Affairs, "Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling", March 24, 2004.

24. VERMONT
25. VIRGINIA
26. WISCONSIN

Nearly all of the state laws that require credit counseling companies to get licenses regulate the companies in other ways as well. Additional substantive provisions include fee limits, requirements that consumers be given written contracts and bond requirements.

Most of the states that have not passed credit counseling licensing laws have at least some laws on the books to regulate credit counselors. For the most part, these states generally prohibit debt management (also known as debt adjusting or budget planning), but allow a long list of exceptions. Most important, nearly all the states exempt non-profit organizations from the general prohibition. The non-profit exemption takes much of the teeth out of the laws as long as many companies that are granted non-profit status continue to behave more like for-profit businesses.⁵

The states that have passed strong laws should be commended for taking an important step toward cleaning up problems in the industry. However, passing a law is only the beginning. There are at least two other essential components to effective laws: 1) The industry must comply with the law; and 2) The law should be enforced against credit counseling companies that fail to comply. This report examines these two critical issues.

The report investigates enforcement of licensing and registration laws only. This is because these are the strongest laws on paper and were generally passed in states that chose to take a strong public stand against abusive credit counseling practices. Our assumption was that these states would most likely be in the forefront of efforts to police the industry. Further, we assumed that inadequate enforcement of licensing and registration would be a sign of inadequate efforts to regulate other substantive requirements. However, a credit counseling company's compliance with licensing rules is by no means a guarantee of quality or an assurance that the company is not violating other substantive provisions of the state law.

SURVEY RESULTS

STATE ENFORCEMENT

A structured survey of state agencies which license and regulate credit counseling companies in eight different states was performed between August and September 2004.⁶

⁵ See footnote 4 regarding I.R.S. efforts to crack down on this problem.

⁶ The information in the survey is accurate as of the date provided. One state agency, Minnesota, was contacted in November 2004. The others were all contacted in August and September 2004.

The states surveyed were Arizona, Idaho, Maine, Maryland, Minnesota, Mississippi, Nebraska, and New York. We selected these states primarily for geographic diversity.⁷

The survey was conducted over the phone and via e-mail with personnel of the office currently handling credit counseling licensing or registration in each state. The main questions asked were:⁸

- 1) How many licenses for credit counseling agencies (CCAs) have been approved, rejected, or are pending since licensing laws in your state went into effect?
- 2) Have there been any enforcement actions against CCAs for licensing violations since licensing laws in your state went into effect?
- 3) What is the size of the staff and budget assigned to handling licensing requests, consumer complaints and enforcements against CCAs?
- 4) If possible, please furnish a list of the CCAs currently licensed to operate in your state.

Each state's responses are listed below.

Arizona

- 1) 20 licenses approved, 0 rejected
- 2) 0 enforcement actions
- 3) 10 staff members handle all aspects of regulating CCAs, but those 10 also work in other departments. No budget information available.
- 4) List of licensed CCAs provided

Idaho

- 1) 28 licenses approved, 0 rejected
- 2) 0 enforcement actions
- 3) 2 staff members. No budget information available.
- 4) List of licensed CCAs provided

Maine

- 1) 29 licenses approved, 0 rejected
- 2) 49 enforcement actions (40 Cease and Desist orders and 9 Assurances of Discontinuance)
- 3) 5 staff members. No budget information available.
- 4) List of licensed CCAs provided

Maryland

- 1) 32 licenses approved, 2 rejected, 6 pending, 4 conditional

⁷ We initially attempted to survey at least ten states with an even broader geographical distribution. However, the other states we contacted did not respond to our requests for information.

⁸ We also asked about the numbers of consumer complaints. Most states reported fairly low volumes of complaints. State officials were generally unable to explain why they received so few complaints, other than the possibility that consumers were not aware of their right to lodge complaints with their agencies. The low numbers reported by the state agencies contrast sharply with national reports by the BBB and others of widespread consumer complaints about the industry.

- 2) 0 enforcement actions
- 3) 2 part-time staff members. No budget information available.
- 4) List of licensed CCAs provided

Minnesota

- 1) 9 licenses approved, 0 rejected
- 2) 0 enforcement actions
- 3) List of licensed CCAs provided

Mississippi

- 1) 39 licenses approved, 0 rejected
- 2) 0 enforcement actions
- 3) 10 staff members handle all aspects of regulating CCAs, but those 10 also work in other departments. No budget information available.
- 4) List of licensed CCAs not provided

Nebraska

- 1) 25 licenses approved, 0 rejected
- 2) 0 enforcement actions
- 3) 1 staff member. No budget information available.
- 4) List of licensed CCAs provided

