

**Prepared Statement of
The Federal Trade Commission**

before the

**Permanent Subcommittee on Investigations
Senate Committee on Governmental Affairs**

on

Consumer Protection Issues in the Credit Counseling Industry

March 24, 2004

I. INTRODUCTION

Mister Chairman and members of the Committee: I am Thomas Leary, Commissioner at the Federal Trade Commission ("FTC" or "Commission").⁽¹⁾ I appreciate the opportunity to appear before you today on behalf of the Commission to discuss consumer protection issues raised in the credit counseling industry. This statement will describe the industry generally, discuss various practices by some of its members that raise consumer protection concerns, and summarize FTC law enforcement and educational efforts in this area.

As an initial matter, it is helpful to understand the Commission's role in enforcing laws that bear on the credit counseling industry. As part of its broad mandate to protect consumers, the Commission enforces the Federal Trade Commission Act ("FTC Act"), which prohibits unfair or deceptive acts or practices that are in or affect commerce.⁽²⁾ The Commission also enforces a number of specific consumer protection statutes, including several relevant to credit counseling, such as the Telemarketing and Consumer Fraud and Abuse Prevention Act,⁽³⁾ the Credit Repair Organizations Act,⁽⁴⁾ and the Gramm-Leach-Bliley Act.⁽⁵⁾

Under its general consumer protection authority, the Commission focuses its resources on a variety of matters of importance to consumers. In addition to examining the significant consumer protection concerns raised by credit counseling services, the subject of today's hearing, the Commission's recent efforts have included:

- **Launching "Do Not Call."** In January 2003, the Commission adopted an amendment to its Telemarketing Sales Rule establishing the National Do Not Call Registry. Within 72 hours after the FTC opened the Registry, consumers had enrolled over 10 million telephone numbers. By its effective date in October 2003, the Registry contained over 53 million telephone numbers and now tops 58 million numbers. A recent Harris Poll found the Registry to be remarkably successful, with over 90 percent of participating consumers reporting a reduction in telemarketing calls.
- **Law Enforcement Against Fraud and Deception.** The FTC targets the most pervasive types of fraud and deception for law enforcement actions. During the past twelve months, the FTC has filed law enforcement actions targeting work-at-home schemes, Internet scams, online auction fraud, deceptive subprime lending practices, advance fee credit scams, and deceptive health, safety, and weight loss claims, among others. During fiscal year 2003, the FTC obtained multiple federal district court orders in these cases, resulting in more than \$448 million in consumer redress.
- **Consumer Privacy and Identity Theft.** This year, the agency undertook aggressive enforcement actions to protect consumers' privacy and prevent identity theft and other misuses of personal information.

Among other things, the agency targeted deception aimed at eliciting personal information from consumers, deceptive spam, and deceptive claims about the security provided in online transactions. In addition, the FTC is currently in the process of issuing a variety of rules to implement statutes just passed by Congress to address spam, consumer credit, and identity theft.

Among the Commission's top priorities this year in the fraud and deception area was stopping abuses within the credit counseling industry. In this area, it is important to note that the FTC Act excludes from the Commission's authority entities that are not organized to carry on business for their own profit or that of their members.⁽⁶⁾ Therefore, the Commission does not have jurisdiction under that Act over credit counseling agencies ("CCAs") that are *bona fide* non-profit organizations.⁽⁷⁾ The mere fact that a CCA has received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, however, does not by itself remove the CCA from Commission jurisdiction. The Commission may assert jurisdiction over a CCA with 501(c)(3) status if the CCA in fact carries on business for profit, including by operating for the purpose of distributing profits or other economic benefits to for-profit entities or individuals.⁽⁸⁾ Thus, our cases in this area have two prongs: first, we must prove that the credit counseling company is in fact a for-profit entity within the meaning of the FTC Act; and second, we must prove that the company violated consumer protection laws. Because of these two prongs, our cases and investigations in this area are particularly fact-intensive.

