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DEBT SETTLEMENT

Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers

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Highlights

Highlights of GAO-10-593T, a testimony before the Committee on Commerce, Science, and Transportation, U.S. Senate

DEBT SETTLEMENT

Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers

Why GAO Did This Study

As consumer debt has risen to historic levels, a growing number of for-profit debt settlement companies have emerged. These companies say they will negotiate with consumers' creditors to accept a lump sum settlement for 40 to 60 cents on the dollar for amounts owed on credit cards and other unsecured debt.

However, there have been allegations that some debt settlement companies engage in fraudulent, abusive, or deceptive practices that leave consumers in worse financial condition. For example, it has been alleged that they commonly charge fees in advance of settling debts or without providing any services at all, a practice on which the Federal Trade Commission (FTC) recently announced a proposed ban due to its harm to consumers. The Committee asked for an investigation of these issues. As a result, GAO attempted to (1) determine through covert testing whether these allegations are accurate; and, if so, (2) determine whether they are widespread, citing specific closed cases.

To achieve these objectives, GAO conducted covert testing by calling 20 companies while posing as fictitious consumers; made overt, unannounced site visits to several companies called; interviewed industry stakeholders; and reviewed information on federal and state legal actions. GAO did not use the services of the companies it called or attempt to verify the facts regarding all of the allegations it found.

View GAO-10-593T or key components.
For more information, contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov.

What GAO Found

GAO's investigation found that some debt settlement companies engage in fraudulent, deceptive, and abusive practices that pose a risk to consumers. Seventeen of the 20 companies GAO called while posing as fictitious consumers say they collect fees before settling consumer debts—a practice FTC has labeled as harmful and proposed banning—while only 1 company said it collects most fees after it successfully settles consumer debt. (GAO was unable to obtain fee information from 2 companies.) In several cases, companies stated that monthly payments would go entirely to fees for up to 4 months before any money would be reserved to settle consumer debt. Nearly all of the companies advised GAO's fictitious consumers to stop paying their creditors, including accounts that were still current. GAO also found that some debt settlement companies provided fraudulent, deceptive, or questionable information to its fictitious consumers, such as claiming unusually high success rates for their programs—as high as 100 percent. FTC and state investigations have typically found that less than 10 percent of consumers successfully complete these programs. Other companies made claims linking their services to government programs and offering to pay $100 to consumers if they could not get them out of debt in 24 hours. To hear clips of undercover calls illustrating fraudulent, abusive, or deceptive practices, see http://www.gao.gov/products/GAO-10-593T.

Examples of Fraudulent or Deceptive Marketing Claims by Debt Settlement Company

New Government Programs!	IF WE CAN'T GET YOU OUT OF DEBT IN 24 HOURS
New free and easy programs are available for those who are in debt right now! Take advantage while they're still avaiable.	We'll Pay You $100

Source: Debt settlement company Web site. Images enhanced by GAO.

GAO found the experiences of its fictitious consumers to be consistent with widespread complaints and charges made by federal and state investigators on behalf of real consumers against debt settlement companies engaged in fraudulent, abusive, or deceptive practices. Allegations identified by GAO involve hundreds of thousands of consumers across the country. Federal and state agencies have taken a growing number of legal actions against these companies in recent years. From these legal actions, GAO identified consumers who experienced tremendous financial damage from entering into a debt settlement program. For example, a North Carolina woman and her husband fell deeper into debt, filed for bankruptcy in an attempt to save their home from foreclosure, and took second jobs as janitors after paying $11,000 to two Florida companies for debt settlement services they never delivered. Another couple, from New York, was counted as a success story by an Arizona company even though the fees it charged plus the settled balance actually totaled more than 140 percent of what they originally owed.

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to discuss our investigation into fraudulent, abusive, and deceptive practices in the debt settlement industry. As historic levels of consumer debt have dramatically increased the demand for debt relief services, a growing number of for-profit companies have appeared, offering to settle consumers' credit card and other unsecured debt for a fee as an alternative to bankruptcy.[1] The companies say they will negotiate with creditors to accept a lump sum settlement less than the amount owed—purported to be as low as pennies on the dollar in many cases. In addition, these companies often say their programs can result in lower monthly payments for consumers than what they had been paying their creditors, and that their programs will help consumers get out of debt sooner than going through bankruptcy or making only minimum payments on their credit cards. They commonly use radio, television, and Internet advertising to solicit consumers. The marketing claims appeal to consumers who may be vulnerable, given the stress of their financial situations.

Some consumers who have hired these companies have complained that they did not obtain relief from their debts and ended up in worse financial circumstances. For example, according to a sworn statement given to state attorneys, a 75-year-old New York woman ended up paying more than $5,100 to a company to settle only $3,900 of debt on one account. The company failed to settle a second one, which she ultimately paid off for about $1,000 more than what she originally owed. At the time she signed up for the debt settlement program, she had been a widow for several years and was working as a pharmacy clerk to help pay her bills and mortgage. She stated that she often neglected her own needs and accrued more debt trying to help her adult daughter care for two children and a sick spouse. She also stated that she was desperate for help and was easily sold on entering a debt settlement program through an unsolicited telephone call and an offer to reduce her debts by 24 to 40 percent. Even though the debt settlement company cost her more than she originally owed, it still counted her as a success story.

Federal and state agencies have made allegations that some debt settlement companies engage in fraudulent, abusive, and deceptive

[1]Unsecured debts are those debts for which there is no collateral, such as most consumer credit card debt.

practices. You asked us to conduct an investigation of these issues. As a result, we attempted to (1) determine through covert testing whether these allegations are accurate; and, if so, (2) determine whether these allegations are widespread, citing specific closed cases. To achieve these objectives, we conducted covert testing by calling 20 companies while posing as fictitious consumers with large amounts of debt; made overt, unannounced site visits to several companies called; conducted interviews with industry stakeholders, such as industry trade associations and the Better Business Bureau (BBB); and reviewed information on federal and state legal actions against debt settlement companies and consumer complaints. We did not actually use the services of any of the companies we called.

For our first objective, we identified debt settlement companies by searching online using search terms likely to be used by actual consumers, and by observing television, radio, and newspaper advertisements. We selected companies from across the nation to call as part of our covert testing by using several criteria, such as (1) types of marketing claims or pitches, such as refund offers, service guarantees, or targeting of specific groups of consumers; (2) presence, if any, of consumer complaints through BBB and other resources; (3) represented size of businesses, to include both small and large companies; (4) availability of consumer-friendly information on companies' Web sites, such as financial education resources, comparisons to other types of debt relief, or advice on handling credit card debt; (5) membership in various industry trade organizations, which requires adherence to specified standards of conduct; and (6) claims of advertising presence on television or radio. In one case, we identified a company through a spam e-mail message received by one of our staff members, which provided a link to the company's Web site.[2] The 20 cases that we selected incorporated a range of debt settlement companies, including some that appeared to make egregious claims and others that appeared more reputable. We found that some of the 20 companies we called are marketing companies that refer potential clients to other—sometimes multiple—affiliated companies. In most cases, we were unable to determine the exact business relationship between these entities. For the purposes of this testimony, our 20 cases represent the original company we called, plus any related marketers and any other affiliated companies with which we spoke. In addition, we called some companies more than once, depending on the circumstances. The findings

[2] Spam is unsolicited "junk" e-mail that usually includes advertising for some product.

for these 20 cases cannot be projected to all debt settlement companies. For our second objective, we identified allegations against debt settlement companies from review of closed and open civil and criminal investigations pursued by federal and state enforcement agencies over the last decade. We did not attempt to verify the facts regarding all of the allegations and complaints we reviewed. We also identified five closed civil and criminal cases where courts found the debt settlement companies liable for their actions and interviewed affected consumers.

We briefed Federal Trade Commission (FTC) officials on the results of our investigation. In addition, we referred cases of fraudulent, deceptive, abusive or questionable information provided by the 20 debt settlement companies we called to FTC as appropriate. We conducted our investigation from November 2009 through April 2010 in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

Background

For-profit debt settlement emerged as a business model as other, decades-old forms of consumer debt relief came under increased regulation. Traditionally, consumers with large amounts of debt turned to nonprofit credit counseling agencies (CCA) for debt relief. CCAs work with consumers and creditors to negotiate debt management plans (DMP), which enable consumers to pay back unsecured debts to their creditors in full, but under terms that make it easier for them to pay off the debts—such as reduced interest rates or elimination of late payment fees. In addition, CCAs often provide consumers with financial education and assist them in developing budgets. In order to qualify for a DMP, consumers must prove they have sufficient income to pay back the full balances owed to creditors under the terms of the potential DMP. As part of a DMP, CCAs contact each of a consumer's creditors to obtain information about what repayment options the creditors may be willing to offer to the consumer. The CCA then creates the final DMP and a repayment schedule, with payments typically spread over 3 to 5 years. Throughout the length of the DMP, the CCA distributes funds to each of a consumer's creditors after the consumer makes each monthly payment to the CCA. Nonprofit CCAs typically receive funding from consumers and from creditors.

Many for-profit CCAs emerged as the level of consumer debt rose over the last decade, leading to new consumer protection concerns. FTC and state attorneys general took legal action against unscrupulous CCAs that engaged in deceptive, abusive, and unfair practices. For example, some

CCAs charged excessive fees, abused their nonprofit status, misrepresented the benefits and likelihood of success of their programs, and committed other deceptive and unfair acts. The Internal Revenue Service (IRS) also undertook a broad examination effort of CCAs for compliance with the Internal Revenue Code and revoked or terminated the federal tax-exempt status of some agencies. As federal and state actions cracked down on these consumer protection abuses, a growing number of consumers became unable to afford traditional DMPs. As a result, many companies began offering for-profit debt settlement services for consumers.

