

**PREPARED STATEMENT OF
THE FEDERAL TRADE COMMISSION**

on

BUSINESS PRACTICES OF DEBT RELIEF COMPANIES

Before the

**SENATE COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION**

Kansas City, Missouri

August 12, 2010

I. Introduction

Senator McCaskill and members of the Committee with Alice Saxe-Hrdy, Assistant Director in the Division of Financial Practices at the Federal Trade Commission ("FTC" or "Commission").¹ I appreciate the opportunity to appear before you today and the Commission thanks this Committee for its interest in the work of the FTC to protect consumers from deception and abuse in the sale of debt relief services.

The Commission has a long history of protecting consumers of financial products and services offered by entities within the agency's jurisdiction. With Americans continuing to feel the effects of the economic downturn, the Commission has stepped up its efforts to stop fraudulent financial schemes that exploit consumers who are particularly vulnerable as a result of financial distress.²

Stopping deceptive debt relief practices is one of our highest consumer protection priorities. Providers of debt relief services purport to help people who cannot pay their debts by negotiating on their behalf with creditors. Debt settlement companies, for example, market their ability to dramatically reduce consumers' debts, often by making claims to reduce debt by specific and substantial amounts, such as "save 40 to 60 percent off your credit card debt." In many instances, consumers pay hundreds or thousands of dollars for these services but get nothing in return.

¹ The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions you may have are my own, however, and do not necessarily reflect the views of the Commission or any Commissioner.

² Since the beginning of 2009, the FTC has brought more than 40 cases to stop scams that prey on consumers suffering from the financial downturn. *See, e.g.,* Press Release, FTC, *FTC Cracks Down on Artists Who Get Jobs in America* (Feb. 17, 2010), available at www.ftc.gov/opa/2010/02/bottomdollar.shtm; Press Release, FTC, *FTC Cracks Down on Sammie Fyng of the "Get Rich in a Day" Scheme* (July 1, 2009), available at www.ftc.gov/opa/2009/07/shortchange.shtm.

The FTC utilizes its four principal tools to protect consumers of debt relief services: law enforcement, rulemaking, consumer education efforts, and research and policy development. To halt deceptive and abusive practices and return money to victimized consumers, the Commission has brought 23 lawsuits in the last several years against credit counseling firms, debt settlement services, and debt negotiators.³ These cases have helped over 500,000 consumers harmed by deceptive and abusive practices.⁴ The Commission continues to actively investigate debt relief companies and pursue aggressive enforcement in this arena. As the Commission's law enforcement experience has shown, victims of these schemes often end up in debt rather than when they began. Especially in these difficult economic times, when so many consumers are struggling to keep their heads above water, this is unacceptable.

Over the past decade, the Commission and state attorneys have brought a combined 259 cases to stop deceptive and abusive practices by debt relief providers that have targeted consumers in financial distress. Despite these sustained efforts, consumer complaints continued to increase as did problematic advertising and telemarketing of these services. To strengthen the agency's ability to stop deception and abuse in the provision of debt relief services, the Commission proposed amendments to the Telemarketing Sales Rule ("TSR"). On July 29, 2010, after a thorough and careful review of the rulemaking record, the Commission announced its

³ A list of the Commission's law enforcement actions against debt relief companies is attached as Appendix A.

⁴ In addition to consumers who lost money to fraudulent debt relief companies, millions of consumers have been harassed by automated robocalls pitching services in violation of the Do Not Call provisions of the Telemarketing Sales Rule. The Commission has charged companies engaging in these robocalls with violations of the Rule. *See e.g., FTC v. Asia Pacific Telecom, Inc.*, No. 10C3168 (N.D. Ill., preliminary injunction issued June 17, 2010); *FTC v. JM Alerstedt vs. Inc.*, No. 09-CV-2021 (M.D. Fla., preliminary injunction issued Dec. 31, 2009); *FTC v. E.A. Relief Tech., LLC*, No. 09-CV-3347 (N.D. Ga., preliminary injunction issued Dec. 17, 2009).

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§§ 16931693; the privacy provisions of the Gramm-Leach-Bliley Act, 15 U.S.C. §§ 68016809; and the Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, § 626, 123 Stat. 524 (Mar. 11, 2009).

¹⁰ The FTC Act exempts banks and other depository institutions and bona fide nonprofits, among others, from the Commission's jurisdiction. 15 U.S.C. §§ 44, 45(a)(2). These exemptions apply to the FTC's jurisdiction under the Telemarketing Act and the TSR as well.

¹¹ See, e.g., FTC, Press Release, *Federal and State Agencies Target Mortgage Relief Scams and Loan Modification Scams* (July 15, 2009), available at www.ftc.gov/opa/2009/07/loanliesshtm (announcing sweptargeting mortgage assistance relief scams, including *FTC v. US Bank National Relief Corp.*, No. SACV09-768 JVS (MGX) (C.D. Cal., final order March 11, 2010) (State of Missouri, State of California, and FTC filed joint case alleging violations of FTC Act and TSR against defendants purporting to provide mortgage assistance relief services)) Press Release, FTC, *FTC Announces "Operation False Charity" Law Enforcement Sweep* (May 20, 2009), available at www.ftc.gov/opa/2009/05/charityfraudsh.htm (including four cases

¹² The Commission has addressed similar problems with respect to companies offering to resolve consumers' mortgagedebts. The Commission has engaged in an aggressive, coordinated enforcement initiative to shut down companies falsely claiming the ability to obtain mortgageloan modifications or other relief for consumers facing foreclosure. In the past year alone, the FTC has brought 10 cases targeting foreclosure rescue and mortgagerefinancing frauds, with other matters under active investigation. In addition, state enforcement agencies have brought more than 200 cases against such firms in recent years. Further, as directed by Congress under the Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, the Commission has initiated a rulemaking proceeding addressing the for-profit companies in this industry. Under the proposed rule, companies could not receive payment until they have obtained for the

¹⁵ *FTC v. Am. Dental Ass'n*, No. PJM 03-3317 (D. Md., final order May 17, 2006).