In recent months, the FTC has actively used its array of law enforcement and educational tools to address its concerns about credit counseling abuses. Highlights of these efforts, discussed in more detail below, include:

- **Law Enforcement.** In November 2003, the FTC filed a lawsuit alleging a variety of deceptive practices by AmeriDebt, Inc., one of the nation's largest CCAs, its former service provider (DebtWorks, Inc.), and DebtWorks' owner, Andris Pukke. At the same time, the Commission entered into a settlement with the Ballenger Group, LLC, AmeriDebt's service provider since January 1, 2003, for its role in the deception. In related areas, the Commission has brought two lawsuits against debt negotiators, and numerous cases against credit repair organizations. The Commission is also currently conducting several non-public investigations of additional CCAs, debt negotiators, and related entities.
- **Consumer Education.** The Commission has issued a variety of consumer educational materials so that consumers can spot fraud and deception and take action to avoid it.
- **Coordination with Other Government Agencies.** The Commission is working with the Internal Revenue Service and the states to address concerns in this area. For example, the FTC, IRS, and state regulators recently issued a joint press release highlighting troubling practices within the industry and providing tips for choosing a credit counselor. The FTC has also coordinated its enforcement efforts with the state attorneys general.

As these efforts show, the FTC Act grants the agency considerable authority to pursue abuses within the credit counseling industry and engage in related educational and policy activities. Therefore, we do not have legislative recommendations at this time.

II. THE CREDIT COUNSELING INDUSTRY

The credit counseling industry has been in existence for about 50 years, providing valuable services to innumerable financially distressed consumers. Typically, the work of CCAs on behalf of their consumer clients is both present and future directed: to help debt-strapped consumers to manage their existing financial problems and to teach them better financial management skills for the future. CCAs historically have been relatively small, community-based non-profit organizations providing consumers with individualized advice and assistance. For these services, most traditional CCAs either charge nothing or solicit modest contributions from clients to help defray their expenses. As explained below, CCAs also can be funded by creditors through so-called "Fair Share" contributions.

CCAs have a number of options to offer their financially-distressed clients, depending on the client's individual circumstances, which range from simple advice and guidance on managing finances to (in extreme cases) advising that consulting a bankruptcy attorney may be the consumer's best option. In addition, CCAs, since the industry's inception, have offered to put

certain clients into a payment program commonly termed a "debt management plan" ("DMP"). DMPs allow consumers to pay off their unsecured debts, such as credit card balances, by making a single, consolidated monthly payment to the CCA, which then disburses those funds to the creditors of debts covered by the DMP. DMPs can also benefit creditors by forestalling consumer bankruptcy. Importantly, traditional CCAs evaluate each client's individual circumstances and needs before deciding whether to enroll that person in a DMP.

When administered properly, DMPs can benefit consumers because some creditors will reduce interest rates and waive certain charges, such as late and over-the-limit fees, for consumers on a plan. Most creditors and some state laws require CCAs to be non-profit entities before they can arrange payment plans for consumers, apparently for the purpose of eliminating the incentive for CCAs to deceive consumers. However, we are concerned that some CCAs may be evading these requirements by setting up non-profit entities that funnel money to for-profit affiliates.

DMPs generate revenue for CCAs in two ways. First, some creditors voluntarily rebate to CCAs a small percentage of the funds that the organizations disburse to them. These payments are called "Fair Share" contributions.⁽⁹⁾ Second, some CCAs solicit "contributions" or "donations" from DMP enrollees, usually consisting of up-front and monthly fees. As discussed later, some CCAs appear to have turned these ostensibly voluntary contributions into *de facto* mandatory fees by automatically deducting money from consumers' payments without adequate disclosure.

In the last decade, the credit counseling industry has experienced dramatic growth, attributable in large part to ballooning consumer debt and the resulting demand for credit counseling to prevent default on that debt. The nature of the industry has also changed. Whereas it was once composed mainly of small, local credit counselors, the last decade has seen the rise of large, high-tech organizations that aggressively market their services to consumers via telemarketing, broadcast and print advertising, and the Internet. These organizations, many of which claim non-profit status, represent a new breed in this industry. Many appear to offer little or no individualized credit counseling, but rather urge all of their clients to enroll in a DMP without consideration of their particular financial situations.

