LIFESTYLE & BU

Debt se start

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Published January

More than two shady debt settlement companies, advocates complain that consumers are still being duped into signing up for the services.

Although the industry best known for late-night television commercials promising to help debtors settle outstanding credit card bills for pennies on the dollar has changed since the new rules took effect, consumer advocates say that change hasn't necessarily been for the best and hasn't come quickly enough.

Critics and industry observers say the new federal rules have led debt settlers to either:

- Go out of business.
- Change their business models to comply with the rules and stop collecting upfront fees for debt negotiations.
- Change their marketing tactics in an attempt to circumvent aspects of the rule that apply to telemarketing activities.

"Today, we are seeing the debt settlement industry morph into other areas," says William P. Binzel, senior adviser and counsel for the National Foundation for Credit Counseling. He represents nonprofit credit counseling agencies that help consumers create plans to manage their finances and pay off what they owe over time in debt management plans rather than make deals to reduce the principal amount of debt.

Their nemesis over the past several years has been the debt settlement industry -- which has collected upfront fees and payments from consumers with the promise of negotiating settlements with creditors to reduce the principal by as much as 50 percent to 70 percent. Unfortunately, as many consumers found, debt settlers often did not fulfill their promises and kept the fees and money paid to them by their clients, who still owed the original debts.

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As of Oct. 31, 2010, for-profit companies that use telemarketing to attract clients cannot charge fees until after they have negotiated settlements with credit card companies and other creditors, according to the new Telemarketing Sales Rules drafted by the Federal Trade Commission. The rules also restrict the amount of fees that can be charged and ban ads that tout impressive settlement success rates unless they have evidence to prove those claims.

"All those guys that were getting customers and collecting fees and not providing any services ... in the new world, they just by definition cannot exist," says Andrew Housser, a member of the board of The Association of Settlement Companies (TASC), an industry trade group.

A cottage industry goes viral
Over the years, the industry has grown from nearly a dozen players in the early 2000s to about 100 in 2006, Housser says. There was a sharp increase in 2007 after the mortgage industry faltered and mortgage workers began to shift into debt settlement careers. By the end of 2009, he says there were thousands of companies offering debt settlement services. Housser says many of those controversial ads were from lead generation companies rather than debt settlers.

"The majority of the companies in this industry were not even providing debt settlement. They were marketers and salespeople and brokerage shops," he says. "Then, there started to be a disconnect between what was being sold and what was being provided."

No independently verifiable figures are available on the washout rate of the debt settlement programs. According to self-reported data submitted to the FTC by debt settlers, only 25 percent of clients who remained in debt settlement programs for three years actually completed their debt repayment plans. The rest of the clients either filed for bankruptcy, found other ways to pay off their debts, or regretted signing up for the programs and stopped paying.

Housser describes the debt settlement process as a dicey venture that attracted companies that "got into the industry without knowing how complicated it is." A successful settlement depends on clients fulfilling their obligations and sticking to budgets and collection agencies and creditors agreeing to stop collection action and accept less than the full amount owed. "There's all sorts of moving parts," he adds. "Historically, this product is difficult to do well. It's complicated. Our average customer has seven different credit cards in different stages of collection ... A lot of the companies may have actually had perfectly good intentions, but just couldn't do it."

Downsizing and more efficiency
Housser says his association's membership has dwindled significantly -- down from 200 in the summer of 2010 to 67 as of January 2011. Housser says only about 20 percent of the industry are members of the trade group. Neither the FTC nor TASC have exact figures on how many companies operate as debt settlers, but Housser says the drop in the overall industry has been similar to what his trade group has experienced. "In response to this rule, a lot of companies have decided to get out of this industry or pursue other business lines."

Binzel, from the credit counseling foundation, counters: "The FTC rule does not preclude debt settlement companies from doing business ... If debt settlement companies say that they cannot operate in an environment that provides good consumer protections, then there is something seriously flawed about their business."

Housser, who is CEO of Freedom Debt Relief, says his own company has changed its business model and now doesn't charge clients fees until they deliver on a settlement. Without fees from clients, the company faces cash flow challenges in meeting payroll and paying rent, he says, adding he has already downsized his staff from 600 to 500. More layoffs may be ahead.

"For the first time ever, literally we're going to be losing money over the first couple of years," Housser says, adding, "But I think it's in the best interest of our industry."

Weeding out bad apples
The trade association wants to weed out the bad apples in their ranks just as much as consumer groups, Housser says. As of Jan. 1, 2011, all members of the trade group must comply with the FTC rules -- regardless of whether they use telemarketing services.

"Historically, it's been very hard for consumers to distinguish good companies from bad," he says. "The ads all look the same. It's been a real source of frustration to companies like ours."

Housser says creditors and debt collectors have expressed more willingness to work with debt settlement companies that are complying with the new FTC guidelines."Before the rule, many creditors found it too difficult to distinguish the good actors from the bad."

"You're going to see somewhat of a shakeout in the industry," says Richard A. Briesch, an associate marketing professor at Southern Methodist University's business school in Dallas. Briesch is author of an August 2009 paper about the debt settlement industry. "There's no denying that there have been some companies that have been bad actors. The law will help put them out of business."

He adds: "It's going to hurt some companies that are trying their best to provide good services."

Abuses continue
Despite the trade group's pledge to self-police its industry, consumer advocates say abuses have continued after the new rules took effect. A coalition of consumer groups sent a letter in December 2010 urging the FTC to beef up enforcement of its rules and go after rogue companies that continue to violate the law.

