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BUREAU OF
CONSUMER PROTECTION

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

COMMISSION AUTHORIZED

May 22, 1992

The Honorable Robert W. Ney
Chairman, Financial Institutions and Insurance Committee
Ohio State Senate
State House
Columbus, Ohio 43226-0604

Dear Senator Ney:

The staff of the Federal Trade Commission is pleased to submit this letter in response to your request for comments on Senate Bill 323.[1] This Bill would regulate the operation and sales practices of "credit services organizations," and is clearly targeted at firms in the business of "credit repair." A substantial segment of the credit repair industry engages in deceptive practices that injure both the general public and individual consumers, presenting pervasive problems even in states that have enacted laws to regulate credit repair organizations. In our experience, credit repair firms rarely do what they promise. Clear, effective disclosures and other requirements included in S.B. 323, such as requiring that credit repair services actually be performed before the consumer must pay for them, are thus likely to benefit consumers and help deter frauds that threaten the integrity of the entire consumer reporting system. We strongly support this proposed legislation, and offer here our views on the industry and on some of the particular features of S.B. 323.

I. Interest and Experience of the Staff of the Federal Trade Commission

The staff of the Federal Trade Commission, upon request of federal, state, and local governmental bodies, comments on regulatory proposals that may affect competition or consumers. The staff has filed comments with the Colorado State Senate and Indiana House of Representatives on legislation to regulate credit repair

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[1] These comments are the views of the staff of the Bureau of Consumer Protection of the Federal Trade Commission and are not necessarily the views of the Commission or those of any individual Commissioner.

organizations.[2] The Commission and its staff have testified before the U.S. Congress on the Federal Credit Repair Organization Act, which was introduced to combat fraudulent practices in the credit repair industry,[3] and on provisions of recently proposed amendments to the Fair Credit Reporting Act ("FCRA") that would deal with credit repair organizations.[4] The staff has investigated and the Commission has brought a number of enforcement actions against the kind of companies that would be covered by S.B. 323.[5]

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[2] See Letter from Claude C. Wild III, Director, Denver Regional Office, to the Honorable Tom Norton, Colorado State Senate (February 21, 1989); letter from C. Steven Baker, Director, Chicago Regional Office, to the Honorable R. Michael Young, Indiana House of Representatives (February 9, 1990).

[3] Commission letter to the Honorable Frank Annunzio, U.S. House of Representatives (May 11, 1987); testimony of Jean Noonan, Associate Director for Credit Practices, Federal Trade Commission, before the Subcommittee on Consumer Affairs and Coinage of the House Committee on Banking, Finance, and Urban Affairs (September 15, 1988), on H.R. 458. A copy of the 1987 letter is attached to this letter for your reference.

[4] Testimony of Janet Steiger, Chairman, Federal Trade Commission, and David Medine, Associate Director for Credit Practices, before the Senate Committee on Commerce, Science, and Transportation, January 9-10, 1992; testimony of Jean Noonan, Associate Director for Credit Practices, before Subcommittee on Consumer Affairs and Coinage, Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, June 6, 1991.

[5] See, e.g., FTC v. Steven Leff, No. CA3-89-2046-H (N.D. Tex., consent decree filed August 16, 1989); FTC v. American Credit Services, Inc., No. 89-3651-KN (C.D. Cal., consent decree filed May 10, 1991); FTC v. Credit Repair, Inc., No. 89-C-0344 (N.D. Ill., consent decree filed March 7, 1990); FTC v. Nationwide Credit, No. 88-4071 (E.D. La., permanent injunction granted, October 19, 1989); FTC v. S&L Professional Credit Clinic, Inc., CA3-90-2307-P (N.D. Tex., complaint filed October 3, 1990); FTC v. NCS Credit Network Inc., No. 90-3650 (N.D. Cal., complaint filed December 21, 1990); FTC v. Credit One Services, Civil Action No. C 92 1577 BAC (N.D. Cal., complaint filed April 28, 1992); FTC v. Michael Jay & Co., Civil Action No. 91-0448 JMI (C.D. Cal., consent decree filed May 18, 1992).

II. Description of S.B. 323

S.B. 323 ("Bill"),[6] if enacted, would establish a detailed and extensive program of regulating credit repair organizations. The Bill would apply to "credit services organizations" ("CSOs"), which it defines in terms of particular services that a firm provides, or represents that it can provide, for compensation. These services are: improving a consumer's credit record, history, or rating; obtaining a loan or credit for a consumer; assisting in either improving a consumer's credit record or obtaining credit; "removing adverse credit information that is accurate and not obsolete" from a consumer's credit record; or altering a consumer's identification to prevent the display of credit history.[7] The Bill would exempt most legitimate firms involved with consumer credit, such as banks, licensed or regulated lenders, nonprofit consumer credit counselors, and creditor-funded consumer reporting agencies.[8]

S.B. 323 would require a CSO to make extensive written disclosures to a consumer before a contract could be executed. The required disclosure statement would describe the services the CSO would provide and the services' costs, explain the consumer's rights against the required security bond and identify the bond surety, and state the availability of non-profit credit counseling services. Finally, the disclosure statement would include, verbatim, a prescribed detailed statement about the FCRA and the consumer's rights.[9] The required statement describes the consumer's rights under the FCRA to a copy of a credit report and the procedures to correct erroneous information on the report. The statement refers to the state law and notifies the consumer of the right to sue under the law and to cancel the contract with the CSO for any reason within three days. In addition, it states explicitly that neither the consumer nor any credit repair or credit services organization has the right to remove accurate, current information, and that accurate information cannot be perm-

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[6] Citations are to the provisions of the Ohio Revised Code that S.B. 323 would enact.