III. CONSUMER PROTECTION ISSUES

Along with these changes in the industry have come complaints about troubling practices, including possible deception about the services offered, poor administration of DMPs, and undisclosed fees associated with DMPs.

The Commission is concerned about deceptive and other illegal practices in which some CCAs may be engaging. Our greatest concern is deception by CCAs about the nature and costs of the services they offer to consumers. The following practices have come to our attention that may violate the FTC Act or other statutes that we enforce:

- *Misrepresentations about fees or "voluntary contributions."* Some CCAs may charge substantial fees (sometimes denominated as "donations" or "voluntary contributions") that they hide from consumers. For example, some CCAs may automatically retain for themselves certain payments consumers make on their DMPs, unless the consumer affirmatively objects. These CCAs may not adequately disclose this fact.
- *Promising results that cannot be delivered.* Some CCAs appear to be marketing DMPs with promises that they will lower consumers' interest rates, monthly payments, or overall debt by an unrealistic or

unattainable amount. Some organizations also appear to be exaggerating the amount of money consumers will save by signing up for a DMP, or are promising falsely to eliminate accurate negative information from consumers' credit reports.(10)

- *Abuse of non-profit status.* As noted above, some unscrupulous CCAs misrepresent that they are non-profit to comply with state laws and creditor guidelines regarding the arrangement of payment plans for consumers. In addition, some CCAs appear to use their 501(c)(3) status to convince consumers to enroll in their DMPs and pay fees or make donations. These CCAs may, for example, claim that consumers' "donations" will be used simply to defray the CCA's expenses. Instead, the bulk of the money may be passed through to individuals or for-profit entities with which the CCAs are closely affiliated. Tax-exempt status also may tend to give these fraudulent CCAs a veneer of respectability by implying that the CCA is serving a charitable or public purpose. Finally, some consumers may believe that a "non-profit" CCA will charge lower fees than a similar for-profit entity.
- *False advertising regarding credit counseling services.* Some CCAs claim to provide advice and education to consumers on handling their finances, when in fact they may merely enroll all clients indiscriminately in DMPs without any actual counseling.
- *Failure to pay creditors in a timely manner or at all.* Some CCAs may fail to pay creditors in a timely fashion or at all. This failure can result in serious consumer harm, such as from late fees that the creditors impose.
- *Failure to abide by telemarketing laws.* To the extent CCAs are not *bona fide* non-profit organizations, they should be complying with the FTC's Telemarketing Sales Rule, including the new national Do-Not-Call registry.
- *Gramm-Leach-Bliley ("GLB") Privacy and Safeguards.* The Commission is also concerned that some CCAs may not be complying with the privacy and security requirements of the Gramm-Leach-Bliley Act, which apply to financial institutions such as credit counseling organizations or similar entities that service loans or collect overdue accounts. The GLB Act requires financial institutions to provide privacy and opt-out notices to consumers regarding the use and disclosure of their personal information, and also to implement safeguards that ensure that such information is appropriately protected from unauthorized access. Failure to comply with these requirements could put sensitive information at risk.

IV. COMMISSION ACTIONS

The Commission has pursued a vigorous program to halt fraud and deception by those who purport to be able to solve consumers' financial difficulties. For example, in November 2003, the FTC filed a lawsuit against Maryland-based AmeriDebt, Inc., which aggressively advertises itself as a non-profit dedicated to assisting consumers with their personal finances.(11) The complaint also names AmeriDebt's former for-profit service provider, DebtWorks, and DebtWorks' owner, Andris Pukke.

According to the complaint, the defendants have engaged in a number of deceptive practices to induce consumers to enter into DMPs. For example, the FTC's complaint alleges that AmeriDebt's promotional materials have misrepresented that consumers enrolling in an AmeriDebt DMP would pay no up-front fees, when in fact the company retains the consumer's entire first payment on the plan (often totaling hundreds of dollars) as a

"contribution." The complaint further alleges that the defendants have falsely claimed that AmeriDebt is a non-profit organization. The Commission charges that, despite AmeriDebt's 501(c)(3) status, it in fact operates for the profit of related parties, including Debtworks and Andris Pukke.