Debt settlement companies offer to negotiate with consumers' creditors to accept lump sum settlements for less than the full balance on the consumers' accounts. The process typically requires consumers to make monthly payments to a bank account from which a debt settlement company will withdraw funds to cover its fees. Some companies require consumers to set up accounts at specific banks, while others allow consumers to use their existing bank accounts. These monthly payments must accumulate until the consumer has saved enough money for the debt settlement company to attempt to negotiate with the consumer's creditors for a reduced balance settlement.[3]

Debt settlement companies typically charge a fee for their services and require payments either at the beginning of the program as an advance fee or after settlement as a contingent fee. Some companies structure the payment of advance fees so that they collect a large portion of them—as high as 40 percent—within the first few months regardless of whether any settlements have been obtained or any contact has been made with the consumer's creditors. Others collect fees throughout the first half of the enrollment period in advance of a settlement. Companies that charge a contingent, or "back-end," fee generally base it on a certain percentage of any settlement they obtain for consumers. They sometimes charge a small, additional fee every month while consumers are attempting to save funds for settlements. In addition, some debt settlement companies handle only one part of the overall settlement process, such as the front-end marketing

[3]Some creditors may sell a consumer's debt to a collection agency after the consumer misses payments for a given period of time—typically 6 to 12 months. The collection agency will then attempt to collect payments from the consumer. In such cases, debt settlement companies will generally negotiate with the collection agency seeking the consumer's money.

or the negotiation with creditors, while other debt settlement companies conduct every part of the process themselves.

Currently, there has been only limited federal action taken against debt settlement companies. Since 2001, FTC has brought at least seven lawsuits against debt settlement companies for engaging in unfair or deceptive marketing.[4] In August 2009, FTC issued a Notice of Proposed Rulemaking to amend the Telemarketing Sales Rule (TSR) to enhance consumer protections related to the sale of debt relief services,[5] including debt settlement services.[6] In its notice, FTC offers multiple criticisms of the debt settlement industry and states that its "concerns begin with the marketing and advertising of the services, but also extend to whether such plans are fundamentally sound for consumers." The proposed rule would amend the TSR to do the following, among other things:

- prohibit companies from charging fees until they have provided debt relief services to consumers;[7]
- require companies to disclose certain information about the debt relief services they offer, including how long it will take for consumers to obtain debt relief and how much the services will cost; and,
- prohibit specific misrepresentations about material aspects of debt relief services, including success rates and whether a debt relief company is a nonprofit.

In its notice, FTC demonstrates that the requesting or receiving payment of advance fees before debts are settled meets its criteria for unfairness, and therefore designates advance fees for debt settlement services as an abusive practice. FTC considers advance fees an abusive practice due to the following:

[4]FTC's regulatory authority related to false advertising is contained in section 5(a) of the Federal Trade Commission Act (15 U.S.C. § 45(a)), which makes unlawful both "unfair" and "deceptive" acts or practices that affect interstate commerce.

[5]The notice primarily discusses three categories of debt relief services—credit counseling, debt settlement, and debt negotiation. While some consider debt negotiation to be another term for debt settlement, FTC refers to debt negotiation as a separate type of debt relief service. In this context, debt negotiation companies are those that offer to obtain interest rate reductions and other concessions from creditors on behalf of consumers, but do not claim to obtain full balance payment plans or lump sum settlements for less than the full balance. See 74 Fed. Reg. 41988, 41997 (Aug. 19, 2009).

[6]74 Fed. Reg. 41988 (Aug. 19, 2009).

[7]Under the TSR, advance fees are currently banned for several other industries, including credit repair services and advance fee loans.

- the substantial injury to consumers caused by advance fees, based on the low likelihood of success for debt settlement programs and the significant burden on consumers paying advance fees—especially fees charged at the front end of a debt settlement program, which FTC states ultimately impede the goal of relieving consumers' debts;
- the injury to consumers caused by advance fees outweighing any countervailing benefits; and,
- the business practices prevalent among debt settlement companies making the injury to consumers reasonably unavoidable, such as representations in advertisements obscuring the generally low success rates of debt settlement. FTC also states in its notice that many consumers entering debt settlement programs are counseled to stop making payments to their creditors in order to facilitate settlements, which has a harmful effect on these consumers' credit scores.

Given the absence of specific federal law, some states have taken the initiative and enacted their own legislation regulating the debt settlement industry. The regulations vary widely from state to state, however. For example, Virginia's detailed legal framework requires debt settlement companies to apply and pay for an operating license, to enter into written agreements with potential customers that describe all services to be performed and provide the customer a right to cancel at any time, and to charge only a maximum $75 set-up fee and $60 monthly fee, among other restrictions.[8] Other states, such as Arkansas[9] and Wyoming,[10] have chosen to simply ban most types of for-profit debt settlement companies from operating in their states at all. Individuals who violate those states' bans are guilty of a misdemeanor and could face up to 1 year imprisonment in Arkansas and up to 6 months imprisonment in Wyoming. On the other hand, New York and Oklahoma, among others, have not yet enacted any laws specifically targeting this industry, thus leaving the public to rely on generally applicable consumer protection laws.

[8]Va. Code Ann. §§ 6.1-363.2 - .26.

[9]Ark. Code Ann. §§ 5-63-301 to -305.

[10]Wyo. Stat. Ann. § 33-14-101 to -103.

Covert Testing Shows That Some Debt Settlement Companies Engage in Fraudulent, Abusive, and Deceptive Practices

Our investigation found that some debt settlement companies engage in fraudulent, deceptive, and abusive practices that pose a risk to consumers already in difficult financial situations. The debt settlement companies and affiliates we called while posing as fictitious consumers with large amounts of debt generally follow a business model that calls for advance fees and stopping payments to creditors—practices that have been identified as abusive and harmful. While we determined that some companies gave consumers sound advice, most of those we contacted provided information that was deceptive, abusive, or, in some cases, fraudulent. Representatives of several companies claimed that their programs had unusually high success rates, made guarantees about the extent to which they could reduce our debts, or offered other information that we found to be fraudulent, deceptive, or otherwise questionable. We did not actually use the services of any of the companies we called. A link to selected audio clips from these calls is available at: http://www.gao.gov/products/GAO-10-593T.

Advance Fees

The debt settlement companies we called generally represented that they would collect fees before settling our debts—a practice FTC has proposed banning due to the harm caused to consumers. We were able to obtain information about fee structures from 18 of the 20 companies we called while posing as fictitious consumers with large amounts of debt,[11] and found that their fee structures generally recall the concerns expressed by FTC. Specifically, we found that 17 of the 20 companies represented that they collected advance fees before debts were settled. Company representatives told us that the advance fees are calculated based on a percentage of the consumer's debts to be settled, citing figures that ranged from 10 to 18 percent. Moreover, representatives from several companies told us that our monthly payments would go entirely to fees for up to 4 months before any money would be reserved for settlements with our creditors. Only 1 of the 20 companies we called represented that it followed a contingent fee model based on a percentage of the reduction of debt it says it obtains for consumers. Representatives from this company said a fee equal to 35 percent of each client's reduced debt was charged. Some companies also represented that they assessed monthly maintenance and other additional fees. One of the 17 advance-fee

[11] Of the two companies for which we were unable to obtain fee information, one company presented an audio recording of general information about its program, and one company's representative told us we did not have enough debt to qualify for its program.

companies also revealed that it charged a contingent fee after each debt is settled based on a percentage of the debt reduction.

FTC has banned advance fees in several industries, such as credit repair, based on analyses that determined these practices to be unfair because sellers often do not provide the services for which they charge. The agency has proposed a similar ban for debt settlement, stating that the advance fees cause substantial injury to consumers. FTC justified this stance toward debt settlement, in part, based on the following findings: advance fees induce financially strapped consumers to stop making payments to their creditors; and consumers are unlikely to succeed in debt settlement programs, given evidence from federal and state agencies that generally shows single-digit success rates.[12] Moreover, FTC stated concerns in its notice that advance fees for debt settlement may actually impede the process of saving money to settle debts, especially substantial fees collected at the beginning of a program. This business model may be especially risky for consumers who are already in financially stressed conditions, given that interest, late fees, and penalties often continue to accrue on the consumers' accounts as they work to save money toward settlements. In addition, consumers with already limited financial resources may be unable to direct adequate funds toward saving for settlements if their resources are being devoted to paying fees.

We asked representatives of some companies what services we would receive as we paid advance fees while saving money for settlements. These representatives generally stated that our advance fees would pay for financial education, updates from attorneys, and communications with our creditors—such as cease and desist letters, to attempt to prevent harassing telephone calls. One representative, however, was unable to provide an explanation of what services we would receive for our advance fees beyond the fact that her company's attorneys would "look at" our accounts every month. Several companies we called had basic financial education resources on their Web sites or provided links to such resources by e-mail. Industry representatives have stated that advance fees are needed to cover essential operating costs, such as overhead and providing the types of services mentioned above for their existing clients. However, FTC found that marketing and acquiring new customers make up a large portion of the operating costs for debt settlement companies. We were

[12]Federal and state agencies have defined success as consumers being able to obtain the results that the debt settlement companies promised them.

unable to verify whether any companies we called provide ongoing services for clients they enroll in their programs, given that we did not enter into business relationships with them.