[7] §4712.01(c)(1).

[8] §4712.01(c)(2). The Bill would also require a CSO to register before doing business and renew the registration annually. §4712.02(A), (H)(1). The registration would disclose the identity of the CSO's owners and any prior or pending litigation, designate an in-state agent for service of process, and include the CSO's standard consumer contract. A surety bond of $100,000 would be required. The bond amount would be available to pay damages to consumers. §4712.06.

[9] §4712.04.

anently removed from credit report files. It sets out the FCRA's time limitations, of seven years for most information and ten years for bankruptcy. The document containing all of these disclosures must be signed by the consumer and the CSO must retain a copy of the signed statement for two years.[10]

Under the Bill, a CSO could not accept payment until after its services were performed.[11] In addition, a CSO could not accept payment solely for referring a consumer to a provider of credit or a credit bureau, unless credit were actually granted as a result of the referral.[12] In general, S.B. 323 prohibits making false or misleading representations in the offer or sale of credit services. In particular, it prohibits asserting that adverse credit history can be cleared up unless the assertion also states clearly that this is possible only if the history is inaccurate or obsolete, and prohibits guaranteeing that the CSO can get credit extended regardless of the consumer's credit history.[13]

As tools for enforcement, the Bill would prohibit advertising CSO services without registration, failing to maintain a statutory agent for service, transferring a certificate of registration, and failing to maintain logs and documentation.[14] As sanctions, the Bill would authorize consumer lawsuits for damages, administrative cease and desist proceedings, injunction actions by the state Division of Consumer Finance, revocation of CSO registration, and criminal penalties.[15]

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[10] Some of these disclosures are also required on the contract itself; in addition, the contract must include all guarantees and promises of refunds, an estimate of how long the services will take (which must not be longer than 60 days), the CSO's address and that of its agent for service, and the CSO's success rate. §4712.05.

[11] §4712.07(A).

[12] §4712.07(B).

[13] §4712.07. The Bill also prohibits making or advising consumers to make false statements about their credit capacity, and submitting disputes to a credit bureau without the consumer's knowledge and written authorization.

[14] §4712.07.

[15] §§4712.12, §§4712.03, §§4712.99.

Our comments are addressed principally to the Bill's required disclosures and certain of the specific prohibitions.[16]

III. Background of the Credit Repair Industry

Fraudulent companies that lead consumers to believe that they can "repair" their bad credit histories have bilked consumers of millions of dollars in the past several years, have caused consumer reporting agencies to waste time and money reinvestigating spurious disputes, and have been the focus of numerous enforcement actions by the Federal Trade Commission and state and local enforcement authorities.[17]

The credit repair business is a relatively recent and rapidly growing phenomenon, marketing services to consumers whose credit bureau reports contain negative information that makes it hard for them to obtain further credit. The principal method these businesses rely upon to improve credit bureau reports is the dispute procedure available to consumers under Section 611 of the FCRA.[18] This procedure is designed to be a self-help mechanism that consumers can use to correct credit reports containing inaccurate or incomplete information. Correcting and updating such information benefits both consumers and creditors by helping to insure that credit-granting decisions are based on information that is complete and accurate.

Our experience indicates that, for most consumers who purchase credit repair services, the principal goal is not to have inaccurate information corrected. It appears instead that many turn to credit repair organizations hoping to minimize significant and legitimate credit problems that they have experienced. Although their credit reports may contain minor inaccuracies, by and large the negative information in the reports is accurate. Therefore, using the FCRA's dispute procedures is unlikely to improve the reports' accuracy significantly.

Yet credit repair companies often mislead consumers to expect that their credit reports can be improved even if the reports are accurate. In fact, if adverse information reported by the credit bureau is accurate, the FCRA permits it to be reported for at least

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[16] Except as noted, we express no opinion as to the other provisions of the Bill.

[17] In addition to the law enforcement actions cited in n. 5, the Commission's efforts against credit repair fraud have included law enforcement investigations and consumer education programs.

[18] 15 U.S.C. §1681.

seven years. Bankruptcy may be reported for ten years. Although credit repair companies occasionally succeed in improving consumers' credit bureau reports, most often they fail.

Credit repair companies may charge from $50 to $1500 for their services, with a fee of $400 to $500 per client appearing to be typical. Commission staff believe that more than fifty percent of credit repair businesses move, or go out of business, in the first year of operation without having delivered the services their clients have paid for. Since the clients are usually told that credit repair takes time, they often do not realize they have been defrauded until the company has disappeared. Consumers who are victims of fraudulent operations not only lose the fees they have paid but may also suffer from having in the meantime forgone other steps to put their credit back on firm ground.