In addition, the complaint challenges claims made by defendants that they teach consumers about their finances and how to manage debt, when in fact they merely enroll consumers in DMPs. Finally, the complaint alleges that AmeriDebt failed to send its customers the privacy notices required by the GLB Act.

At the same time it filed its complaint against Ameridebt, the Commission entered into a settlement with the Ballenger Group, LLC, which has serviced AmeriDebt's DMPs since January 1, 2003.⁽¹²⁾ The settlement resolved FTC allegations that Ballenger, which had close ties to the AmeriDebt defendants, contributed to AmeriDebt's deception by repeating some of the misrepresentations in telephone calls with consumers. The settlement contains strong injunctive relief, and requires Ballenger to pay \$750,000 in consumer redress.

The Commission has also brought enforcement actions in the related industry of debt negotiation. Unlike CCAs, debt negotiation companies do not offer credit counseling or enroll consumers in DMPs. Rather, they purport to be able to negotiate settlements of consumers' unsecured debts with the creditors. Last month, the Commission filed a lawsuit against two debt negotiation companies, Innovative Systems Technology, Inc. and Debt Resolution Specialists, Inc., and their principals, alleging that the defendants misrepresented that they could "drastically" reduce consumers' debt by negotiating with creditors.⁽¹³⁾ The complaint alleges that in fact defendants were unable to negotiate substantial reductions in the amount consumers owed. It also alleges that, as a result of purchasing defendants' debt negotiation services, consumers' credit ratings suffered, their total debt increased, and some consumers even became the target of legal action by creditors.

In addition, in September 2002, the Commission filed a lawsuit against Jubilee Financial Services, a debt negotiation company, alleging, among other things, that Jubilee falsely promised that consumers who enrolled in its program would be able to pay off their debts at a substantially reduced rate; misled consumers about the effects of the program on their credit report; and failed to tell them that, as a result of the program, negative information would likely appear on consumers' reports and stay there for seven years.⁽¹⁴⁾ Instead of extricating themselves from debt, many of Jubilee's victims were left with little alternative but to file for bankruptcy. Over the past several years, the Commission also has prosecuted numerous cases under the Credit Repair Organizations Act ("CROA"),⁽¹⁵⁾ which prohibits fraudulent practices by organizations that promise to improve consumers' credit histories, such as falsely promising to remove accurate credit information from consumers' credit reports. The Commission has successfully conducted several sweeps of entities allegedly violating CROA, including Operation Eraser⁽¹⁶⁾ and Operation New ID-Bad IDea.⁽¹⁷⁾ Most recently, in August 2003, the Commission reached a settlement with one of the largest credit repair organizations in the United States, through which the defendants agreed to pay more than \$1.15 million in consumer redress.⁽¹⁸⁾

The Commission also has engaged in extensive educational efforts to help consumers spot and avoid credit counseling and credit repair scams. Most recently, the Commission, in conjunction with the Internal Revenue Service and state regulators, issued a joint press release regarding CCAs, urging consumers to be cautious and providing tips for choosing a credit counseling organization.⁽¹⁹⁾ The release advises consumers to pay careful attention to what fees the agency charges, the nature of the services it offers, and the terms of the contract. Consumers should also consider using agencies that offer actual counseling and education and do not simply enroll all clients in DMPs.

The IRS announced at the same time its intention to re-examine certain CCAs with 501(c)(3) status to determine whether they are operating in a manner that complies with the laws and regulations governing tax-exempt status. The IRS also stated that in the future it will examine more rigorously CCAs' 501(c)(3) applications. Specifically, the IRS noted that organizations that place clients on DMPs without significant education and counseling do not qualify for tax-exempt status.⁽²⁰⁾

In addition, the Commission recently issued two consumer education brochures, *Knee Deep in Debt*⁽²¹⁾ and *Fiscal Fitness: Choosing a Credit Counselor*,⁽²²⁾ which provide advice to consumers about how to handle debt and how to choose a credit counselor. We highlighted these publications when we filed the AmeriDebt case, and over 75,000 copies have been distributed in print and through the Web since that time.