Directing Consumers to Stop Paying Creditors

We also found that the companies we called generally follow a business model that poses a risk to consumers by encouraging them to stop making payments to their creditors, a practice that harms consumers because of the damage it typically causes to their credit scores. Representatives of nearly all the companies we called—17 out of 20—advised us to stop paying our creditors, by either telling us that we would have to stop making payments upon entering their programs or by informing us that stopping payments was necessary for their programs to work, even for accounts on which we said we were still current. The following quotes demonstrate some of the statements made by representatives of the companies we called regarding our payments to creditors:

- "You stop paying, uh, those payments out to those creditors. The only thing you're going to have to worry about is this payment here [to company]."
- "One-hundred percent of our clients stop making their monthly payments as soon as they enroll into the program."
- "I won't tell anybody not to pay their bills; I said one-hundred percent of the clients who have been successful have stopped paying their bills."
- "Say you enrolled in the program. At that point you would no longer make any of your credit card payments. All of them would go late."

Among the 17 companies encouraging us to stop paying our creditors or representing that stopping payments is a condition of their program,[13] 5 were members of an industry trade group called The Association of Settlement Companies (TASC) at the time we made our calls. TASC's written standards, adherence to which is required of all member companies, explicitly state "No Member shall direct a potential or current client to stop making monthly payments to their creditors." A representative of 1 of these 5 TASC member companies told us that she could not direct us to stop paying our creditors, but later stated that if we could afford to make our payments then her program was not "the best solution" for us. In addition, a representative of 1 of these 5 TASC member

[13]As stated above, some companies we called referred us to one or more affiliates. We were unable to determine the relationship between these companies and their affiliates.

companies appropriately screened us out by telling us that we had too low of income to afford that company's program under the scenario we presented; he later described his company's program as requiring clients to stop making their payments. In addition to these 5 TASC member companies, we spoke to a representative from another TASC member company who told us that we did not have enough debt to qualify for that company's program. In addition, 4 of the companies that told us to stop paying our creditors or represented that stopping payments was a condition of their program were members of a different industry trade group called the United States Organizations for Bankruptcy Alternatives (USOBA) at the time of our calls. According to USOBA representatives whom we interviewed, its member companies do not tell potential clients to stop paying their creditors. We received particularly good advice from a representative of 1 additional USOBA member company—not among the 4 listed above—whose representative told us that we should worry about taking care of our late mortgage payments before we worried about settling our credit card debts.

Stopping payments to creditors results in damage to consumers' credit scores. According to FICO (formerly the Fair Isaac Corporation), the developer of the statistically based scoring system used to generate most consumer credit scores, payment history makes up about 35 percent of a consumer's credit score. Moreover, the damage to credit scores resulting from stopping payments is generally worse for consumers who have better credit histories—such as consumers who maintained good payment histories prior to entering a debt settlement program that required them to stop making payments. In its notice, FTC also discussed the harmful effect that stopping payments has on consumers' credit scores.

Success Rates

In several cases, representatives of companies we called claimed success rates for their programs that we found to be suspiciously high—85 percent, 93 percent, even 100 percent. In its notice, FTC cites claims of high likelihood of success as a frequent representation in the debt settlement industry. The success rates we heard are significantly higher than is suggested by evidence obtained by federal and state agencies. When these agencies have obtained documentation on debt settlement success rates, the figures have often been in the single digits. For example, as part of an annual registration process in Colorado, the state's Attorney General compiled data on success rates for all debt settlement companies statewide. The data show that, from 2006 to 2008, less than 10 percent of Colorado consumers successfully completed their debt settlement programs. Our case studies discussed below provide additional evidence of similarly low success rates.

Industry-reported data have claimed a higher success rate for debt settlement programs. According to TASC, data gathered from a survey of some of its largest member companies in 2009 shows that 34.4 percent of consumers participating in a debt settlement program offered by a TASC member company completed their debt settlement programs by settling at least 75 percent of their enrolled debts.[14] A previous study released by TASC in 2008 claimed overall completion rates between 35 and 60 percent. However, federal and state agencies have raised concerns with the methodology behind TASC's data. For example, these agencies have argued that (1) TASC's data were self-reported by its member companies, and may not reflect all member companies; (2) not every TASC member company that submitted data defined completion in the same way; and (3) the fact that consumers complete a debt settlement program does not necessarily imply that these consumers successfully obtained the debt relief services for which they paid. We did not attempt to validate success or completion data from TASC or federal or state agencies.

TASC and USOBA have cited several factors that might contribute to consumers' success rates in debt settlement programs, such as that most consumers entering debt settlement programs are in extreme financial hardship and may choose to quit their program after settling some debts and improving their financial situations. However, FTC stated in its notice that the prevalent fee structure in the debt settlement industry—substantial up-front fees—may be a major factor in the generally low consumer success rates as well. TASC and USOBA have both offered suggestions for ways to boost consumer success rates, such as improved processes for determining consumers' suitability for debt settlement programs.

Debt settlement success rates also play a key role in the BBB rating system for companies in the industry. Due to the volume and nature of

[14]While TASC requires its member companies to make a series of disclosures in its discussions with potential clients, the individual completion rate for each company's program or the 34.4 percent overall completion rate mentioned in TASC's study are not among the required disclosures.

consumer complaints,[15] among other factors, BBB recently designated debt settlement as an “inherently problematic” type of business and, in September 2009, implemented new rating criteria for debt settlement companies to reflect this designation. Under this designation, no debt settlement company may earn a BBB rating higher than a C -.[16] While BBB has designated other types of businesses as inherently problematic—such as pay-day loan centers, businesses that charge fees for publicly available information on government jobs, scientifically unproven medical devices and products, advance fee modeling agencies, and wealth-building or real estate seminars—debt settlement companies are the only type of business currently allowed by BBB to escape the inherently problematic designation if they provide evidence to BBB that they meet a series of criteria. These criteria require a debt settlement company to prove, among other things, that:

- It has substantiated all advertising claims, including claims relating to the benefits or efficacy of debt settlement;
- It makes certain disclosures to consumers, including clear and conspicuous disclosure of program fees and the risks of debt settlement;
- It has adequate procedures for screening out consumers who are not appropriate candidates for debt settlement; and
- A majority (at least 50 percent) of its clients successfully complete its program and obtain a reduction in debt that is significant and exceeds the fees charged by the company.

[15]According to data it provided to us, BBB has received thousands of complaints about debt settlement companies in recent years, with the number of complaints rising from 8 in 2004 to nearly 1,800 in 2009. This figure may underestimate the total number of complaints related to debt settlement, as not all companies providing debt settlement services are classified as debt settlement companies by BBB. According to BBB, these complaints are related primarily to debt settlement companies: (1) charging advance fees without providing services as promised to consumers and sometimes without providing any services at all; (2) failing to disclose important information to consumers, such as unannounced fees; and (3) failing or refusing to provide refunds to consumers.

[16]According to BBB, its rating system uses grades based on a proprietary formula that incorporates information known to BBB and its experience with the business under assessment. The ratings are intended to represent BBB’s degree of confidence the business is operating in a trustworthy manner and will make a good faith effort to resolve any customer concerns. The rating system uses grades from A to F, with plusses and minuses, so that A + is the highest grade and F is the lowest. Some debt settlement companies may currently have a BBB rating higher than a C - because they were misclassified (e.g., characterized by BBB as something other than a debt settlement company) or because debt settlement does not represent a substantial portion of its services.

According to a BBB official, he was unaware of any debt settlement company that had yet successfully demonstrated that it met these criteria, as of March 2010. Officials from TASC and USOBA told us they strongly disagree with BBB's new rating system for debt settlement companies. According to these officials, the new rating system minimizes the importance of resolved consumer complaints, requires an unrealistic measure of programs' success rate—50 percent—and inhibits consumers' ability to differentiate between reputable and disreputable debt settlement companies.

Guaranteed Reductions in Debt

Representatives from some companies also guaranteed or promised that they could obtain minimum reductions in our debts if we signed up for their services. For example, some representatives stated that they would save us 40 to 50 cents on the dollar once they negotiated settlements with our creditors. In its notice, FTC cites claims of specific reductions in debt as an example of a consumer protection abuse in the debt settlement industry.

Fraudulent or Other Deceptive Representations

We found examples of companies offering fraudulent or other deceptive information, such as using names and imagery for their services that indicates that their program is linked to the government. Table 1 below shows examples of fraudulent or deceptive information from companies we called.

Table 1: Examples of Fraudulent or Deceptive Information Provided by Debt Settlement Companies We Called

No.	Representation	Comments
1	Debt settlement companies are “licensed and regulated” by TASC, which is “like the SEC [United States Securities and Exchange Commission] for stock traders.”	TASC is a nonprofit trade association that lobbies lawmakers on behalf of the debt settlement industry. It is not a licensing or regulatory authority.
2	Stopping payments will “knock [credit score] down a couple of points…However, unlike bankruptcy or any other credit counseling program, this only affects your credit while you’re in the program.”	According to FICO, stopping payments to creditors as part of a debt settlement can drop credit scores anywhere between 65 to 125 points. In addition, missed payments leading up to a debt settlement can remain on a consumer’s credit report for 7 years even after a debt is settled.
3	Debt settlements will be noted on consumers’ credit reports as “paid in full” or “paid as agreed.”	According to FICO, settlements are typically listed on consumers’ credit reports as “settlement accepted on the account” or “settled for less than full balance.”
4	Company advertises a “National Debt Relief Stimulus Plan.”	The company’s services are not affiliated with a government program or part of the American Recovery and Reinvestment Act of 2009 (the “stimulus”).
5	Company promised that calls from creditors seeking money will “slow down and eventually stop” if we just told our creditors we had hired the company.	Debt settlement companies cannot prevent creditors from contacting consumers. Companies often advise consumers to terminate all communication with their creditors, ask consumers to assign power of attorney to them, and send cease and desist letters to creditors in an attempt to cut off further communications.

Source: GAO.