The proliferation of fraudulent credit repair companies is a matter of serious concern to the FTC and to other law enforcement bodies across the country. To combat the problem, the FTC has adopted a two-pronged strategy of educating consumers about the problem and bringing enforcement actions against fraudulent operators. The FTC has filed complaints in federal district court against six credit repair companies; four of these companies have signed consent decrees to settle the charges.[19]

Because the credit repair industry is elusive and fragmented, it is difficult, if not impossible, to determine how big the industry is or to estimate accurately how much economic harm consumers have suffered. The harm caused by credit repair fraud extends beyond the purchasers of credit repair services. Consumers and businesses alike benefit from a properly functioning credit reporting system, which is crucial to the maintenance of a healthy economy. If abuses by fraudulent credit repair companies impede that system's effectiveness, both consumers and legitimate business are victims.[20]

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[19] See cases cited in n. 5. The Commission files a complaint when it has "reason to believe" that the law has been, or is being, violated, and it appears to the Commission that a proceeding is in the public interest. The complaint is not a finding or ruling that the defendant has actually violated the law, and a consent decree is for settlement purposes only and does not constitute an admission of a law violation; however, consent decrees have the force of law, which means that the FTC can seek civil penalties against companies that violate their consent orders.

[20] At one time, instruction manuals and training seminars appeared that taught how to open and operate a credit repair company. Such marketing may have stimulated the growth of the credit repair industry despite efforts by law enforcement

The methods used by credit repair companies can affect the credit reporting system adversely. The credit repair companies' most common method is to dispute everything on a consumer's report, either at one time or in "dispute rounds." This strategy aims to overwhelm the system with so many disputes that reverification is impossible within a reasonable period of time.[21] If information cannot be reverified, either because the creditor does not respond or the creditor acknowledges that there has been a mistake, it must be removed. Usually, this strategy does not work, because the credit reporting agency reverifies the information with the creditor and the accurate information stays in the consumer's report. But sometimes accurate information is removed; when that happens, creditors may be injured and creditworthy consumers lose the benefit of a reliable credit reporting system.

IV. Disclosure Requirements

In general, caution is usually recommended in imposing elaborate and detailed affirmative disclosure obligations, because they may increase firms' costs and reduce business efficiency. But we believe that an exception to this general rule is warranted by the current state of the credit repair industry, because of the high incidence of fraud. Certain increased costs imposed by complete disclosures written in simple, non-technical language are likely to be outweighed by the benefits of providing consumers with more truthful information.

One of these benefits is that disclosure may reduce a credit repair company's ability to misrepresent what it can do for consumers. In the staff's experience, consumers who seek the help of credit repair companies lack basic knowledge about the FCRA and how the credit reporting system works. Of particular importance, they often do not understand that accurate, adverse information will almost never be removed from their credit histories until it becomes obsolete. Consumers who do not realize that fact easily fall prey to exaggerated or false claims.

In our view, the disclosures that S.B. 323 would require should go far toward correcting that problem. Many of them follow closely language that the Commission and the staff recommended for mandatory disclosures in federal legislation proposed to regulate

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authorities to establish controls.

[21] Under § 611 of the FCRA, when a consumer disputes an item, the credit bureau must reinvestigate that item unless it decides that the dispute is frivolous or irrelevant. Upon reinvestigation, information that is found to be inaccurate or incomplete must be corrected and information that cannot be verified must be deleted.

credit repair firms.[22] Required language should simply and succinctly explain the limitations on circumstances under which a consumer or a credit repair company may improve consumer reports, and advise consumers of their rights to sue a credit repair company and to cancel a credit repair contract within a certain period of time. To be most effective, any required disclosure should be conveyed in simple, non-technical language, on a separate document, before a consumer signs a contract or pays a fee, and the required disclosure should be specified in model language set out in the law.[23]

The adoption of a short, simple required disclosure statement conveying information that consumers can easily comprehend will leave less room for fraudulent operators to prey on vulnerable consumers. Based on our experience, we believe that leaving specific disclosure language to each CSO's discretion might result in disclosures that, although accurate and complete, are purposely written in language consumers perceive to be long and complex. Such legalistic disclosures might have the unintended effect of aiding the fraudulent operator rather than assisting the consumer. A favorite ploy of fraudulent operators is to represent that their

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[22] See n. 3 supra. Similar legislation has been introduced in the present Congress, as H.R. 29.

[23] In its comments on the federal Credit Repair Organizations legislation, see n. 2, the Commission proposed the following language:

1. You have no legal right to have accurate information removed from your credit bureau report. Under the Fair Credit Reporting Act, the credit bureau must remove accurate negative information from your report only if it is over seven years old. Bankruptcy can be reported for 10 years. Even when a debt has been completely repaid, your report can show that it was paid late if that is accurate.

2. The Credit Repair Organizations Act also gives you the right to cancel your contract for any reason within three working days from the date you sign it.