New York

- 1) 45 licenses approved, 1 rejected⁹
- 2) 0 enforcement actions
- 3) 5 office staff and 7 field staff
- 4) List of licensed CCAs provided

Seven of eight (87.5%) states in our survey reported no enforcement actions for licensing violations against credit counseling companies since their state licensing laws went into effect. This is particularly striking given the results of our industry compliance survey, discussed below, which found that nearly half of the credit counseling companies surveyed offered to do business in all of the states in our survey even when they were not licensed in those states.¹⁰

These results are based on information provided by the state licensing agencies. The agencies claimed that their records included any Attorney General actions filed in

⁹ The 45 licenses represent the number of licenses approved in the last five years. Eleven more were issued more than five years ago for a total of 56. New York also reported that some applicants have withdrawn applications based on questions asked by the enforcement agency, but that the state does not track the numbers of withdrawals.

¹⁰ The only exception was Mississippi and only because that state agency did not provide us with a list of licensed credit counseling companies.

their state.¹¹ However, the Attorney General's office in at least one of the eight states, Minnesota, filed a separate lawsuit against a national credit counseling company. Despite this important case, most of the other state Attorney General activity against credit counseling companies has occurred in states that regulate credit counseling/debt management, but do not require registration or licensing. These cases are still relatively rare and almost exclusively target a few, very large credit counseling companies. While these enforcement actions are important, the results of our survey show that many companies, including those that openly violate state licensing requirements, are breaking the law without suffering any consequences.

Our survey also indicates that many states are not rigorously scrutinizing credit counseling licensing applications. **Six of the eight states in the survey, 75%, had not rejected any applications for licensure or registration.** This is critical because aggressive enforcement must occur not only after bad actions have occurred, but also at the front end to help prevent unscrupulous companies from setting up shop.

Lack of resources is generally the primary reason cited for poor enforcement records. Our survey showed that staff and budget for handling credit counseling companies are often shared with other departments or offices. In general, it appears that the states have not devoted sufficient resources to these agencies.

INDUSTRY COMPLIANCE

When a law is passed and goes into effect, those entities that fall under its scope are responsible for obeying the law. Although seemingly obvious, this point is often overlooked in a rush to criticize under-resourced public agencies. Public agencies, as discussed above, should also be held accountable if they fail to enforce laws. However, even if states devote significantly more resources to enforcement as we recommend below, they will never have enough resources to investigate every offender. Enforcement, in part, must occur at the industry level.

To begin to test self-enforcement, we surveyed 26 credit counseling companies. Of these twenty six companies, eight were members of the National Foundation of Credit Counseling (NFCC), the oldest of the industry trade associations.¹² Eight were members of the Association of Independent Consumer Credit Counseling Agencies (AICCCA).¹³ The others were not explicitly affiliated with either of these two trade associations. All claimed to be non-profit organizations.

¹¹ All respondents explained that because their office is the one handling CCAs, any enforcement actions against a CCA, including actions later taken by the state Attorney General, would have to start with them or they would at least be notified of an action for their records. The information on enforcement actions provided by each state is based on this explanation.

¹² The National Foundation for Credit Counseling (www.nfcc.org) was founded in 1951. The association reports that it serves over 1.5 million households each year.

¹³ The Association of Independent Consumer Credit Counseling Agencies (www.aiccca.org) was incorporated in 1993.

Of the 26 companies called, we could not reach one because the company did not have a live person answering the phone. We called this company twice and left messages, but never received a return call. We reached 25 companies and called each of them twice. Each time, the caller said she was a resident of one of the states in the agency enforcement survey that the particular company was not licensed in and asked if the company would take her as a client.¹⁴

Of the 25 companies we reached, only slightly more than half (52%) complied with state licensing laws by declining to provide services in states where they were not licensed. This compliance percentage varied significantly depending on trade association affiliation. 100% of NFCC but only 62.5% of AICCCA members complied with the state licensing laws. **0% of credit counseling companies unaffiliated with either NFCC or AICCCA (“unaffiliated companies”) complied with state licensing laws.** This last finding is particularly troubling since estimates show that about 80% of the approximately 870 “non-profit” credit counseling companies in operation are not members of NFCC or AICCCA.¹⁵

As reported above, every unaffiliated company in our study offered to assist a potential customer in a state where the company was not licensed or registered. However, the problem is not confined to unaffiliated credit counseling companies. **Forty-eight percent of all companies in the survey simply ignored state licensing laws.** None of the representatives the caller spoke with at these companies even hesitated to take the caller as a client. Many company representatives simply said “where you live doesn’t matter. We can help clients no matter where they’re from.” After one of these comments the caller blatantly asked the representative “so you don’t need to be licensed in my state to help me?” The representative replied “oh, no. We have clients in almost every state.” In fact, many companies advertise that they are “national” agencies.