Five of our cases are highlighted below. The companies in these cases made multiple fraudulent or deceptive representations either to our fictitious consumers by telephone, on their Web sites and through company documents or to our staff during unannounced, overt site visits. Table 2 below shows basic information represented by these companies, including the location, fees, and industry trade association membership of each of these companies and their affiliates, if any. (Table 4 in appendix I provides summary information on all 20 companies we called.)

Table 2: Representations Made by Select Debt Settlement Companies We Called

No.	Location of company and affiliates	Fees[a]	Association membership[b]
1	Florida; affiliates in Florida, Massachusetts, California, and New Jersey[b]	• Advance fees based on 15% of enrolled debt, with monthly payments required throughout program	TASC;[c] affiliates in TASC and USOBA
2	Unknown; affiliates in Arizona, Texas, and California[b]	• Advance fees based on 12% of enrolled debt • First three monthly payments go to fees • $25 monthly maintenance fee • Additional contingent fee based on 4% of reduction in debt company obtains for clients	Affiliate in USOBA
3	California	• Advance fees based on 16% of enrolled debt, with monthly payments required throughout program • First three monthly payments go to fees • $100 fee for out-of-state clients	TASC (at the time of our call)
4	California	• Advance fees based on 17% of enrolled debt, with monthly payments required throughout program • First three monthly payments go to fees • $840 maintenance fee (total throughout program) • $623.50 trust account fee (total throughout program)	TASC
5	California	• Advance fees based on 15% of enrolled debt	TASC (at the time of our call)

Source: GAO analysis of information obtained from debt settlement companies.

[a]Fee information reflects fees disclosed to us; some companies may charge additional fees that were not disclosed. Debt settlement companies typically charge fees requiring payments either at the beginning of the program as an advance fee or after each settlement as a contingent fee. Some companies structure the payment of advance fees so that they collect a large portion of them—as high as 40 percent—within the first few months regardless of whether any settlements have been obtained or any contact has been made with the consumer's creditors. Others collect fees throughout the first half of the enrollment period in advance of a settlement. Companies that charge a contingent fee generally base it on a certain percentage of any settlement they actually obtain for consumers. They sometimes charge a small, additional fee every month while consumers are attempting to save funds for settlements.

[b]Some companies we called referred us to one or more affiliates. It was not always clear to us exactly with which company or affiliate we were speaking, where the companies or affiliates were located, or what the relationships were between the companies and affiliates. In some cases, separate affiliates of the same company claimed to be members of different industry trade associations.

[c]While Company 1 claimed to be a member of TASC, it appears this was a false representation.

Company 1

Company 1 made several fraudulent and deceptive representations. We identified Company 1 when one of our investigators received an unsolicited spam message through his private e-mail account advertising debt settlement services, with a mailing address in the country of Lebanon listed at the bottom. A link in the message brought us to a Web site advertising “New Government Programs! New free and easy programs are available for those who are in debt right now! Take advantage while they’re still avaiable [sic].” (See figure 1 below.) The Web site also featured logos for TASC and BBB, along with other insignias declaring “Satisfaction Guaranteed” and “Privacy 100% Guaranteed.” When we called the number listed on the Web site, a representative answered using the name of an affiliate different than the company name listed on the Web site. He explained that the Web site was a “generic advertisement” to spread information about his company. Throughout our conversation, he made multiple statements that we found to be deceptive or questionable. According to the representative, the “worst case scenario” for settlement of our debts would be “40 cents on the dollar.” He stated that his company has helped 100 percent of its clients get out of debt in 3 years or less, and that “every single creditor settles. There’s not one creditor we haven’t been able to reach a settlement with.” When asked about the government programs advertised on the Web site, he replied “What we’re offering is not part of any government program whatsoever…. It’s just that the government is allowing this to take place at this time…. The government is putting pressure on banks to allow things like this so that, you know, there’s no more bankruptcies or things along those lines.” Even though the Web site displayed a TASC logo, we were unable to find either Company 1 or this affiliate on TASC’s member directory. The executive director of TASC confirmed to us later that neither Company 1—as it listed itself on its Web site—nor this affiliate is a member of the organization. The affiliate’s Web site displays a logo for USOBA, and we confirmed its membership with that organization.

Figure 1: Fraudulent or Deceptive Advertising Claims Featured on Company 1’s Web Site

Source: Debt settlement company Web site. Images enhanced by GAO.

Shortly after we called Company 1 the first time, we noticed that the Web site contained some changes—when we attempted to leave the Web site on later visits, a pop-up message appeared declaring "If we can't get you out of debt in 24 hours we'll pay you $100!" (See figure 1 above.) We called Company 1 again and a representative said that he was with Company 1. He later stated that he was actually with an affiliate of Company 1—a different affiliate than the first representative with whom we spoke. He described the Web site for Company 1 as a "landing page" used to attract business to his company. This second representative also offered deceptive or questionable information, such as a 93 percent success rate for his program. When asked about the government programs advertised on Company 1's Web site, he replied that the government program was related to creditors' ability to obtain tax credits from the IRS for the debts they sell to collection agencies. Regarding the offer to get consumers out of debt within 24 hours, he said that this was for clients who have the financial resources to make a large lump sum payment at the very beginning of the program. However, he added that "ninety-nine point nine percent of the people that come to us do not have the ability to do that." When we asked about the risk of being sued by our creditors, he told us that "a judgment is nothing more than a fancy I.O.U." We were able to find this second affiliate on TASC's member directory, and the executive director of TASC later confirmed that this affiliate is a member of TASC.[17]

We made a site visit to Company 1 in Florida. The owner of Company 1 admitted that the company does not really exist and is really just a marketing Web site, and told us he actually owns a different company that offers both debt settlement and mortgage modification services. He claimed that he did not know that Company 1's Web site contained information about an alleged government program, and logos for TASC and BBB. However, he acknowledged that neither Company 1 nor his real company is a member of TASC despite the logo featured on the Web site.[18] When asked about the offer to get consumers out of debt within 24 hours, he replied that this was a "typo" and that the offer should say 24 months rather than 24 hours.[19] Our investigators observed employees at the

[17]We also identified an additional Web site at a different address that was nearly identical to the one that referred us to the two representatives discussed above, with the same phone number and logos for TASC and BBB, but listing what appeared to be a different company name entirely.

[18]TASC's executive director confirmed that Company 1 is not a member.

[19]Prior to our site visit, we found a testimonial from an alleged client on Company 1's Web site claiming that Company 1 helped her to cut her monthly bills in half in 24 hours.

location listed for Company 1 representing on the telephone that they were employees of the second affiliate mentioned above. Moreover, when the owner of Company 1 gave our investigators a copy of the script his employees use when speaking with potential clients, the text of the script implied that they were representatives of the second affiliate. We were unable to determine the actual relationship, if any, between Company 1, its affiliates, or the other company the owner claimed he runs.

Company 2

Company 2's online and radio advertisements feature multiple fraudulent or deceptive claims. The company's Web site advertises that its services will "Reduce balances to 40% - 60%," "Eliminate excessive Credit Card Debt interest immediately," and "End late payment fee's [sic]." When we called Company 2, it referred us to at least 3 different affiliates. It was not always clear exactly with which company's representatives we were speaking.[20] Representatives from these affiliates described Company 2 as a marketing group that referred potential clients to them. We also identified radio advertisements placed in several major cities purporting to be from Company 2, in which it claimed to offer a "government authorized" and "government approved" debt settlement program. When we called the telephone number listed in one of the radio advertisements, a representative answered from one of the affiliates of Company 2 that we had spoken to earlier. When asked about the government-approved debt settlement program, the representative acknowledged the radio advertisement and replied "it is government approved…. They allow for us to do this. You know, the banks received, you know, bailout money last year. I'm sure you saw it on the news. There has to be some type of assistance for people on a consumer level also." According to this representative, Company 2 runs similar advertisements on television and radio stations nationwide.

We were unable to visit Company 2 because we could not determine its physical location. However, we visited the affiliate whose representative discussed the radio advertisement with us, which is located in California. Officials from this affiliate told us that their company is "the most legitimate debt settlement company," and that their employees receive

[20] A recent report by the Maryland Consumer Rights Coalition stated that debt settlement companies "often seem a many-headed Hydra" with parent companies split from other divisions that handle the marketing and solicitation. The report further states that this division of services causes confusion for consumers trying to track the progress of their debt settlement, and for agencies attempting to enforce compliance.

commission based on the number of clients they enroll in the company's program. They also claimed that their company was not associated with Company 2, and refused to disclose to us the number of clients in their program or the total amount of consumer debt their company is currently handling. On two separate covert telephone calls we made to Company 2, representatives of this affiliate stated they were with Company 2 at the beginning of each call but later informed us that they actually were with the affiliate and that Company 2 handled their marketing. When asked during our site visit if we could see their call center, officials refused.

Company 3

Company 3 targets Christians for its debt settlement services by employing a Biblical marketing theme, both on its Web site and over the phone. Representatives of Company 3 told our fictitious consumers that they run a nonprofit ministry affiliated with their for-profit debt settlement company, with funds from debt settlement feeding into the ministry and missionary trips overseas. In addition, representatives told us that their program has an 85 percent success rate and that they would negotiate our debt down to 40 or 60 percent of what we currently owed. About the risk of being sued by our creditors, a representative remarked to us that "It's just a computer thing. I mean, sometimes there's a handful of them that they'll have reserved to go after and it's just random. But even if they were to do that in your case, it's just a small percentage; we'd be able to advise you at that time, too. You don't need an attorney in the matter or anything like that. It's just a civil thing."