3. The Federal Trade Commission enforces these federal laws. For more information, call or write:

   Division of Credit Practices
   Federal Trade Commission
   Washington, D.C. 20580
   (202) 326-3233

methods comply with the law and that they possess special expertise in interpreting and using the FCRA's dispute procedures. Some states with disclosure requirements still have substantial problems with credit repair fraud, in part, perhaps, because their laws do not specify simple, explicit disclosures.[24]

V. Prohibited Practices

The Commission has strongly supported proposals, like that in S.B. 323, to bar a credit repair firm from receiving reimbursement before its services are performed.[25] Similar provisions are included in the credit repair laws of New York and Tennessee and in the proposals now pending to amend the federal FCRA. This approach resolves in advance the problem of making the consumer whole after the perpetrator of a fraud has fled. Although stringent, it is an approach that the Commission has said is warranted, given the credit repair industry's history of consumer fraud. In our experience, credit repair firms rarely do what they promise, so the service-now-pay-later approach would put the fraudulent operators out of business.

S.B. 323 would also prohibit a CSO from charging a fee solely for referring a consumer to a provider of credit or a credit bureau, unless credit were actually extended as a result.[26] In the past, the staff of the Commission has questioned whether prohibiting CSOs from charging for referrals addresses a practice that is necessarily deceptive or injurious to consumers.[27] A complete prohibition may be broader than necessary to protect

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[24] While we have had opportunities to review in other contexts many of the disclosures that S.B. 323 would require, we have not previously studied the costs and benefits to consumers of requiring CSOs to disclose their success rates in providing credit repair services. Thus, we are less confident about this requirement's desirability. We note that requiring the disclosure of CSO success rates may raise some difficult questions of interpretation and application. In addition, it might, ironically, make possible another deception: CSOs intent on fraud could lie about high success rates while claiming to be fulfilling a legal disclosure obligation. Thus they might attract more consumers with this deception than would CSOs providing services honestly, who would report much lower numbers.

[25] See statements cited in n. 3 and n. 4.

[26] §4712.07(B).

[27] See, e.g., comment to Indiana, n. 2, and letter to Representative Annunzio, n. 3, supra.

consumers from misrepresentations by CSOs about credit extended by others. Instead, such a prohibition may deny consumers a valuable source of information about credit availability. The limited prohibition set out in S.B. 323 may discourage unscrupulous CSOs from resorting to a related method of separating consumers from their money without providing a service in return. However, because the Bill's definition of covered CSOs is broad enough to include firms that are engaged only in credit referral services, the constraints might also impair firms that offer credit referral services but are not engaged in the kinds of credit repair fraud that are the Bill's principal targets.

Credit referral services could be of value to consumers. To establish a good credit record, a consumer may first need to obtain a line of credit from which a credit history can be built. Thus, a consumer might value a clearinghouse of information about those businesses that are likely to extend credit to consumers who have had credit problems. A consumer may not have access to this information without the assistance of a third party, which could be a CSO covered by S.B. 323. If, through the assistance of a CSO, a consumer who cannot otherwise obtain credit is able to do so, the consumer may consider this a worthwhile service and be willing to pay for it. Whether the credit is offered on terms that are desirable to the consumer will depend on the financial circumstances and options available to the consumer.

The critical issue, in our view, is whether consumers understand what they are purchasing. Declaring it unlawful for CSOs to charge a fee for providing this assistance might remove the CSOs' incentive to provide information that consumers may otherwise be willing to purchase. The approach of S.B. 323, although less drastic than a complete ban, might still inhibit firms from offering consumers desirable services. Although some misrepresentations would be curbed because CSOs would make no money from illusory referrals, some useful services would also be curbed because CSOs would make no money from good faith referrals that proved unsuccessful.

S.B. 323 applies to CSOs, as defined by services provided, but exempts a wide range of institutions that may provide some of these same services.[28] The services that define a covered CSO include

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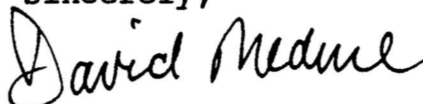
[28] The bill appears to be drafted to place one particular type of business, CSOs, under very tight scrutiny. This is reflected in many of its administrative requirements, such as advance registration and surety bonding. In the past, the Commission has questioned the effectiveness of bonding requirements by pointing out, for example, that truly unscrupulous operators would probably not bother to comply with them. <u>See</u> statements cited in n. 3. Consequently, the promise of funds to repay consumers in this

not only credit repair, but also other services, such as assisting in obtaining credit, that are often performed by firms that are not in the credit repair business. The long list of exemptions is apparently needed so that these other firms would not be subject to new regulatory requirements. Another approach that might be considered would be to draft the legislation and regulations to apply only to firms that are engaged in the credit repair function. The firms covered because of their credit repair operations might also be subject to closer regulation of their other operations as well, if the legislature found it warranted. In our experience, such a targeted approach may make possible a simpler definition of the firms to be regulated, without the need for a lengthy list of exemptions. By addressing only credit repair firms, it might avoid impairing firms offering legitimate credit referral services.

