

September 24, 2010

**Re: Support for S. 3264 - Debt Settlement Consumer Protection Act of 2010**

Dear Senator:

Our organizations, representing millions of consumers across the United States, strongly support the Debt Settlement Consumer Protection Act of 2010 -- S. 3264, sponsored by Senator Charles Schumer; and H.R. 5387 sponsored by Representative Luis Gutierrez. We ask you to cosponsor this important legislation to protect Americans from harmful debt settlement industry practices, and to support it.

It is crucial to enact this legislation as soon as possible to protect vulnerable consumers from the effects of harmful debt settlement practices.

The debt settlement industry claims that it will help consumers negotiate with creditors to pay off debts for less than the amount owed. Debt settlement providers encourage consumers to stop paying their creditors and instead accumulate money in a special account to fund later settlements. However, debt settlement companies generally deduct fees directly from those savings *before* any debts are settled, and keep taking fees every month, even if they never settle one penny of the consumer's debt. Since creditors are not getting paid, they may increase collection activity and even sue.

Recent amendments to the FTC's Telemarketing Sales Rule concerning debt relief services do not eliminate the need for this bill. The FTC's rule addresses the timing of the fees, but does not cap the amount of allowable fees and does not tie the amount of the fees to the amount of the savings. Additionally, the new FTC protection does not cover consumers who enter into debt settlement contracts without incoming or outgoing phone calls, such as Internet-placed orders or through in-person sales.

The Debt Settlement Consumer Protection Act of 2010 imposes a "pay for results" approach to debt settlement fees. It addresses the central abuses of the debt settlement industry; capping fees at a \$50 enrollment fee<sup>1</sup> plus 5% of the real savings from each completed or paid settlement<sup>2</sup>, among other protections<sup>3</sup>.

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<sup>1</sup> S. 3264/H.R. 5387 § 1004 (c)(2)

<sup>2</sup> S. 3264/H.R. 5387 § 1004 (d)(2)

<sup>3</sup> S. 3264/H.R. 5387 § 1011

Debt settlement was identified in the March 2009 issue of *Consumer Reports* as one of five “financial traps.”<sup>4</sup> In June 2010, the *New York Times* on consumer problems with debt settlement services, stating:

Consumers rarely emerge from debt settlement programs with their credit card balances eliminated ... and many wind up worse off, with severely damaged credit, ceaseless threats from collection agents and lawsuits from creditors<sup>5</sup>

In April 2010 Congressional testimony, the US Government Accountability Office (GAO) described the results of its investigation into the debt settlement industry.<sup>6</sup> The GAO found that:

- **17 of the 20 debt settlement companies charged fees before debts were settled.**<sup>7</sup>
- **Debt settlement companies provided fraudulent information and deceptive practices to lure vulnerable customers** with claims of unusually high success rates. According to the GAO, in several cases, success rates were quoted as being “85 percent, 93 percent, and even 100 percent.” The GAO reported that industry surveys show a far lower rate of completion of debt settlement programs – 34.4%, even when the industry defined “completion.”<sup>8</sup>
- **Debt settlement companies often leave consumers worse off** than if they had never entered into the debt settlement contract.<sup>9</sup> GAO mystery-shopped 20 debt settlement companies and reported that only one told the shopper that debt settlement was not appropriate for that individual.<sup>10</sup> The GAO said that the experiences of its mystery shoppers were “consistent with widespread complaints and charges made by federal and state investigators on behalf of real consumers.”<sup>11</sup>

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<sup>4</sup> “Financial Traps are Flourishing, Tough Times Have Bred Five Costly Come Ons: High Fee Debt Settlement”, *Consumer Reports*, March 2009; <http://www.consumerreports.org/cro/magazine-archive/march-2009/money/scams/high-fee-debt-settlement/scams-high-fee-debt-settlement.htm>

<sup>5</sup> Goodman, Peter. “Peddling Relief, Firms Put Debtors in Deeper Hole.” *New York Times*. June 18, 2010. <http://www.nytimes.com/2010/06/19/business/economy/19debt.html?emc=eta1>

<sup>6</sup> United States Government Accountability Office, Testimony Before the Committee on Commerce, Science, and Transportation, U.S. Senate, Debt Settlement: Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers, Statement of Gregory D. Kutz, Managing Director Forensic Audits and Special Investigations, GAO-10-593-T April 22, 2010, available at <http://www.gao.gov/new.items/d10593t.pdf>

<sup>7</sup> GAO-10-593-T, April 2010. p.7

<sup>8</sup> GAO-10-593-T, April 2010. pp. 10, 11, FN4

<sup>9</sup> One consumer example provided in the GAO testimony said that “even though the debt settlement company cost her more than she originally owed, it still counted her as a success story.” (p.1)

<sup>10</sup> Clips from these test shopping experiences can be heard at: <http://www.gao.gov/products/GAO-10-593T>.