CONCLUSIONS

State agency enforcement and industry compliance are interconnected. Seven of the eight states in our survey had taken no enforcement actions against credit counseling companies in their states. Yet we found at least one, and in most cases multiple, licensing violations in each of these states. The only exception was Mississippi which did not provide a list of licensed agencies, making it impossible to investigate compliance for that state.

Further investigation of this problem should not be difficult. At a minimum, state enforcement agencies can do what we did in our survey and call companies that advertise

¹⁴ For all credit counseling companies in the survey, the companies called were not licensed in those states at the time we called based on information we received from the state agencies. Since Mississippi did not provide a list of licensed agencies, the caller did not state that she was from Mississippi.

¹⁵ See Leslie E. Linfield, “Consumer Credit Counseling Reform: The Good, the Bad and the Ugly”, ABI Journal, November 2004 at 14. The estimate of 870 credit counseling companies was reported in U.S. Senate Permanent Subcommittee on Investigations, “Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling”, March 24, 2004. More information about NFCC and AICCCA members is available on their web sites, www.nfcc.org and www.aiccca.org.

widely, but are not licensed in their states, and simply ask companies whether they will provide services to prospective customers in their state. Any company that offers to provide services or in fact is providing services without a license is violating the state law. Agencies should probe further for other substantive violations, but operating without a license is a clear place to start.

Industry representatives often claim that it is too difficult for them to comply with the patchwork of state laws. Our survey shows that many respond by simply ignoring the laws. Instead, the appropriate and law-abiding response is that a company should not do business in a state if it cannot or will not abide by the laws in that state. They must require their counselors to simply tell callers or other customers from those states that they cannot assist them.

RECOMMENDATIONS

Ensuring that consumers are protected from unscrupulous credit counseling companies requires a four step action plan:

1. Passage of strong consumer legislation.

The eight states in our survey, and others, should be commended for passing solid credit counseling laws. Some of these laws could still be improved to better protect consumers. However, these states have come a long way in addressing the most serious abuses in the industry. We recommend that other states also pass strong laws to protect consumers.

2. Industry compliance.

Although many credit counseling companies and their trade associations talk a good game, the real test is how they act. One measurement of action is whether the companies comply with existing laws. Our survey found some very troubling trends in this regard as only about half of all companies surveyed (52%) complied with state licensing laws. Most strikingly, all companies that were unaffiliated with either NFCC or AICCCA stated wrongly that they could serve consumers in states where the companies were not licensed.

Failure to comply with licensing laws is likely just the tip of the iceberg. These companies are very likely violating other laws as well and continuing to engage in the types of abuses documented in our 2003 report.

Many of the credit counseling trade associations have developed best practices standards that purportedly apply to all of their members. While we support development of strong best practices standards, they should never be viewed as replacing effective

public regulation and compliance with public regulation. In any case, it is not clear whether these best practices standards are enforced in any meaningful way.

3. Public and private oversight and enforcement.

As noted above, the federal enforcement agencies have begun to take some action against unscrupulous credit counseling companies, although much more needs to be done. We are particularly eager to see whether the I.R.S. backs up its strong language with aggressive action. The signs to date are very promising, but there is still much to be done. We call on Congress to continue to monitor and encourage I.R.S. activity in this regard.

With respect to states, our survey shows a poor enforcement record. Attorney General enforcement has also been sparse. The problem is that strong laws have no teeth if they are not enforced. We recommend that the appropriate resources be allocated to agencies to do their jobs. This not only means enforcement after problems arise, but also careful consideration of applications at the front end. Six of the eight states in our survey (75%) approved every single application received.

The poor public enforcement record highlights the need to ensure that consumers have the right to bring private actions as well. Unfortunately, the majority of states that have passed new laws have not specifically provided for a consumer right to sue under the law. These private rights are essential in order to bring about greater enforcement of credit counseling laws and greater protection of consumers.

4. Creditor Actions.

Although not addressed in detail in this report, our April 2003 report focused on the tremendous power creditors hold in this industry. Their power stems largely from the fact that they hold the purse strings through a process called Fair Share. Through this arrangement, the creditors return a portion of payments they receive from the credit counseling companies. Creditors have steadily cut back on Fair Share payments to credit counseling companies in recent years. At the same time, some creditors have begun to take steps to set their own standards on who they will do business with.

Creditors have been allowed to operate under the radar too long. Creditors that choose to continue working with credit counseling companies must first provide those companies with a reasonable level of financial support. This is not enough. At a minimum, creditors also have an obligation to ensure that these funds go to companies that do not engage in abusive practices. Future reports will more closely examine the creditor side of the equation.