VI. Conclusion

On balance, S.B. 323, if enacted, would represent a strong and valuable contribution to combatting the serious problem of credit repair fraud. Please let me know if you have any questions concerning this letter or if we can be of further assistance.

Sincerely,



David Medine
Associate Director for
Credit Practices

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manner might be illusory.

OFFICE OF THE CHAIRMAN

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

May 11, 1987

The Honorable Frank Annunzio
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Annunzio:

Thank you for your recent letter forwarding a copy of H.R. 458, the Credit Repair Organizations Act, to the Federal Trade Commission. We appreciate the opportunity to comment on the proposed legislation.

The credit repair business appears to be a relatively recent phenomenon. It involves the marketing of credit repair services to consumers whose credit bureau reports contain negative information that interferes with their ability to obtain credit. The principal method such businesses rely upon to improve consumers' credit bureau reports is the dispute procedure available to consumers under Section 611 of the Fair Credit Reporting Act (FCRA). Section 611 is designed to provide consumers with a self-help mechanism to correct credit reports that contain inaccurate or incomplete information. Correcting and updating such information benefits creditors as well as consumers by helping to ensure that credit-granting decisions are made on the basis of complete and accurate information reflecting the probable creditworthiness of the consumer.

It does not appear, however, that most consumers who employ the services of a credit repair organization seek to correct inaccurate information. Based on the monitoring experience of Commission staff, it appears instead that many of those who turn to credit repair organizations have experienced significant credit problems in the past, which they hope to minimize.[1] Although minor inaccuracies may appear in their credit reports, by and large the adverse information that is reported about them fairly reflects what actually occurred. Utilization of FCRA dispute procedures is, therefore, unlikely to aid these consumers. Nonetheless, through advertisements and oral representations, credit repair organizations often lead consumers to

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[1] The Commission brought an enforcement action against six credit repair practitioners in 1986 (see Federal Trade Commission docket numbers C-3185 through C-3190) and presently is monitoring the activities of several others.

believe that adverse information in their credit reports can be deleted or modified regardless of its accuracy. In fact, however, if adverse information reported by the credit bureau is accurate, under the FCRA it may be reported for at least seven years. Bankruptcy may be reported for ten years. Although the FCRA does not require credit bureaus to report adverse information for this period of time, it explicitly authorizes them to do so. Credit bureaus, which are in the business of selling credit history information to creditors, ordinarily report such information for as long as is legally permissible.

It appears that credit repair organizations occasionally improve consumers' credit bureau reports, but fail to do so in most instances -- principally because most of the information they dispute is accurate and within the permissible reporting period. Their services are frequently sold on a money-back guarantee basis, but consumers have reported difficulties in obtaining refunds. The company may be out of business, lack the funds to pay by the time consumers seek refunds, or simply refuse to honor the guarantee. Credit repair organizations have caused economic injury to credit bureaus as well as to consumers by generating large numbers of groundless disputes that credit bureaus must process. To the extent that a credit repair organization does succeed in deleting accurate adverse information from a consumer's credit history, creditors are deprived of information that might otherwise have been a decisive factor in the credit-granting decision. Creditors have expressed concern to the Commission that deletion of accurate information may result in increased lending risk.[2]

The Commission's staff believes that a substantial segment of the credit repair industry presently engages in practices that injure both the general public and individual consumers. Whether

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2 Credit bureaus are required by Section 611 of the FCRA to reinvestigate disputed information within a reasonable period of time and to delete information that they cannot verify. A credit bureau may delete accurate information from a consumer's credit bureau report because, for example, it is overwhelmed by disputes generated by credit repair organizations or because creditors fail to respond promptly to verification requests.

the potential scope of this problem justifies enactment of federal legislation is an issue for Congress to decide.[3] As the primary law enforcement agency, however, the Commission believes that it has a unique perspective to contribute if Congress chooses to enact such legislation. In our view, the proposed legislation would be strengthened by changing its focus somewhat.

H.R. 458 would impose a bonding requirement on credit repair organizations. It also would provide consumers with the right to sue and to obtain payment from a surety when a credit repair organization violates the terms of the statute. The Commission opposes this approach because we have serious reservations about how well it would work in practice. The way that the bond is intended to function is far from clear. In addition, administration of a bonding requirement involves oversight and enforcement responsibilities that are better undertaken by the states than the federal government, in our view.

From the perspective of public law enforcement, the Commission believes that requiring disclosures about the FCRA's limited basis for changing credit reports would protect consumers more simply and effectively. Their right to sue a credit repair organization that engages in deception should also be disclosed. Moreover, although we believe that the proposed private right of action for consumers may aid in enforcing the law, we think that enforcement of the Credit Repair Organizations Act would be enhanced considerably if Congress were to grant the Commission authority to seek civil penalties for violations of its provisions. The ensuing comments discuss these issues in more detail. They also suggest narrowing the definition of a credit repair organization and eliminating one of Section 404's prohibited practices.