We visited Company 3 in California, where we found it located in a strip mall near a grocery store. The owner of Company 3 told us that he owned a mortgage company and sold cars prior to entering the debt settlement industry. Company 3 handles the front end of the debt settlement process by signing up clients, and uses a third-party company and law firm for the rest of the process. Most of the employees of Company 3 are contractors who earn $200 commission for each client enrolled, with bonuses for employees who enroll a high number of clients. According to Company 3 officials, they enrolled approximately 1,200 to 1,300 new clients in the first 2 ½ months of 2010. When asked if we could see a copy of their IRS Form 990 for the nonprofit side of their operation, the owner replied, "The Bible says you should never let the left hand know what the right hand is doing."[21] Company officials provided us with a sample of its contract, which states that "In the event Client comes into a lump sum of money and wishes to settle an account before original designated completion date, Client must first pay [Company 3] Fee. The remainder of the lump sum will be utilized in settling Client's unresolved program debt." The contract also states that Company 3 does not provide legal representation or any legal advice to its clients.

Company 4

We became interested in calling Company 4 when we noticed on its Web site that it advertised a "U.S. National Debt Relief Plan," with a logo depicting a shield filled with a U.S. flag. When asked about this plan, a representative stated that it was "a consumer advocacy program entitled [sic] to help consumers get out of debt" but that "it's not a government agency. We just take advantage of the fact that the government are [sic] giving money to the banks to get out of debt and we just show you and go through the route of settling out your accounts." The representative also told us that our first three monthly payments would go entirely to paying fees with no money set aside for savings. He said that Company 4 uses this advance fee structure because, during the first few months of the program, the company would be setting up our account and mailing cease and desist letters to our creditors, and "to show that you have the commitment to be in the program."

When we visited Company 4 in California, officials told us that the company only handles the front-end marketing of the debt settlement process, and that it had enrolled approximately 1,000 clients in the first 2 ½ months of 2010. In early March 2010, TASC issued a statement on its Web site noting a recent increase in companies practicing deceptive marketing, including companies sending letters to potential clients resembling government documents and using terms like "U.S. National Debt Relief Plan." Company 4 marketed the "U.S. National Debt Relief Plan," and is a member of TASC.

Company 5

A representative of Company 5 advised us that we could not afford its debt settlement program because our fictitious consumer's income was too low

[21] IRS Form 990 is a federal information return filed annually by tax-exempt public charities. Information reported on this return includes assets held, contributions received, and grants paid.

and his expenses were too high. He suggested that we consider credit counseling or bankruptcy as options if we were unable to make substantial improvements in our budget. However, when we indicated that we may obtain a new job soon that would boost our income, he provided details on how Company 5's debt settlement program works. He told us that it generally takes about 7 to 8 months to save up enough money to begin negotiating settlements. When we asked what services we would be paying for during those first 7 to 8 months, he replied that our fees would pay for the ability to get out of debt within 36 months, and monthly education and updates from the company's attorneys. Company 5's Web site advertised that it can help consumers who are experiencing stress, anxiety, and depression associated with being in debt. When we asked about these services, the representative laughed and said these services are arranged through debt negotiators who will hold monthly strategy calls with us.

We attempted to visit Company 5 in California, but found that it was no longer at the location listed on its Web site. Employees of several other companies in neighboring office suites told us that Company 5 had moved to another office down the hall, which was listed under a different company name. An official from this company denied knowing anything about Company 5, and claimed that his company did not provide debt settlement services. However, records we obtained indicate that the name of Company 5's owner is the same as the name on this official's driver's license. In addition, the Web site for this other company indicates that it does, in fact, provide debt settlement services. After we returned from our site visit, the Web site for Company 5 was down for maintenance.

Allegations of Fraud, Abuse, and Deception in the Debt Settlement Industry Are Widespread

We found the experience of our fictitious consumers to be consistent with the widespread complaints and charges made by federal and state investigators on behalf of real consumers against debt settlement companies. We identified allegations of fraud, deception and other questionable activities that involve hundreds of thousands of consumers.[22] We drew this figure from closed and open civil and criminal cases governments have pursued against these companies over the last decade. Our calculation likely underestimates the total number of consumers affected, since we obtained information from only 12 federal and state agencies about the clients within their jurisdiction that they identified in

[22] We did not attempt to verify the facts regarding all of the allegations pursued by federal and state agencies that we identified.

some of the cases they pursued.[23] Federal and state agencies have reported taking a growing number of legal actions against companies that offer these services in recent years. As mentioned above, since 2001, FTC has brought at least seven lawsuits against debt settlement companies for engaging in unfair or deceptive marketing. The National Association of Attorneys General (NAAG) said in an October 2009 letter to FTC that 21 states brought at least 128 enforcement actions against 84 debt relief companies, including debt settlement companies, over the previous 5 years.[24] The group stated that the number of complaints received by the states about debt relief companies—especially debt settlement companies—had more than doubled since 2007. Lastly, the group noted that any business model requiring "cash-strapped consumers to pay substantial up-front fees" raised significant consumer protection concerns and agreed with a consumer group that called it "inherently harmful."

Attorneys general from 40 states and 1 territory submitted the letter, saying they supported FTC's proposed rule changes to combat unfair and deceptive practices in the industry. They cited similar debt settlement activities that prompted their own enforcement actions, including the following:

- collecting advance fees in many instances without providing services;
- misleading consumers about the likelihood of a settlement;
- misleading consumers about the settlement process and its adverse effect on their credit ratings;
- making unsubstantiated claims of consumer savings;
- deceptively representing the length of time necessary to complete the program;
- misleading or failing to adequately inform consumers that they will be subject to continued collection efforts, including lawsuits;

[23]We obtained information from the following agencies: Federal Trade Commission, U.S. Department of Justice, and state law enforcement agencies in Alabama, Colorado, Delaware, Florida, Illinois, North Carolina, New York, Texas, Vermont, and West Virginia. They identified clients through company records, individual complaints, and restitution paid. We focused on select states with enforcement actions listed in a National Association of Attorneys General letter. We did not attempt to query all 50 states.

[24]According to the letter, the 128 enforcement actions listed in its attachment do not represent a comprehensive list of all cases filed or regulatory actions taken against debt relief companies. We did not attempt to verify the facts regarding all of the actions listed in the letter. Details regarding 3 of these enforcement actions are provided below, as case studies 1, 3, and 4.

- misleading or failing to adequately inform consumers that their account balances will increase due to extended nonpayment under the program; and
- deceptive disparagement of bankruptcy as an alternative for debtors.

The state attorneys general expressed concern the industry would grow exponentially given the current economic climate and a regulatory environment that allows substantial advance fees to be collected. They criticized the advance fees as providing minimal incentive for companies to perform services because they get paid whether or not they take any action on behalf of the consumer. They also noted that low set-up costs help in the promotion of debt settlement as a cheap business opportunity. They stated that they would continue to take enforcement actions against unscrupulous operators in the industry, but that they also believed the proposed FTC rule changes would substantially aid law enforcement agencies in addressing harms caused to consumers.

We developed case studies from five closed civil or criminal actions in which state or federal courts found debt settlement companies liable for fraudulent, unfair or deceptive actions that left clients in worse financial condition—bankrupt, owing more debt, and with lower credit scores and more judgments against them. We also examined the experiences of a consumer from each of these cases. Table 3 below shows key information from each of these five cases. Further details are discussed below.

Table 3: Select Cases of Debt Settlement Companies Engaged in Fraudulent, Abusive, or Deceptive Practices

No.	Company location	Federal/state agency	Case details
1	Arizona; affiliates in Arizona and Florida	New York Attorney General	• More than 500 New Yorkers withdrew from the debt settlement program after paying over $1 million in fees only to receive more debt, tarnished credit ratings, and increased collection calls and creditor lawsuits. • Nearly half of the New York clients that completed the program during the Attorney General's investigation, or 27 out of 64, ultimately paid more than they originally owed. • Only 0.3 % of the New York clients realized the promised savings. • A New York court found the company and its affiliates liable for statutory fraud and ordered restitution for clients who paid more than they owed.
2	New York and Vermont	U.S. Attorney General	• An attorney and his law firm associates misappropriated and embezzled millions of dollars from 15,000 clients seeking debt reduction help over a 6-year period, forcing some customers into bankruptcy. • The group lured consumers through television and radio advertisements by falsely claiming a 50 to 70 % savings off unsecured debt, an improvement in credit scores and bankruptcy avoidance. • Only 8 % of the group's clients completed the program. • Clients paid advance fees for these services and funded escrow accounts from which their creditors were supposed to be paid. The fees were not considered "earned" until consumer debts were settled. • The fees collected were used in part to fund huge payments to the attorney and two of his associates before they provided any services to clients. • The client escrow accounts were drawn upon, in part, to cover overdrafts from the law firm's operating account and to make payments to the attorney's wife, among other things. • The law firm filed for bankruptcy in 2003. • A federal jury found the attorney guilty in 2005 on multiple felony counts, including fraud. His six associates pled guilty to federal charges.
3	Florida	North Carolina Attorney General	• Two companies and their owners ran an illegal debt settlement business using unfair and deceptive practices, collecting over $500,000 from about 220 North Carolinians who rarely obtained the services they purchased. • North Carolina law prohibits anyone from acting as a for-profit intermediary between residents and their creditors for the purpose of reducing, settling, or altering debt payments, except in limited circumstances. It specifically bans advance fees for these services. • The companies and their owners, one of whom was an attorney, marketed their services in part using third-party "referral agents" who received compensation for directing consumers to the group. • Many clients dropped out of the program dissatisfied. Few received refunds or obtained settlements with their creditors. Many filed for bankruptcy. • A North Carolina court found that the group's actions violated state law and banned the parties from doing any debt-related business with state residents. In a separate action in January 2009, the attorney was disbarred for a period of 5 years.

