



Consumer Federation of America

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DEBT SETTLEMENT AGENCIES CREATE FAR MORE CONSUMER PROBLEMS THAN THEY SOLVE

CFA Urges States and Federal Agencies to Establish and Maintain Strong Controls on These Companies

Washington, DC – Debt settlement companies have been severely criticized by federal and state government agencies, by financial columnists, and by consumer advocates, yet continue to market dubious services to consumers desperate for debt relief. While these companies offer the promise of substantial reductions in a consumer's debt load, they also require consumers to default on all these debts. A cascade of problems can follow, which include:

- late fees, default interest rates, and penalties;
- debt collection ending in lawsuits and wage garnishment; and
- far lower credit scores guaranteeing high rates on future loans.

“Consumers seeking assistance from debt settlement companies are essentially playing the lottery, only instead of risking only the modest cost of a ticket, they are in great danger of substantially worsening an already difficult financial situation,” said Stephen Brobeck, Executive Director of the Consumer Federation of America.

Debt settlement companies take advantage of consumer desperation by offering seemingly magical solutions to financial problems – creditor approval of sharp reductions in substantial debts. But these reductions do not occur unless creditors agree, and they often do not. Consumers have no way of knowing up front if creditors will agree to a debt reduction or, instead, will impose fees that increase total debt. For some consumers, the debt settlement company settles some debts, usually charging high fees, but the remaining debt load balloons as creditors hike fees and interest rates. Even when debts are settled, consumers are often surprised to learn that they have incurred debt-cancellation income tax liability.

Some companies have attempted to “legitimize” their work by forming an association, the American Fair Credit Council, which purports to have created standards and conducts annual on-site audits of “accredited companies.” Yet, a review of Better Business Bureau and consumer complaint websites reveals complaints against all seven accredited members, and a relatively large number of complaints against one accredited

member, Freedom Debt Relief, that also claims to be the largest debt settlement company.

All these consumer complaints were filed after the Federal Trade Commission (FTC) took commendable action in 2010 to check bad practices of the companies. In this year, it issued a rule that, among other provisions, prohibited advance fees before the consumer had made at least one payment to a creditor as a result of a negotiated agreement, provided some protection to consumer saving in “dedicated accounts” managed by the companies, and required new disclosures when the companies telemarket their services. While this rule eliminated some of the worst abuses, it did not address the fundamental flaw in debt settlement – requiring consumers to default on their debts.

Some companies have ignored the FTC rule by continuing to charge large up-front fees before any debts are settled. Other companies are using law firms as a “front,” charging large retainers instead of advance fees. Consumers have complained frequently about these firms, especially Legal Helpers Debt Resolution operating in the law firm of Macey & Aleman.

States and Federal Agencies Should Take Further Action to Curb Abuses

Some states wisely ban debt settlement companies altogether. They should continue to do so – at least until the industry comes up with a model in which consumers cannot end up worse off than they started.

States that allow debt settlement should require companies to screen their clients for “suitability” for the service. These states should require a “not worse off” provision to provide consumers with a refund if they end up worse off. The states should also set limits on the fees these companies charge.

States should also require debt settlement companies to report on the outcomes achieved for their clients. This reporting should provide sufficient detail for policymakers and the public to know what proportion of clients end up worse off.

These common sense requirements should become a federal standard. We urge the Consumer Financial Protection Bureau (CFPB) to enact a rule to this effect. We commend the FTC and the CFPB for their effective enforcement actions against some of the most egregious abusers. Further action is needed beyond enforcement of the 2010 Rule to stop companies from luring clients with unsupported claims of outcomes that many clients never see.

There are usually no simple solutions for individual consumers burdened with large debts, but some solutions are better than others. CFA recommends that these consumers consider seeking advice from reputable, nonprofit credit counseling agencies, some of whom have local offices. These agencies have well-established relationships with major creditors and can help work out payment plans that are affordable. If,

however, the debts are too large for these plans, consumers should consider filing for personal bankruptcy.

The Consumer Federation of America is a nonprofit association of more than 250 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.