Disclosure Requirements: Section 405

The Commission supports the inclusion of effective disclosure requirements in this legislation. Despite educational efforts,

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3 Although we are aware of a few large credit repair organizations, a great many others appear to be small and relatively unstable. We have no basis for estimating the number of customers they currently attract or predicting whether their clientele may diminish in the near future as a result of consumer education and unfavorable publicity.

many consumers continue to be unaware of the FCRA's rules governing the reporting of information by credit bureaus. As a result, these consumers are easily misled by credit repair organizations that offer to repair or improve their credit histories. Requiring credit repair organizations to disclose information about the FCRA prior to execution of a sales contract should reduce their ability to misrepresent what the credit repair process is likely to achieve. The Commission believes that the focus of the disclosures required under Section 405(b) of the proposed legislation should be shifted, however. Section 405(b)(1) requires a credit repair organization, prior to the execution of a contract, to disclose to consumers their right to review their own credit files and to dispute the completeness or accuracy of information contained therein. The effect of this section is to bar a credit repair organization that only sells information about consumers' rights to correct information concerning their credit record, credit history, or credit rating from charging a fee for making this information available to consumers.[4] There is no apparent reason for a prohibition of this sort. Other businesses and professions routinely charge for the disclosure of information about rights and opportunities provided by law; indeed, this is a key component in the provision of many professional services.

Moreover, the disclosures required by Section 405(b)(1) do not address what appears to be the principal cause of injury to consumers in their dealings with credit repair organizations. Injury does not arise because credit repair organizations, for a fee, exercise rights that consumers could exercise themselves at little or no cost. Instead, consumers are injured when they pay money to an organization to do something that neither that organization nor they themselves can accomplish. We think that disclosures explaining instead the limited circumstances under which credit history information must be altered by credit bureaus would provide consumers with an informed basis for evaluating a credit repair organization's claims and that this is their best protection. It may also be worthwhile to require disclosures that consumers may sue a credit repair organization if it engages in deception and that they may rescind any contract within three days of signing it. Finally, we think it would be helpful to identify the Federal Trade Commission as the relevant law enforcement authority, so that consumers with questions will know whom to contact.

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4 Of course, this concern is less significant to credit repair organizations that also sell services for the purpose of improving a consumer's credit record, credit history, or credit rating.

There are two additional sets of disclosures that Section 405 presently requires. Section 405(b)(2) requires a complete and detailed disclosure of the services to be performed and the total amount to be paid for these services, disclosures which are duplicated in Section 406 governing the content of contracts. We question the utility of requiring a detailed description of services to be performed. Even a minutely detailed description could easily avoid conveying clear and definitive information about what will be done in the case of an individual consumer. Section 405(b)(3) requires disclosure of the consumer's right to proceed against a bond and identifies the surety. Information about the right to proceed against a bond clearly would be significant to consumers if Congress should decide to retain the bond requirement. However, for reasons discussed in the ensuing section, we do not endorse a bond requirement.

We suggest that, to be most effective, any required disclosures be conveyed on a separate sheet of paper, in simple, non-technical language, before the consumer signs a contract or the credit repair organization receives any payment. So as to avoid possible obfuscation, we recommend that credit repair organizations be required to follow language that is identical or substantially similar to model language proposed by Congress.

For example, the required disclosure might begin with a warning not to sign a contract or pay money for credit repair services before reading the notice. It might then state:

1. You have no legal right to have accurate information removed from your credit bureau report. Under the Fair Credit Reporting Act, the credit bureau must remove accurate negative information from your report only if it is over 7 years old. Bankruptcy can be reported for 10 years. Even when a debt has been completely repaid, your report can show that it was paid late if that is accurate.

2. You have the right to sue a credit repair or credit improvement company that violates the Credit Repair Organizations Act. This law prohibits deceptive practices by credit repair companies.

3. The Credit Repair Organizations Act also gives you the right to cancel your contract for any reason within 3 working days from the date you sign it.

4. The Federal Trade Commission enforces these federal laws. For more information, call or write:

   Division of Credit Practices
   Federal Trade Commission
   Washington, D.C. 20580
   (202) 326-3225

For enforcement purposes, each disclosure statement should be signed by the consumer as an acknowledgement of having read it before entering into the contract. The consumer's name, address, and telephone number should be included, as should the sales agent's signature and the company's name, address, and telephone number. The statement should be signed in duplicate, so that the consumer may retain one copy and the credit repair organization may retain the other for the two-year period that, we assume, Section 405(c) would require.[5]

We believe that these disclosures would effectively warn consumers against contracting with credit repair organizations whose businesses are based on explicit or implicit misrepresentations of what the law permits. However, these disclosures should not adversely affect the activities of credit improvement counselors who do not rely on consumers' ignorance of the credit reporting laws or otherwise attempt to mislead them.

Bonding Requirements: Section 404(a)

The proposed legislation requires a credit repair organization to obtain a $50,000 surety bond if it wishes to obtain payment for services in advance of performance. A surety is a third-party guarantor who promises to pay if the principal does not and requires a percentage of the bond amount for providing this assurance.[6] The percentage is often small because the

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5 It would facilitate both compliance and enforcement if the evidence that a credit repair organization should retain to demonstrate compliance under Section 405(c) were set forth in greater detail.