The FTC has pledged to monitor activities and, if necessary, take action against violators, but consumer advocates say the agency isn't staffed adequately to truly police the industry.

Since the new rules ban companies that use telemarketing as a means to sign up new customers from charging upfront fees for their services, some companies have attempted to circumvent the rules by running ads that urge potential customers to visit a website to sign up for debt settlement services.

Instead of telemarketing calls, consumers may be hit with spam e-mails saying they may qualify for debt relief services or asking them to complete surveys about debt.

From radio to the Internet
"We're seeing a rise of activity on the Internet as a marketing vehicle and that's not covered under the telemarketing sales rules," says Binzel, from the foundation of credit counselors. "Any transactions that take place over the Internet or face to face would not be covered by the FTC rule."

FTC attorney Evan Zullow says the new rules are stronger than many people think.

"The definition of telemarketing is really quite broad," he says. "Even if a consumer goes to a website to get information, the consumer at some point has to have a telephone call with the company. During that call, the primary pitch is made for debt relief services. Just because some component of the interaction with the consumer is made over the Net, that doesn't exclude it."

At the point that a consumer calls a debt settlement company or the company calls a consumer, "it would be covered by the rule," Zullow says. He adds: "Certainly, we're monitoring the marketplace here very closely. You better believe if a company is engaged in deception or abusive practices or causing harm to consumers, we're going to take a very close look at them."

Binzel said a more comprehensive federal law is needed to cover all potential debt settlement activities for both for-profit and nonprofit entities. He and others expect the new Consumer Financial Protection Bureau, due to launch operations by midsummer, to take up the issue. The federal bureau will have broad powers to police the financial services industry for unfair and deceptive practices.

People who have tried and failed to get help from debt settlers are turning to nonprofit credit counselors for help. Counseling agencies refer to these clients -- who often have lost what little money they had to shady debt settlers -- as debt settlement "refugees."

"We're still having consumers come to our members saying they have been scammed by these guys," says David Jones, president of the Association of Independent Consumer Credit Counseling Agencies (AICCCA). "They continue to operate illegally. The ads are still out there. These guys are just trying to make as much money as they can before they run for the hills."

Jones says based on the size of the debt settlement industry, "there are thousands and thousands of people that have been duped by this whole thing. All of the fallout from that is going to be felt over the next couple of years."

Cherry picking the good cases
Housser from the settlement industry trade group says the fallout of the new rules may be fewer consumers receiving help getting out of debt and more people either filing for bankruptcy or facing civil lawsuits and garnishment of their wages.

He says debt settlement companies that continue to operate are likely to only sign up debtors with cases they can win quickly so negotiators can collect their fees as fast as possible.

"In the new world, the post FTC-rule world, if you're not getting results for customers, you're not making any money," Housser says. Debt settlers likely won't sign up clients with "low probability of success" in negotiating settlements with creditors. He asks: "Am I really going to want to do all that work for free if there's only a 25 percent chance of success? I think it's only natural that companies will start to turn down cases with a lower probability of success because they won't work for so little or no return."

Says Housser: "On the positive side, the fact that we are not charging any fees until after the first settlement means that we will be able to get the first settlement earlier in the process, which should improve customer satisfaction and therefore retention. On the downside, the fact that consumers are paying no fees at all in the early months of the program may decrease their commitment to the process. Without 'skin in the game,' consumers may be less likely to stick with it."

Nonprofit consumer credit counseling agencies that are in direct competition with debt settlers say some consumers will be better served by going to credit counselors for help. Those nonprofit agencies charge minimal or no monthly fees based on the client's income and enroll consumers in debt management plans (DMPs) to pay their entire balance off over time. Credit counselors are typically able to get creditors to agree to reduced interest rates or waived fees while enrolled in DMPs. Any debt payments go directly to creditors during the first month.

Debt settlement companies, on the other hand, typically collect money from customers and hang on to the cash for long periods until they have enough to make a lump-sum settlement offer. During that time, no payments are going toward the debt.

Binzel, from the credit counseling foundation, points out another key difference between nonprofit credit counselors and debt settlers. Credit counseling agencies assess a client's entire financial situation -- taking into account mortgage debt, car loans and credit card debt -- and suggest ways to trim the family budget or earn extra income to repay debts.

"We view the consumer's economic and financial situation holistically," Binzel says. "If they're having problems paying their credit card bills, they're likely also having problems paying their mortgage or car loan or other debts. That's the problem with debt settlement companies that try to sell a product. Nonprofits deal with education and counseling; we're not trying to sell a product."

Briesch, the SMU business professor, says a segment of consumers will lose out because of the new FTC rules.

Fewer choices for consumers?
"Consumers are going to lose some from this ... because there are fewer choices to help them out," he says. "For a lot of people in debt settlement, that's their last choice before bankruptcy. They don't qualify for credit counseling. They don't have enough income."

Some debtors may consider going it alone and attempt to negotiate directly with creditors themselves. Both Briesch and Housser agree that not everyone is cut out for this kind of haggling.

"They can try to do it on their own, which some people, depending on their personality, can do. Most people can't," says Housser. "Or they can stick their head in the sand, which unfortunately is what got a lot of people into trouble in the first place."

Even bankruptcy may not be an option for many debtors. The 2005 bankruptcy law made it more difficult to file for protection from creditors. "People are being put between a rock and a hard place," Briesch says, adding that, for some people with large credit card debts, "they will have to pay it off over long periods of time."

He adds: "Consumers' options are becoming more limited. I'm hoping the industry can respond."

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