V. CONCLUSION

The Commission recognizes that credit counseling can provide financially distressed consumers with valuable assistance in managing their money and paying their debts, and that many, if not most, CCAs operate honestly and fairly. The Commission is concerned, however, that some firms may be deceiving consumers about who they are, what they do, and how much they charge. The victims of the deception may find themselves in even more dire financial straits than before. The Commission, acting with our law enforcement partners, will continue to work to protect consumers in this critical area.

Endnotes:

1. The views expressed in this statement represent the views of the Commission. My oral statement and responses to questions you may have are my own and do not necessarily reflect the Commission's views or the views of any individual Commissioner.
2. 15 U.S.C. § 45(a).
3. 15 U.S.C. § 6101-6108.
4. 15 U.S.C. § 1679 *et seq.*
5. 15 U.S.C. § 6801 *et seq.*
6. 15 U.S.C. §§ 44 & 45(a).
7. Most creditors and some state laws require CCAs to be non-profit entities before they can arrange payment plans for consumers.
8. *See, e.g., Ohio Christian Coll.*, 80 F.T.C. 815, 848-49 (1972).
9. Some creditors are reexamining their Fair Share programs and considering alternate means for providing financial support to CCAs. These alternate means include providing lump sum charitable donations to be used for counseling and education, rather than tying donations to amounts collected in DMPs.
10. Negative but accurate information cannot be removed from a credit report until the time specified by the Fair Credit Reporting Act has lapsed (generally, seven years after the event occurred). 15 U.S.C. § 1681c.

11. See FTC Press Release, *FTC Files Lawsuit Against AmeriDebt* (Nov. 19, 2003), available at <http://www.ftc.gov/opa/2003/11/ameridebt.htm>.

12. *Id.*

13. See FTC Press Release, *FTC Challenges Bogus Debt Negotiation Service* (Feb. 13, 2004), available at <http://www.ftc.gov/opa/2004/02/briggsbaker.htm>. The Commission also settled with one of the principals. *Id.* The settlement permanently bans the principal from participating in any debt reduction, negotiation, or consolidation business and from misrepresenting any fact material to a consumer's decision to purchase a good or service.

14. See FTC Press Release, *FTC, States Give "No Credit" to Finance-Related Scams in Latest Joint Law Enforcement Sweep* (Sept. 5, 2002), available at <http://www.ftc.gov/opa/2002/09/opnocredit.htm>. The Commission subsequently settled with two principals of the corporate defendants. The settlement, among other things, bans those individuals from advertising, marketing, or providing debt negotiation services. See FTC Press Release, *Jubilee Financial Services Defendants Banned from Providing Debt Negotiation Services* (Aug. 29, 2003), available at <http://www.ftc.gov/opa/2003/08/jubilee.htm>.

15. 15 U.S.C. § 1679 *et seq.*

16. See FTC Press Release, *Credit Repair? Buyer Beware! FTC, States Announce Crackdown On Scams That Bilk Consumers* (Mar. 5, 1998), available at <http://www.ftc.gov/opa/1998/03/eraser.htm>.

17. See FTC Press Release, *Credit Identity Defendants Settle FTC Charges: Promoting False Identification Numbers to Create a "New Credit Identity" Is Illegal* (Oct. 21, 1999), available at <http://www.ftc.gov/opa/1999/10/badidea.htm>.

18. See FTC Press Release, *Nationwide Credit Repair Operation to Pay More than \$1.15 Million in Consumer Redress* (Aug. 11, 2003), available at <http://www.ftc.gov/opa/2003/08/nationwide.htm>.

19. See FTC Press Release, *FTC, IRS, and State Regulators Urge Care When Seeking Help from Credit Counseling Organizations* (Oct. 14, 2003), available at <http://www.ftc.gov/opa/2003/10/ftcirs.htm>.

20. See Press Release, *IRS Takes Steps to Ensure Credit Counseling Organizations Comply with Requirements for Tax-Exempt Status* (Oct. 17, 2003), available at <http://www.irs.gov/newsroom/article/0,,id=114575,00.html>.

21. See <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre19.pdf>.

22. See <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre26.pdf>.