6 We assume that indemnification of this sort is what the legislation is intended to produce. It is our understanding that surety agreements take many different forms, however, and are designed to achieve many different purposes.

surety retains the right to recover the amount paid from the principal. In order to obtain a bond a company must persuade the surety that it is a good risk. In the case of a credit repair organization, we assume that a surety would want some assurance that the organization's practices will conform to the law and that, as a result, the organization is not likely to be held liable for violating the law. Prior business experiences, business and personal credit history, income, assets, and other indicia of reliability may be factors in determining whether an organization is able to obtain a bond. A business that does not appear to be sufficiently risk-free ordinarily would be required by the surety to put up collateral corresponding to the amount of the bond. Under the proposed legislation, a company that cannot or does not wish to obtain a surety bond is not barred from the credit repair business. Although it would be prohibited from receiving fees prior to performing the services it sold, it could obligate consumers in advance to pay for services upon completion of performance.

The purpose of the proposed bond requirement, we assume, is to make funds available for the payment of consumers' claims. The Commission is concerned that it may not serve this purpose in practice, however. Businesses that are engaged in deliberate consumer fraud may well ignore the bonding requirement. Moreover, the requirement may be too amorphous to achieve its intended purpose. The legislation does not outline in any detail how the bond is to function or who is to administer payments from it. It does not explain what procedures are to be followed in the event of competing claims that exceed the bond amount or whether the bond amount of $50,000 must be continuously maintained. It is not clear from the statutory language whether an organization that does business in more than one state must provide for a $50,000 bond in each state or whether, alternatively, a single $50,000 bond issued by a surety licensed to do business in each of those states would suffice.[7] It also is unclear whether residents of one state may make claims against a bond issued in another state when the bond funds in their state of residence have been paid out. Nor is it clear whether consumers are intended to name the surety as a defendant in an

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[7] Credit repair organizations vary considerably in operational structure (franchises are becoming more common), size, and business volume. If Congress should decide to include a bond requirement in this legislation, we suggest that it examine ways to link the value and number of bonds required to variables such as these.

action or to seek payment from the surety only if conventional efforts to satisfy a judgment from the credit repair organization have been exhausted.

Insurers who issue surety bonds, such as government performance bonds or indemnity guarantees, may well be reluctant to issue any bond pursuant to this legislation, regardless of the character of the credit repair organization at issue. Sureties ordinarily want to know that their obligations and liabilities are fixed and clear before agreeing to act in this capacity. Under the law as presently drafted, few if any insurers may be willing to act as sureties for credit repair organizations. Even if the bonding requirement and consumers' access to it were spelled out in more detail, however, we are not persuaded that it should be included in federal legislation. The equitable distribution of bond funds may be difficult or impossible without the intervention of a disinterested third party, such as a state administrative agency. On balance, the Commission believes that the bonding of credit repair organizations should be left to the states to legislate and administer.

Enforcement: Sections 409 and 411

Section 409 of the Act provides consumers with the right to sue for a violation of any of its provisions. It provides for actual damages, additional damages, costs of bringing the action, and attorney's fees. By providing consumers with a mechanism for recovering, at a minimum, the fees paid to a violative organization, this right of private action should help to make the statute self-enforcing.

Nonetheless, the Commission believes that enforcement of any credit repair organization legislation Congress might enact would be strengthened considerably if Congress were to grant the Commission civil penalty enforcement authority for violations of its terms.[8] At present, Section 411 of the proposed legislation

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8 Congress typically accords the Commission civil penalty authority by authorizing enforcement of statutory violations as if they were violations of a Commission trade regulation rule, i.e., through Section 5(m)(1)(A) of the Federal Trade Commission Act, which empowers the Commission to seek civil penalties. See Section 704(c) of the Equal Credit Opportunity Act, 15 U.S.C. § 1691c; Section 814(a) of the Fair Debt Collection Practices Act, 15 U.S.C. § 1692l.

accords only administrative enforcement authority to the Commission. It provides that a violation of its terms constitutes an unfair or deceptive act or practice in violation of Section 5(a) of the Federal Trade Commission Act and is enforceable through the Commission's administrative adjudication procedures under Section 5(b). The Commission currently possesses Section 5 enforcement authority over credit repair organizations.[9] Thus, as proposed, the grant of authority to enforce the credit repair statute would not expand the Commission's powers, although the affirmative requirements of the law would simplify enforcement to some extent.

By including civil penalty authority in the Act, Congress would accord the Commission greater flexibility in selecting enforcement alternatives and would also, we believe, promote more vigorous enforcement. Particularly in cases involving deliberate fraud, the power to require a company to disgorge its profits through imposition of a civil fine may be the only way to address adequately the violative conduct.[10] Because civil penalty actions are brought and resolved in federal court, the final order -- whether it involves injunctive relief, a civil fine, or more -- is directly enforceable by the court. The contempt powers available to the court are a potent tool if compliance problems arise.

