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Consumer Credit Counseling Reform: The Good, the Bad and the Ugly

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It's one o'clock in the morning, and you're having trouble sleeping. You turn on the television and see a smiling woman tell you how she can cut your debt in half. Promises of stopped collection efforts, improved credit ratings and reduced interest rates are everywhere. You've probably noticed that these ads have proliferated in the past few years. The federal government has noticed too.



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The credit counseling industry, which consisted of about 200 nonprofit agencies working with approximately 700,000 consumers just a decade ago, has exploded. The Internal Revenue Service (IRS) now estimates that there are more than 870 nonprofit credit counseling agencies in operation.¹

Estimates place the number of consumers seeking credit counseling services at approximately 9 million. This number is difficult to pin down because only the two major credit counseling trade organizations, the National Foundation for Credit Counseling (NFCC) and the Association of Independent Consumer Credit Counseling Agencies (AICCCA), report accurate numbers. Approximately 160 credit counseling agencies are members of NFCC²

or AICCCA,³ and they reported helping 2.5 million consumers last year.

Why the sudden explosion in demand for credit counseling and the number of providers? It's basic economics. The Federal Reserve reported that America's consumer debt topped \$2 trillion,⁴ and the average household is carrying credit card debt of approximately \$9,200.⁵ Nonprofit credit counseling agencies were historically created by creditors as a means to assist consumers to repay debt and avoid bankruptcy. In return for administering repayment plans, known as debt-management plans (DMPs), creditors pay agencies a percentage of the debt repaid (known as "fair share") to fund counseling efforts. At the industry's peak, the fair share paid by creditors was 15 percent. In the '90s some enterprising businesspeople did the math. They saw that an increase in debt load combined with a generous creditor contribution created a healthy economic opportunity for them if they disguised themselves as nonprofit business entities.

The industry experienced explosive growth. Competition and blatant fraud meant counseling and education fell by the wayside, and creditors woke up one day to discover that the number of proposals from credit counseling agencies was increasing at an alarming rate. All of these factors led to calls for reform.

A Stack of White Papers

The National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) were the first groups to raise the alarm in their jointly published report *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants* (April 2003). The key problems noted were deceptive and misleading practices, excessive costs and the growing abuse of nonprofit status. Most of the criticism was directed at the newer entrants to the credit counseling industry, though NFCC and AICCCA members were also called to task.

NCLC and CFA made four recommendations to reform the industry: First, step

up enforcement of nonprofit status by the Internal Revenue Service (IRS). Second, enact federal legislation to regulate what has become a national industry. Third, improve self-regulation of the credit counseling industry through NFCC and AICCCA. Finally, enact creditor reform and better support credit counseling efforts. Following *Credit Counseling in Crisis*, the Senate Permanent Subcommittee on Investigations released a telling report titled "Profiteering in a Nonprofit Industry: Abusive Practices in Credit Counseling."⁶

In this report, even industry experts were surprised to learn that some of the less scrupulous credit counseling agencies were far worse than they imagined. The report examined three large, newer entrants to the industry and discovered abuse of their nonprofit status that reaped millions of dollars for their for-profit ancillary businesses, all at the cost of debt-burdened consumers.

The subcommittee found that the organizations in question made no effort to provide true counseling or educational programming, and that their primary focus was to generate fee income from DMP administration.⁷ The report stated that "some credit counseling agencies are engaged in abusive practices that hurt debtors, including...charging excessive fees, putting marketing before counseling and providing debtors with inadequate educational, counseling and debt-management services." The report also stated that "nonprofit credit counseling agencies are funneling millions of dollars each year from cash-strapped debtors to insiders and affiliated for-profit businesses, in apparent violation of tax laws..."⁸

The subcommittee recommended better regulation of credit counseling agencies by the creditors themselves to include basing payment of fair share upon adherence to articulated standards and requiring mandatory agency membership in either NFCC or AICCCA.⁹ Additional recommendations included stepped-up enforcement of tax-exempt status by the IRS and action by the Federal Trade Commission (FTC) against

¹ *Profiteering in a Nonprofit Industry: Abusive Practices in Credit Counseling: Hearings Before Permanent Subcommittee on Investigations*, 108th Cong., 2nd Sess. 3 (2004) [hereinafter *Senate Hearings*].

² See www.nfcc.org.

³ See www.aiccca.org.

⁴ See www.federalreserve.gov/releases/#annual.

⁵ Singletary, Michelle, "With Credit Counselors Like These, Who Needs..." *Miami Herald*, Mar. 7, 2004.

⁶ Senate Hearings, *supra* at note 1.

⁷ *Id.* at 34.