No.	Company location	Federal/state agency	Case details
4	Maryland	Maryland Attorney General	• A Maryland attorney, his law firm and their marketers used unfair and deceptive trade practices to collect $3.4 million from about 6,200 clients over a 2 year period to settle debt but provided little or no services in return, causing harm to consumer credit histories and credit scores. • The group told clients that its employees were qualified credit counselors capable of recommending the most appropriate action, but instead it provided virtually the same advice to everyone—enter debt settlement plans profitable for the group. • The group reached an agreement in 2007 with the Attorney General, agreeing to immediately cease and desist selling unlicensed debt settlement services, pay restitution to customers, and pay investigatory costs and a fine to the state consumer protection office. • The Attorney General filed a lawsuit in 2008 against the group for violating the terms of their agreement and the state's consumer protection act. The court ordered the group to fulfill the terms of its previous agreement, pay a fine and costs of $180,000, and pay restitution of almost $2.6 million.
5	California	Federal Trade Commission	• Four related California companies lured more than 1,000 consumers into a debt settlement program through false promises of reducing debt, halting collection calls, removing negative credit report information, and holding payments in trust to settle accounts—from which, the FTC alleged, more than $2 million later went "missing." • FTC filed a complaint against the companies in August 2002, alleging that numerous consumers who enrolled in the program saw their indebtedness increase after incurring late fees, finance charges, and overdraft charges. Many ultimately filed for bankruptcy. • The federal court entered default judgments against all four companies, banning them from engaging in any debt settlement services and ordering them to collectively pay $1.7 million in restitution to consumers, among other actions.

Source: GAO analysis of case studies discussed below.

Case Study 1

An Arizona company and its affiliates used false advertising and deceptive marketing to fraudulently induce more than 500 New Yorkers into paying over $1 million in fees for a debt settlement program that left them with more debt, tarnished credit ratings, and increased collection calls and creditor lawsuits. The group told clients that consumers typically saved between 25 percent and 40 percent, including all fees and charges. It also promised to substantially reduce credit card debt in as little as 24 months. However, according to the New York Attorney General, only 0.3 percent of the company's clients realized these savings and few ever completed the program. Only 64 of the group's New York clients finished the program during the time period of the Attorney General's investigation (between January 2005 and September 2008); another 537 withdrew from the program after paying fees. Those who finished the program complained of being deceived and harmed by the group. Nearly half of them actually paid more than they owed. For example, one said, "I actually paid 87 percent more than what was originally due." Another said that the company "did not settle any of my accounts until I was actually sued by my creditors." A state court found the group liable for statutory fraud, ordered it to pay restitution to clients who completed the program but paid more than they owed, and prohibited it from doing business with consumers in New York unless it posted a $500,000 performance bond.

The group required clients to authorize electronic debits from their personal bank accounts in an amount that typically ranged between $300 and $1,000 each month, depending on the consumers' cash flow and expected settlements. The group told clients that once the funds accrued to a sufficient amount, it would negotiate with creditors for a settlement. Clients were instructed to stop making credit card payments during this time and to cease all communication with their creditors. The group did not include most of the program fees it charged in its calculation of the "savings" clients would achieve. The fees included the following: $399 for "set up"; an amount equal to three times the clients monthly payment for "enrollment"; $49 per month for administrative and bank fees; and an amount equal to 29 percent of the difference between the amount originally due and the settlement amount for a "final fee." The set-up and enrollment fees had to be paid in full before the group would allow money to accrue for a settlement.

The experience of one New York family exemplifies the harm suffered by the group's clients. According to a sworn statement the wife gave to state attorneys, the couple owed about $21,700 in credit card debt accumulated after the husband was laid off. In 2006, the wife received a call from a telemarketer saying that the Arizona company had looked into her family's credit history and found that it could cut their credit card debt in half. She and her husband joined the program and began making $325 in monthly payments to settle five accounts, even though they were current on their bills. "Who wouldn't want to save 50 percent on her credit cards?" the wife told state attorneys. The couple was advised to stop paying their creditors, which they did after being told by the company that no penalties and interest would accrue as a result. The couple was soon being harassed by their creditors, who called at all times of day, including evenings and weekends. Four of the couple's small accounts were settled during this time. However, the creditor with the largest balance, which totaled about $19,000, took the couple to court. The pair withdrew from the program and settled the lawsuit for $28,000, including $9,000 in penalties and interest. They subsequently had to pay this creditor $300 per month. The wife called this outcome "disastrous for us." Nevertheless, the couple received a "congratulations" letter from the company, saying the pair had paid only 79.3 percent of what was originally owed on the four settled accounts.

Documents that the couple gave state attorneys, however, show otherwise: after adding the $2,506 in fees they were charged, the pair actually paid more than 140 percent of what was originally owed on the four accounts. The wife told state attorneys that the Arizona company “failed our family in every respect, and we are counted as one of its success stories!”

Case Study 2

An attorney and his law firm associates defrauded about 15,000 clients seeking debt reduction help, causing them to lose millions of dollars and forcing legions of them to file for bankruptcy. The group lured consumers through television and radio advertisements, falsely claiming a 50 to 70 percent savings off unsecured debt, an improvement in credit scores and bankruptcy avoidance. The group, with offices initially in New York and later in Vermont, further promised that if clients did not receive a settlement, they would be entitled to a full refund. Clients paid fees for these services and funded escrow accounts from which their creditors were supposed to be paid. Under the terms of the contract that clients signed, the fees were not considered “earned” until consumer debts were settled. The group, however, did not reduce debt for most of its clients (only 8 percent completed the program, according to a witness cited by the U.S. Department of Justice) and failed to pay refunds to many of those who withdrew from the program or were forced into bankruptcy. Instead, the fees collected were used in part to fund huge payments to the attorney and two of his associates before they provided any services to clients. The client escrow accounts, meanwhile, were drawn upon to cover overdrafts from the law firm’s operating account and make payments to the attorney’s wife, among other things. The law firm filed for bankruptcy in 2003. A federal jury found the attorney guilty in 2005 on multiple felony counts, including fraud. His six associates pled guilty to federal charges.

To enter the law firm’s debt settlement program, clients signed an agreement that authorized monthly automatic deductions from their bank accounts. The first four payments often went into a retainer account to collect advance fees owed to the firm, despite the fact that the clients had pressing debt problems. The advance fees equaled about 25 to 28 percent of the total projected savings from the client’s debt settlement plan. Thereafter, about half of payments also were deposited into an escrow account to settle client debts held by creditors until the retainer account was fully funded. Subsequent monthly deductions went into escrow account until enough money accrued to make a settlement offer on behalf of the client. Although not formalized in written contract, many clients were instructed to stop making their minimum monthly payments to creditors. They were told that continuing to pay creditors would inhibit the firm's ability to reach a settlement.

One of the firm's New York clients who federal authorities interviewed enrolled in the debt settlement program after hearing an advertisement on the radio. The woman, who owed $60,000, was experiencing marital problems and feared becoming a single mother with small children and a large amount of debt. She called the toll-free number and arranged for a meeting at a New York office. One of the firm's associates, who later pleaded guilty to interstate transmittal of stolen money and preparing a false tax return, told her that the advance fees she paid would be held in trust until all of her debt was settled. She paid about $7,000 to $8,000 to the firm to settle her debts until one of her creditors obtained a judgment against her, causing her bank account to be frozen. When she contacted the firm to withdraw and ask for a refund, her calls were not returned. She ultimately filed for bankruptcy. The firm never secured a settlement on her behalf. She filed a civil lawsuit and won a default judgment against the firm for $10,000 including attorney fees, but told us she never recovered any money from the court decision. In relating her experiences with the debt settlement company, she described the attorney as "a ghoul and a vulture… preying on vulnerable consumers."

Case Study 3

Two Florida companies and their owners ran an illegal debt settlement business using unfair and deceptive practices, collecting over $500,000 from about 220 North Carolinians who rarely obtained the services they purchased and found themselves in far worse financial positions. North Carolina law prohibits anyone from acting as a for-profit intermediary between residents and their creditors for the purpose of reducing, settling or altering debt payments, except in limited circumstances. The state ban specifically includes situations where an individual is receiving advance fees to provide these services. To enforce these laws, the North Carolina Attorney General filed a complaint in February 2008 accusing the group of operating a "classic advance-fee scam, designed to extract up-front fees from financially strapped consumers whether or not any useful services are performed." The companies and their owners, one of whom was an attorney, marketed their services in part using numerous third-party "referral agents" who received compensation for directing consumers to the group. One such referral agent listed a local telephone number which, when dialed, actually rang a telemarketing "boiler room" in Massachusetts or Florida. The group and its agents told consumers that their unsecured debts could be reduced by up to 60 percent in as little as 1 to 3 years and thus avoid bankruptcy. The group typically charged clients an advance fee of 15 to 25 percent of their total debt, paid through monthly debits from their bank accounts. It also advised them to cease all communication and payments to creditors, stating that it could stop any harassment and provide "legal protection." When consumers were sued, however, the group gave them no legal assistance. They also experienced difficulty in contacting the group and were often put on hold, disconnected, or "given the runaround," state prosecutors said. Many clients dropped out of the program dissatisfied. Few received refunds or obtained settlements with their creditors. Many filed for bankruptcy. A North Carolina court found that the group's actions violated state law and banned the parties from doing any debt-related business with state residents. State prosecutors ultimately secured refunds for some of the group's clients. In a separate action in January 2009, the attorney also was disbarred for a period of 5 years.