Precedent exists in the federal consumer credit protection field for establishing a range of enforcement mechanisms. Congress has accorded the Commission the authority to seek civil penalties for violations of the Equal Credit Opportunity Act and the Fair Debt Collection Practices Act under sections providing for administrative enforcement. Other sections of these statutes provide for the imposition of civil liability by authorizing consumers to bring private damage suits. The Commission's enforcement experience with these laws indicates that different enforcement approaches can serve different but often complementary enforcement goals. As a result, we believe that allowing the Commission to seek civil penalties for violations of this Act would assist enforcement efforts.

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[9] The enforcement activity referred to in footnote 1 above was based on that Section 5 authority.

[10] The credit repair business is often a transient one. When a company moves from state to state, the likelihood that individual consumers or local law enforcement authorities will succeed in bringing an action against it is substantially reduced.

Businesses Subject to the Act: Section 403(d)

The definition of a credit repair organization in Section 403(d), like most of the provisions of the proposed legislation, focuses on businesses selling credit repair or credit improvement services, i.e., services to remove adverse information from consumers' credit bureau reports. The definition of a credit repair organization appears to be needlessly broad, however. It includes entities that, for a fee, provide services for the purpose of "obtaining an extension of consumer credit for a consumer. . . ." This definition would include, for example, automated mortgage loan shopping services and other businesses that sell information about currently available terms and conditions of credit. Such businesses can provide an important consumer service in a credit-oriented economy and should not be subjected to regulation in the absence of evidence that they cause consumer injury. We therefore recommend that the definition of a credit repair organization be revised to eliminate reference to those who assist in obtaining credit extensions for consumers. Individual businesses that make false claims about their ability to obtain credit for consumers are, we believe, better dealt with on a case-by-case basis under Section 5 of the Federal Trade Commission Act or similar state consumer protection laws.

We note that the proposed legislation presently exempts a number of institutions and professions from the definition of a credit repair organization. Depository institutions, real estate brokers, and broker-dealers appear to be exempted because, in the ordinary course of business, they may assist consumers in obtaining credit. If Congress adopts the foregoing recommendation to redefine a credit repair organization, these exemptions may be unnecessary. The Commission is not aware that such entities ordinarily sell services to consumers for the purpose of improving their credit bureau reports. We suggest that the exemptions for consumer reporting agencies and debt collectors be eliminated as well. Neither of these entities advises or assists consumers in improving credit bureau reports for a fee.[11]

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11 When credit bureaus remove negative information that is inaccurate or obsolete they may improve consumers' credit reports. Because this is not a service that credit bureaus may charge for but a right granted to consumers by the FCRA, credit bureaus would not fall within the definition of a credit repair organization. Services that credit bureaus are permitted to charge for are described in Section 612 of the FCRA.

Under this approach only two exemptions remain -- nonprofit organizations and attorneys. Nonprofit organizations, such as the consumer credit counseling services operated by the National Foundation for Consumer Credit, sometimes charge a small fee for advising consumers about credit history problems. Attorneys may also advise or assist their clients concerning their credit histories and their rights under the Fair Credit Reporting Act.

In the Commission's view it is preferable to avoid exemptions when possible. Exemptions can create enforcement gaps.[12] They give a competitive advantage to one group or profession over another. Regulations necessarily impose some burdens on business and, if regulation is necessary, the underlying rationale ordinarily should be equally applicable to all industry members. We suggest therefore that Congress consider whether the definition of a credit repair organization should provide for any exemptions. Particularly if the bonding requirement is eliminated, as the Commission has proposed, complying with the affirmative requirements of the Act should not be unduly onerous.

Prohibited Practices: Section 404(b)

Section 404(b) of the proposed legislation prohibits charging fees solely for referring a consumer to a retail seller who will or may make credit available to the consumer on substantially the same terms as those available to the general public. If Congress revises the definition of a credit repair organization to exclude those who refer consumers to creditors for possible credit extension, it may wish to delete this provision as well, as it appears to be directed at practices associated with credit referral rather than with credit repair.

In any event, the Commission questions whether the practice that this section addresses necessarily injures consumers.[13] If, through the assistance of a credit repair organization, a consumer who cannot otherwise obtain credit is able to do so, the consumer

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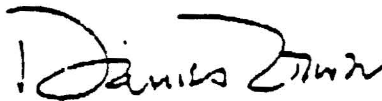
12 For example, the attorney-at-law exemption to the Fair Debt Collection Practices Act was recently repealed because it had become a haven for attorneys who practiced debt collection rather than law.

13 Moreover, if this practice were injurious, the Commission is not certain why the injury would arise only in connection with credit extended by retail sellers as opposed to other categories of creditors.

may well deem this a service worth paying for. The critical issue, in our view, is not whether the credit to be provided is available to others on the same terms or even on more favorable terms, but whether the consumer understands what he or she is paying for. Whether the credit is offered on terms that are desirable to the consumer will depend on the financial circumstances and options available to that consumer.

Thank you again for soliciting the Commission's views on the Credit Repair Organizations Act. We hope that these comments will be useful in your deliberations.

By direction of the Commission,



Daniel Oliver
Chairman