<sup>11</sup> GAO-10-593-T, April 2010. p. 21

- **The GAO “identified allegations of fraud, deception, and other questionable activities involving hundreds of thousands of consumers,” and it stated that this “likely underestimates the total number of consumers affected.”<sup>12</sup>**
- **The Better Business Bureau (BBB) designated debt settlement as an “inherently problematic” type of business because of the nature and the volume of consumer complaints. The BBB developed criteria for a debt settlement company to demonstrate that it did not fall under the “inherently problematic” category, such as substantiation for advertising claims, procedures to screen out consumers who are inappropriate candidates for debt settlement, and a threshold that at least half of the customers receive significant debt reduction in an amount exceeding the fees charged. However, no debt settlement company “had yet successfully demonstrated that it met these criteria.” The GAO quoted officials for two leading debt settlement trade associations who characterized the BBB 50% success rate criteria as an “unrealistic measure.”<sup>12</sup>**

The debt settlement industry does not have a good record of helping consumers become debt-free. An industry survey, filed with the Federal Trade Commission (FTC) and cited in the GAO report (p. 11 and fn. 14), included a study of large debt settlement companies within the TASC trade association membership showing that nearly two thirds of the consumers still had from one quarter to all of their debt three years after enrolling in debt settlement.<sup>13</sup> The GAO also reported that another source showed that less than 10% of consumers successfully completed debt settlement programs between 2006 and 2008. (p.10).

In light of its poor record of eliminating debt, the debt settlement industry’s method of charging fees is especially harmful to consumers. Debt settlement companies typically charge consumers 14-18% of the entire debt amount, deduct fees monthly from consumers’ savings accounts, and collect the entire fee by the end of the first half of the contract. Consumers pay front-loaded fees long before any debts settle, and the companies keep these fees even if only a small portion, or even none, of the debt is settled.

Consumer problems with debt settlement are illustrated in the 128 enforcement actions brought by 21 states against debt relief companies for unfair or deceptive trade

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<sup>12</sup> GAO-10-593-T, April 2010. pp. 11-13

<sup>13</sup> The Association of Settlement Companies (TASC), October 26, 2009, comments to the FTC on the proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services, p. 9-11. <http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00202.pdf>.] Survey showed that only 34.4% of consumers who started debt settlement three years earlier had either “substantially completed” their debt settlement plans or were still actively saving for settlements. Only 24.6% had eliminated at least 75% of their debt; while 9.8% were still trying to get rid of their debts through settlement three years after starting debt settlement.

practices.<sup>14</sup> In these cases, the Attorneys General describe adverse consequences for many consumers of entering into debt settlement contracts, including:

- Fees were collected, but services were not provided;
- Interest, and often penalties, continue to accrue on the debt, and the amount the consumer owes will continue to increase;
- Collection activity will likely increase following the cessation of payments;
- Stopping regular payments on debts to put money aside for debt settlement, will harm the consumer's credit record;
- The consumer can still be sued on the debts; and
- The consumer's wages and bank accounts can still be garnished.

S. 3264 and H.R. 5387 would give consumers the best protection – no fees if there are no results and a specific cap on fees once there are results. The Debt Settlement Consumer Credit Protection Act will require that debt settlement fees be based on the savings achieved from the amount of the enrolled debt. Companies that produce timely results would earn timely fees, creating a strong incentive for debt settlement companies to sign up only those consumers to whom they reasonably expect to be able to deliver results. Consumers will be protected from paying high fees for no results, and from paying fees full fees for partial results.

In addition to the fee reform, the Debt Settlement Consumer Credit Protection Act prevents other common unfair and deceptive practices; provides an ample right to cancel,<sup>15</sup> requires clear disclosures about adverse consequences that may accompany debt settlement,<sup>16</sup> and addresses advertising claims.<sup>17</sup> The legislation also requires debt settlement companies to perform a financial analysis before signing up consumers, and to accept only those consumers for whom they determine that the program is suitable.<sup>18</sup>

Now is the time to protect financially vulnerable consumers. S. 3264 and H.R. 5387, the Debt Settlement Consumer Protection Act of 2010, will go far to curb the proven abuses in the debt settlement industry.

We ask you to join as a cosponsor of the Debt Settlement Consumer Protection Act of 2010.

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<sup>14</sup> National Association of Attorneys General (NAAG) comments to the FTC on proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services, October 23, 2009, <http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00192.pdf>

<sup>15</sup> S. 3264/H.R. 5387 §1006

<sup>16</sup> S. 3264/H.R. 5387 §1002 (b)(5)(B)

<sup>17</sup> S. 3264/H.R. 5387 §1009

<sup>18</sup> S. 3264/H.R. 5387 §1002 (c)

Very truly yours,

Gail Hillebrand  
Consumers Union

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Consumer Federation of America

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Sally Greenberg  
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