An example of the service the group's clients received can found in the experience of a rural North Carolina couple. According to the wife's sworn statement, the pair found it increasingly difficult to meet their monthly financial obligations after the husband became ill and temporarily lost his income. They searched for ways to reduce their unsecured debt on the Internet and found what turned out to be one of the group's referral agents. They were told that the initial monthly payment of about $1,700 would be deducted from their bank account for the first 3 months of the program to cover attorney fees. Subsequent monthly payments of about $1,200 were to go towards settlements with creditors. The couple joined the program in hopes of avoiding bankruptcy and made their first installment in February 2007. Seven months later, the wife called the group for a status on her account and was told the couple had only accrued about $3,000 in savings, despite paying the group over $11,000 to date. She also learned that none of their credit accounts had been settled and they had been charged additional attorney fees of $499 each month. They withdrew from the program and demanded a full refund, since the group had done nothing "other than take our money with no accountability." The couple started receiving collection notices and threats of lawsuits. Their debts had now increased since they were no longer making payments to creditors. In an attempt to save their home from foreclosure, the couple filed for Chapter 13 bankruptcy. They also took second jobs as janitors to help pay off their debts. The wife told us that during the day she works as a bank teller and her husband is employed as an electrical engineer. One of their creditors suggested they call their state Attorney General. "My husband and I are worse off than before we entered into an agreement with (the group) for debt settlement services," the wife said in her sworn statement. The state Attorney General ultimately secured a full refund for the couple.

Case Study 4

A Maryland attorney, his law firm, and their marketers used unfair and deceptive trade practices to collect $3.4 million from about 6,200 clients over a 2-year period to settle debt but provided little or no services in return, causing harm to consumer credit histories and credit scores. The group told its clients that they could settle debts with creditors for half of the total amount owed, but either did not do so or negotiated agreements that saved significantly less than promised. Only $811,136—less than a quarter of the money the group collected— was either paid to creditors or refunded to clients. Moreover, about $240,000 was taken from client trust accounts to pay for the law firm's debt and expenses. The group told clients that its employees were qualified credit counselors capable of recommending the most appropriate action, but instead it provided virtually the same advice to everyone – enter debt settlement plans profitable for the group. The Maryland Office of the Attorney General began an investigation of the group because it was not licensed to provide debt settlement services in the state. The group reached an agreement in 2007 with the Attorney General, agreeing to immediately cease and desist selling unlicensed debt settlement services, pay restitution to customers, and pay investigatory costs and a fine to the state consumer protection office. However, the Attorney General filed a lawsuit in 2008 against the attorney, his law firm, and their marketers accusing them of continuing to provide debt settlement services, thus violating the terms of their agreement and the state's consumer protection act. The court ruled in favor of the Attorney General and ordered the group to fulfill the terms of its previous agreement, pay a fine and costs of $180,000, and pay restitution of almost $2.6 million. As of March 2010, the attorney had only paid $20,000.

Clients made numerous complaints to the Maryland Office of the Attorney General, detailing the financial harm they suffered from the group. A New Hampshire couple struggling to pay their bills joined the debt settlement program in August 2007 and authorized the firm to automatically deduct about $650 from their checking account each month, according to a letter they sent to the Attorney General. Although the couple had approximately $41,000 in credit card debt when they joined the program, the wife told us that they had a good credit history and had never missed a payment. However, she said that they were told they had to stop making payments to their creditors when they entered the program. The collection letters and phone calls from creditors started "arriving constantly" by the end of

September, the couple told the Attorney General. Threats of lawsuits followed 2 months later. The couple withdrew from the program in February 2008, after paying the firm $3,895 and receiving no relief from their debts. They told the Attorney General they were so far in default on their credit cards, with interest and fees added on top, that they considered bankruptcy to be the best option available to them. According to the wife, their credit score dropped from 720 down to 605 as a result of their experience with this debt settlement program. She added that they ultimately entered into a consumer credit counseling program after they learned that state law requires such counseling prior to bankruptcy. When asked to compare the two different debt relief programs, she said that credit counseling is "legit" and helps consumers to get out of debt, but that "debt settlement is a crock."

Case Study 5

Four related California companies lured more than 1,000 consumers into a debt settlement program through false promises of reducing debt, halting collection calls, removing negative credit-report information, and holding payments in trust to settle accounts—from which, FTC alleged, more than $2 million later went "missing." The companies' telemarketers told consumers that the group could cut their debt by as much as 60 percent in exchange for a nonrefundable fee, thus improving their financial status. The companies did not disclose that the fees typically amounted to hundreds or thousands of dollars. They said that the monthly payments withdrawn from consumers' bank accounts would be held in trust to settle their debt at a reduced amount. Consumers were instructed to immediately stop paying their unsecured creditors so that they would be considered a "hardship," putting them in a better position to negotiate settlement terms. The companies stated that they would contact the creditors and tell them to cease all contact with their customers, thus preventing collection calls. They also told consumers that any negative information that appeared on their credit report would be removed at the conclusion of the program.

FTC filed a complaint against the companies in August 2002, alleging that numerous consumers who enrolled in the program saw their debt increase after incurring late fees, finance charges and overdraft charges. Negative information often appeared on the consumers' credit reports—such as charge-offs, collections and wage garnishments—and will stay on their record for a period of up to 7 years. FTC determined that in numerous instances, the companies did not contact consumers' creditors or collectors, nor did they return calls. FTC later determined that more than $2 million the companies collected to be held in trust for making settlements was missing. Given their worsened financial condition, many consumers ultimately filed for bankruptcy. The federal court entered default judgments against all four companies, banning them from engaging in any debt settlement services and ordering them to collectively pay $1.7 million in restitution to consumers, among other actions. FTC brought suit against four executives of the companies, but these cases ended in settlement agreements without any liability or fault established. As part of the settlements, however, the executives agreed to be permanently banned from participating in debt settlement services and to pay between approximately $220,000 and $2.6 million, depending on the amount of consumer injury that stemmed from their activities. The monetary judgments were largely suspended, except in two instances where the executives surrendered property and other assets to help satisfy what they owed, because of their inability to repay consumers.

The experience of a secretary from Riverside, Calif., illustrates the harm that FTC determined the companies to have caused consumers. She joined the program after receiving an e-mail in August 2000 and being told by a representative from one of the companies that she could be completely out of debt in 16 months, according to a written statement she gave to FTC under penalty of perjury. At the time, she made about $27,000 a year, owed a total of $7,000 in credit card debt and was making little progress towards reducing her balances given that her salary barely covered rent, food, car payments, and insurance. The company also offered a debt management class, which she stated had appealed to her because she wanted to learn how to better manage her money. She never received the promised training, though, despite asking for it several times. Three months after she joined the program, letters from creditors started arriving threatening legal action if she did not pay. Counselors with her debt settlement company told her to ignore them, calling the move a “scare” tactic. She started to panic after she received a court summons in late 2000 stating that a lawsuit had been filed against her. A counselor again told her not to worry, that everything would be okay. After a court summons arrived from a second credit card company, a counselor told her to fax the documents to the company and that staff would deal with it. The state courts, however, entered two judgments against her in March 2001. She later received notice that her wages would be garnished by 25 percent. “I was frantic,” she stated. “I was barely making ends meet on my salary.” By July 2001—less than a year after the secretary entered the debt settlement program—her credit card debt had more than doubled to about $15,000, because of late charges, interest, and other fees. She filed for bankruptcy that same month. She later sued the company that enrolled her in the program and settled for what she had paid in program fees, about $1,700, plus court costs.

Mr. Chairman, this concludes our statement. We would be pleased to answer any questions that you or other members of the committee may have at this time.

Appendix I: Debt Settlement Companies

Table 4 below summarizes examples of fraudulent, deceptive, abusive or questionable information provided by the 20 debt settlement companies we called. We have referred these cases, as appropriate, to the Federal Trade Commission (FTC).

Table 4: Representations Made by Debt Settlement Companies We Called

No.	Location of company and affiliates	Fees[a]	Association membership[b]	Case details
1	Florida; affiliates in Florida, Massachusetts, California, and New Jersey[b]	• Advance fees based on 15% of enrolled debt, with monthly payments required throughout program	The Association of Settlement Companies (TASC);[c] affiliates in TASC and United States Organizations for Bankruptcy Alternatives (USOBA)	• Marketing Web site that referred us to two affiliates • Representative from one affiliate (a member of USOBA) stated "everyone who enters the program makes the independent decision to stop paying their creditors" • Identified through spam e-mail message received by one of our investigators • Web site advertised "New Government Programs!" and "If we can't get you out of debt in 24 hours we'll pay you $100" • Representatives claimed high success rates—93% and 100% • Representative from USOBA-member affiliate claimed that "worst case scenario" for our settlements would be "40 cents on the dollar," and that "every single creditor settles." He also promised that hiring his company would ensure that calls from creditors would "slow down and eventually stop" • Representative from TASC-member affiliate claimed that TASC was "like the SEC for stock traders" and serves as the regulating body for the industry • Owner of company acknowledged TASC logo featured on Web site despite company not being a member of TASC • For further details, see section on "Company 1" in this testimony