⁸ *Id.*

⁹ *Id.*

credit counseling agencies that “engage in deceptive or unfair trade practices.”¹⁰

Of special interest to the bankruptcy bar, the subcommittee recommended that the Senate should “consider modifying credit counseling provisions in the pending bankruptcy legislation to strengthen protections against abusive practices, including determining whether a single authority...should issue a central list of qualifying credit counseling agencies to provide counseling to bankruptcy petitioners and whether credit counseling fee limits would be appropriate.”¹¹

Finally, the subcommittee recommended that the Senate consider enacting federal legislation, perhaps modeled after the Debt Repair Organizations Act of 1996.¹² The most voluminous treatise to hit the desk was the 80-page report published by Consumers for Responsible Credit Solutions (CRCS) entitled *Nonprofits in Service to One of America’s Most Profitable Industries*.¹³ Though mostly a critique of the credit industry and the traditional nonprofit credit counseling organizations, this report did raise the issue of myriad state laws and regulations that are often inconsistent and conflicting with regard to the nonprofit status requirements for credit counseling organizations.¹⁴

CRCS proposals for reform include reducing creditor control of the credit counseling industry by limiting affiliations on nonprofit governing boards, requiring creditor participation in debt-repayment plans akin to a chapter 13 scheme, and the passage of federal legislation that would allow both for-profit and nonprofit credit counseling agencies.¹⁵

Congress Responds

There are currently two bills pending on Capitol Hill that directly address reform in the credit counseling industry.

The first bill to reform the credit counseling industry was introduced by Rep. Julia Carson (D. Ind.) and is called the Debt Counseling, Debt Consolidation and Debt Settlement Practices Improvement Act of 2003 (H.R. 3331), 108th Cong., 1st Sess. (2003). H.R. 3331 would amend the Consumer Credit Protection Act to protect consumers from unfair and deceptive practices by organizations providing debt-counseling, debt-consolidation or debt-settlement services.

If enacted, H.R. 3331 would prohibit debt-counseling, debt-consolidation or debt-settlement organizations from unreasonably disclosing information to third parties

regarding amounts owed by a consumer. It would also prohibit making fraudulent, deceptive or misleading representations in order to obtain information about or solicit business from any consumer, or in connection with providing services for or on behalf of any consumer. Finally, it prohibits engaging in any unfair or deceptive act or practice.

H.R. 3331 would require that all organizations register with the Secretary of the Treasury and sets forth a civil-remedies clause that would hold an organization liable to both the United States and to any individual suffering harm, but by its own terms H.R. 3331 could not be construed as superseding any requirement of state law. H.R. 3331 is not comprehensive in scope: It does not address the issue of nonprofit vs. for-profit status, nor does it include counseling or education requirements. Furthermore, its apparent focus is punitive; it outlines prohibited activities and offers punishments for wrongdoers rather than setting standards and encouraging corrective action.

Though noble in its attempt to reform, H.R. 3331 has received little support from those within or outside of the industry. NFCC has taken no formal position on H.R. 3331, while AICCCA is opposed to its enactment.

The second bill was introduced by Sen. Daniel Akaka (D. Hawaii) and is titled the Credit Card Minimum Payment Warning Act (S. 2475), 108th Cong., 2nd Sess. (2004). Though not a reform bill per se, §3 of S. 2475 deals with access to credit counseling and proposes that creditors maintain a toll-free number with referral information.

S. 2475 also directs the governors of the Federal Reserve System and the FTC to set guidelines and criteria for approving nonprofit budget and credit counseling agencies for inclusion in the toll-free referral list. A close read of the language reveals its similarity to §106 of H.R. 975, 108th Cong., 1st Sess. (2003)—that perpetually pending bill known as Bankruptcy Reform.

S. 2475 legislatively forces creditors to tell potentially overstressed customers that credit counseling exists. One would hope that creditors would be willing to do this type of referral on their own, as they would benefit from the receipt of future payments. That being said, S. 2475 does restrict credit counseling referrals to nonprofits with standards in place, criteria supported by both industry and consumer advocates. However, once again, the language of S. 2475 is not comprehensive and does not reform the industry as a whole.

As of this writing, H.R. 3331 and S. 2475 have been the only federal legislative attempts to directly respond to the various

problems highlighted by the white papers mentioned above. Unfortunately, it is expected that the 108th Congress will retire without any federal resolutions to the credit counseling crisis.

Quiet Crusaders

Even before the first white paper was published, a group of concerned judges, practitioners and academics quietly convened in order to determine if reform was needed in the credit counseling industry. In December 2002, a report was presented to the National Conference of Commissioners on Uniform State Laws (NCCUSL) recommending that a drafting project be initiated. The resulting draft has gone through several revisions and is currently entitled the Uniform Consumer Debt Counseling Act (UCDCA). The Drafting Committee anticipates presenting the final version to the National Conference in August of 2005.