No.	Location of company and affiliates	Fees[a]	Association membership[b]	Case details
2	Unknown; affiliates in Arizona, Texas, and California[b]	• Advance fees based on 12% of enrolled debt • First three monthly payments go to fees • $25 monthly maintenance fee • Additional contingent fee based on 4% of reduction in debt company obtains for clients	Affiliate in USOBA	• Marketing Web site that referred us to at least three affiliates • Representatives from two affiliates told us we would not make our monthly payments to creditors while in the program • Representative from one affiliate told us we could not afford debt settlement and suggested that we consider bankruptcy as an alternative • Web site advertised "Reduce balances to 40% - 60%," "Eliminate excessive Credit Card Debt interest immediately," and "End late payment fee's [sic]" • Company's radio advertisements claimed "government approved" and "government authorized" debt settlement • Representative from one affiliate stated creditors would send letters to us indicating that our settled accounts are considered "paid in full" • For further details, see section on "Company 2" in this testimony
3	California	• Advance fees based on 16% of enrolled debt, with monthly payments required throughout program • First three monthly payments go to fees • $100 fee for out-of-state clients	TASC (at the time of our call)	• Web site targeted at Christian consumers • Multiple representatives told us we would not make payments to our creditors once we entered company's program • Representative told us that stopping payments to our creditors would "knock [our credit score] down a couple of points," and that our credit would only be affected while we were in the program • Representatives claimed that program has 85% success rate, that lawsuits from creditors were "just random" and did not require an attorney, and that they would negotiate our debt down to 40 to 60% of what we owed • Representative told us that creditors would report our accounts settled for less than the full balance as "paid in full" or "paid as agreed" • Owner told us during our site visit that the company recently dropped its TASC membership due to rising costs • For further details, see section on "Company 3" in this testimony

No.	Location of company and affiliates	Fees[a]	Association membership[b]	Case details
4	California	• Advance fees based on 17% of enrolled debt, with monthly payments required throughout program • First three monthly payments go to fees • $840 maintenance fee (total throughout program) • $623.50 trust account fee (total throughout program)	TASC	• Company advertised "U.S. National Debt Relief Plan," with a logo depicting a shield filled with a U.S. flag • Representative stated that, upon entering the program, we would "no longer be making payments to your creditors on a monthly basis" • Representative justified first three monthly payments going only to fees as necessary because it covered initial set-up costs and "to show that you have the commitment to be in the program" • For further details, see section on "Company 4" in this testimony
5	California	• Advance fees based on 15% of enrolled debt	TASC (at the time of our call)	• Representative told us we were too poor for debt settlement and advised us to consider bankruptcy as an alternative; later described company's debt settlement program • Representative stated that we could not continue paying our creditors while in company's program • After our undercover call but prior to release of this testimony, company appears to have gone out of business • For further details, see section on "Company 5" in this testimony
6	Texas	• Advance fees based on 15% of enrolled debt, with monthly payments required during first 24 months (program length unknown)	Unknown	• Representative stated that "One-hundred % of our clients stop making those [credit card] payments" in order for program to work; later directed us to divert money from paying creditors to account from which company withdraws fees • Representative advised us to give company's telephone number to creditors as our telephone number, to avoid calls from creditors • Representative stated "basically what we do is…we negotiate with your creditors to basically cut your bills in half. So when we go to negotiate, we go to negotiate at 50 cents on the dollar. That's what we guarantee. Now, we can also get less," and added as an example one major bank that he claimed "normally settles" for only 30 cents on the dollar. • Represented their program could prevent creditors from suing us or garnishing our wages

No.	Location of company and affiliates	Fees[a]	Association membership[b]	Case details
7	California	• Advance fees based on 10% of enrolled debt, with monthly payments required during first 12 months (of estimated 38-month program)	Unknown	• Advertises "National Debt Relief Stimulus Plan" • Representative told us we would stop paying our creditors, and that "the only thing you're going to have to worry about is this payment here [company's fees]" • Representative stated that lawsuits were a "scare tactic" • Web site states it can "Prevent Creditor Harassment" • Representative claimed company could reduce our balances so that we would pay "anywhere from 30 to 60 % on what you owe"
8	Texas	• Advance fees based on 12% of enrolled debt, with monthly payments required during first 15 months (of estimated 48-month program) • First four monthly payments go to fees	TASC	• Regarding payments to our creditors, representative stated "you're gonna have to cut them off so that they haven't received anything" • Representative claimed "every account that we work on will be at least 40 cents on the dollar"
9	Texas	• Advance fees based on 15% of enrolled debt, with monthly payments required during first 12 months (of estimated 24-month program)	Unknown	• Representative stated that "one-hundred % of our clients stop making their monthly payments as soon as they enroll into the program" • Representative encouraged us to explore other debt relief options as well as debt settlement • Name of company changed during our investigation
10	Texas	• Advance fees based on 17% of debt, with monthly payments required during first 19 months (of estimated 48-month maximum program)	USOBA	• Representative stated that upon enrolling in company's program "you would no longer make any of your credit card payments. All of them would go late" • Representative claimed to "negotiate your debt down to 50 % or less of what you owe" • Representative said advance fees paid for attorneys who would "look at" our account monthly • Representative was unable to explain refund policy by telephone • Representative suggested we change our address on billing statements to address for company's attorneys

No.	Location of company and affiliates	Fees[a]	Association membership[b]	Case details
11	Florida	• Unknown—only received recorded information	Unknown	• Telephone number listed on Web site went to a 7-minute recording • Recording stated that we would stop paying our creditors upon entering program • Recording claimed to send letters to credit bureaus that would "remove any late marks that you may have received on the account"
12	California	• Advance fees based on 15% of enrolled debt	Unknown	• Front-end marketing company, with 28 different Web sites used to solicit customers for referral to one debt settlement company • Representative stated that affiliate handling actual settlement process would call us back; we did not receive a return call
13	Texas	• Advance fees based on 10% of enrolled debt, with monthly payments required throughout program	USOBA	• Representative stated that program does not work for everyone, but does work for everyone who has a hardship • Representative stated company's services are helpful to consumers "because we allow [consumers'] accounts to go delinquent and past due and into collections" • An e-mail sent after our call stated that upon enrolling in the program, "we will inform your creditors that you will no longer be making payments on the accounts"
14	Arizona	• Advance fees based on 12.9% of enrolled debt, with monthly payments required during first 10 to 12 months (of estimated 30-month program)	Unknown	• Representative stated that "9 out of 10 of our clients are current," but stop making payments when entering program • When asked whether to stop paying accounts that are current, representative replied "Absolutely"
15	California	• Advance fees based on 15% of enrolled debt • First three monthly payments go to fees • $30 monthly maintenance fee • $14.50 monthly trust account fee	TASC	• Representative stated that she could not interfere with our obligation to pay our creditors, and encouraged us to continue making payments if we could afford to do so at the same time as saving for settling debts • Representative later stated that if we could continue making our minimum payments "maybe this [debt settlement] isn't the best solution for you"

No.	Location of company and affiliates	Fees[a]	Association membership[b]	Case details
16	Florida	• Contingent fees based on 35% of reduction in debt company obtains for clients • First monthly payment goes to enrollment fee • $53 monthly maintenance fee	USOBA	• Web site targeted at Christian consumers • Representative stated that "you stop paying everybody. That's what makes you qualify. You fall behind." • Company's contract states there is a $1,000 termination fee for dropping out of the program • Representative suggested that we could pay our initial fee with a credit card • Representative offered to also provide us information on debt consolidation loans, to determine which option would be best
17	California	• Advance fees based on 18% of enrolled debt, with monthly payments required during first 18 to 24 months (of estimated 36-month program)	USOBA	• Representative encouraged us to take care of our late mortgage payments before worrying about paying off or settling our credit card debts
18	Unknown	• Advance fees based on 15% of enrolled debt, with monthly payments required throughout program • First three monthly payments go to fees	Unknown	• Web site targeted at Christian consumers • Web site describes one of the "blessings" of its program as "Immediate increase of spendable cash-flow [sic]" • Representative told us the program is based on our stopping payments to creditors
19	Maryland	• Advance fees based on 15% of enrolled debt • $9.85 monthly bank fee	Unknown	• Representative stated that it "wouldn't make sense" to continue making payments while in a debt settlement program • Representative said that program "works for some" but is "not great for others," and that company discourages consumers from debt settlement if they plan to buy a house soon, due to credit score damage
20	California	• Unknown—representative said we did not have enough debt to qualify for program	TASC	• Representative stated that we did not have enough debt to qualify for the company's debt settlement program

Source: GAO analysis of information obtained from debt settlement companies.

[a]Fee information reflects fees disclosed to us; some companies may charge additional fees that were not disclosed. Debt settlement companies typically charge fees requiring payments either at the beginning of the program as an advance fee or after each settlement as a contingent fee. Some companies structure the payment of advance fees so that they collect a large portion of them—as high as 40 percent—within the first few months regardless of whether any settlements have been obtained or any contact has been made with the consumer's creditors. Others collect fees throughout the first half of the enrollment period in advance of a settlement. Companies that charge a contingent fee generally base it on a certain percentage of any settlement they actually obtain for consumers. They sometimes charge a small, additional fee every month while consumers are busy attempting to save funds for settlements. FTC has criticized advance fees, stating that consumers often suffer irreparable injury as a result of paying them in advance of receiving services. The agency maintains that the practice of taking fees before a settlement is obtained results in a number of adverse consequences for consumers: late fees or other penalty charges, interest charges, delinquencies reported to credit bureaus that decrease the consumer's credit score, and sometimes legal action to collect the debt.

[b]Some companies we called referred us to one or more affiliates. It was not always clear to us exactly with which company or affiliate we were speaking, where the companies or affiliates were located, or what the relationships were between the companies and affiliates. In some cases, separate affiliates of the same company claimed to be members of different industry trade associations.

[c]While Company 1 claimed to be a member of TASC, it appears this was a false representation.

Appendix II: GAO Contacts and Staff Acknowledgments

GAO Contacts

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov.

Contacts points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony.

Staff Acknowledgments

GAO staff who made major contributions to this testimony include Cindy Brown Barnes, Assistant Director; Andy O'Connell, Assistant Director; Christopher W. Backley; Amy E. Brown; Eric Charles; Scott Clayton; Ken Hill; Jennifer Huffman; Appleton Kamdoum; Jason Kelly; Barbara Lewis; Natalie Maddox; Doug Manor; Steven Martin; Vicki McClure; James Murphy; Mark Needham; and Ramon Rodriguez.

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