Without doubt, the most comprehensive attempt at reform the UCDCA would tightly regulate credit counseling as well as debt settlement and debt consolidation, two closely related industries widely believed to also be fraught with abuse and fraud. The language of the UCDCA reveals stringent registration requirements for both in-state and foreign entities. Bonding is required as a means to protect consumers who entrust their remaining funds to these third-party organizations for safekeeping. Restrictions are placed on the monthly fees that can be charged to consumers for debt-management plans, as well as on set-up fees for new accounts. Strict guidelines on trust account requirements and the handling of clients’ funds are also put into place.

The UCDCA requires that “in every calendar year, every debt-management-services provider shall spend on public education concerning personal finance an amount of money equal to the amount it spends on advertising.”¹⁶ Furthermore, every consumer placed on a DMP must be “provided...with a consumer education program that contains information about managing [household/personal] finances.”¹⁷

One controversial aspect of the UCDCA in its current form is its allowance of both for-profit and nonprofit entities. This is drawing mixed reviews, as there are some concerns among both industry and consumer advocates that predatory for-profit businesses will find ways to realize large profits at the expense of cash-strapped consumers.

¹⁰ *Id.*

¹¹ *Id.* at 34-35.

¹² *Id.* at 35.

¹³ *Nonprofits in Service to One of America’s Most Profitable Industries*, Consumers for Responsible Credit Solutions (2004).

¹⁴ *Id.* at 13.

¹⁵ *Id.* at 11-14.

¹⁶ Uniform Consumer Debt Counseling Act §24 (Tentative Draft September 2004).

¹⁷ *Id.* at §14(b)(1).

Uniform acts are a slow and laborious process, but they have the benefit of state input at both the drafting and enactment phases, as NCCUSL has representation from every state, and each state has the option of modifying the act to suit its particular needs. This slower process, with its multiple drafts and revisions, is also assured not to present a “quick fix” that might worsen the problem, but rather a well thought-out, practical solution. Of the three reforms presented, the UCDCA provides the most comprehensive and long-term solution.

Additional Thoughts

In June 2004, Mark Everson, Commissioner of Internal Revenue, testified before the Senate Finance Committee.¹⁸ He outlined a plan to step up enforcement of nonprofit status in the credit counseling industry that called for increased audits of existing credit counseling organizations, stricter reviews of new applications for credit counseling agencies and continued cooperation with the FTC and the states’ attorneys general.

If the IRS is a sleeping giant, many of the unscrupulous players are about to feel its wrath now that it has awakened and taken notice. The IRS efforts alone shall go far toward reform, and as long as sufficient funding and staffing are provided to the commissioner, a significant checks-and-balances system will be in place.

Should federal legislation materialize, it must be determined who would actually oversee and regulate the credit counseling industry. In pending bankruptcy reform legislation, this responsibility would fall to the Executive Office for the U.S. Trustee. As seen above, other proposals have ranged from the Department of the Treasury to the Federal Reserve and FTC.

One suggestion might be to follow the model of a Self Regulatory Organization (SRO). An SRO is a non-government organization that has statutory responsibility to regulate its own members through the adoption and enforcement of rules of conduct for fair, ethical and efficient practices. The classic example would be the National Association of Security Dealers. Another potential model is the SRO hybrid, such as the Public Company Accounting Oversight Board, which was created by the Sarbanes-Oxley Act of 2002.

The two existing credit counseling trade associations, NFCC and AICCCA, both of which set standards for their members, have been serving voluntarily in this role for years. These two organizations could be consolidated and transformed into an SRO

¹⁸ “Hearing on Charitable Giving Problems and Best Practices Before the Committee on Finance U.S. Senate,” 108th Cong., 2nd Sess. (2004) (statement of Mark W. Everson, Commissioner Internal Revenue).

that could provide effective and meaningful industry oversight.

Most importantly, all of the stakeholders must come to the table willing to compromise. The creditors must look at credit counseling as a cooperative partnership between agency and client, and not as an alternative collection arm. A client who successfully works through a debt-management plan is one who avoided bankruptcy, learned through education how to be a better consumer, and rehabilitated themselves and is now ready to responsibly re-enter the credit market.

Credit counseling agencies must look to creditors as collaborative partners in working with clients who are not legally insolvent. They must narrowly tailor debt-management plans and provide them only to those who are not bankrupt but cannot afford to repay their debts under their current contractual terms. Furthermore, credit counseling agencies must be the stewards for effective consumer counseling, rehabilitation and adult financial literacy education.

Finally, the client must understand that credit counseling is not a quick fix but a long-term commitment to debt repayment, behavior modification and rehabilitation, as well as an opportunity to learn important life skills through financial literacy education. Only the combination of legislative effort and stakeholder cooperation will lead to meaningful and effective reform. ■

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