¹⁶ *See* Press Release, FTC, *FTC's Action on Dental Services*, [http://www.ftc.gov/ftc/press/060506dental.htm](#).

- violations of the TSR's provisions that require certain disclosures and prohibit misrepresentations, as well as the requirements of the TSR's Do Not Call provisions.²⁰

In addition, over the last several years, in response to abuses such as these the IRS has challenged a number of purportedly nonprofit CCAs – both through enforcement of existing statutes and new tax code provisions – resulting in the revocation, or proceedings to revoke, the nonprofit status of 41 CCAs.²¹ In addition, state authorities have brought at least 21 cases against CCAs under their own statutes and rules.

B. Debt Settlement Services

Debt settlement companies purport to obtain from consumers' unsecured creditors lump sum settlements for significantly less than the full outstanding balance of the consumers' debts. Unlike a traditional DMP, the goal of a debt settlement plan is to enable the consumer to repay only a portion of the total debt owed. Debt settlement providers heavily market through Internet, television, radio, and print advertising. The advertisements typically make claims about the

²⁰ See *FTC v. Leikin*, No. 06-cv-61851-WJZ (S.D. Fla., final order May 5, 2008); *United States v. C. E. de la Fuente Found. of America*, No. CV 06-3654 ABC(VBKx) (C.D. Cal., final order June 16, 2006).

²¹ Eileen Ambrose, *Credit Firms' Status Revoked; IRS Says 41 Debt Counselors Will Lose Tax-Exempt Status*, BALTIMORE SUN, May 16, 2006. To enhance the IRS's ability to oversee CCAs, Congress amended the IRS Code in 2006, adding Section 501(q) to provide specific eligibility criteria for CCAs seeking tax-exempt status as well as criteria for retaining that status. See Pension Protection Act of 2006, Pub. L. No. 109-280, § 1220 (Aug. 2006) (codified at 26 U.S.C. § 501(q)). Among other things, Section 501(q) of the IRS Code prohibits tax-exempt CCAs from refusing to provide credit counseling services due to a consumer's inability to pay or a consumer's ineligibility or unwillingness to agree to enroll in a DMP; charging more than "reasonable fees" for services; and, unless allowed by state law, basing fees on a percentage of a client's debt, DMP payments, or savings from enrolling in a DMP. In addition, as a result of changes in the federal bankruptcy code, 158 nonprofit CCAs, including the largest entities, have been subjected to rigorous screening by the Department of Justice's Executive Office of the U.S. Trustee. Finally, nonprofit credit counseling agencies must comply with state laws in 49 states, most of which specify particular fee limits.

company's supposed ability to reduce consumers' debts to a fraction of the full amount owed, and then encourage consumers to call a toll-free number for more information.²² During the calls, telemarketers repeat and embellish many of these claims.

Most debt settlement companies charge consumers hundreds, or even thousands, of dollars in upfront fees, in many cases with the entire amount of fees due within the first few months of enrollment and before any debts are settled. An increasing number of providers spread their fees over a longer period – for example, 12 to 18 months – but consumers generally still pay a substantial portion of the fees before any of their payments are used to pay down their debt. Most consumers drop out of these programs before completion, and they typically forfeit all of the money they paid to the debt settlement company regardless of whether they received any settlements from their creditors.²³

Since 2004, the Commission has brought nine actions against debt settlement providers, alleging that they deceived consumers about key aspects of their programs.²⁴ The defendants' misrepresentations included claims that:

- the provider will, or is highly likely to, obtain large reductions in debt for enrollees, e.g., a 50 percent reduction or elimination of debt in 12 to 36 months;²⁵

²² See, e.g., *FTC v. Connors*, No. SA CV 06-701 DOC (RNBx) (C.D. Cal., final order Oct. 2, 2008); *FTC v. E. S. Tuiss, Inc.*, No. CV-07-4087 (E.D.N.Y., final order Aug. 29, 2008); *FTC v. Debt Settlement*, No. 1:07-cv-00558-RPM (D. Colo., final order Apr. 11, 2008); *FTC v. Blue Fin. Services, Inc.*, No. 02-6468 ABC (Ex) (C.D. Cal., final order Dec. 12, 2004).

²³ *Thompson v. Sakr*, 75 Fed. Reg. at 48471-72 (citing commenters).

²⁴ See Appendix A (items 2, 6, 11, 12, 13, 19, 20, 22, and 23).

²⁵ See, e.g., *FTC v. E. S. Tuiss, Inc.*, No. CV-07-4087 (E.D.N.Y., final order Aug. 29, 2008); *FTC v. Houston System, Inc.*, No. CV04-0728 GAF JTLx (C.D. Cal., final order July 13, 2005).

- the provider will stop harassing calls from debt collectors as well as collection lawsuits;²⁶
- the provider has special relationships with creditors and is expert in inducing creditors to

²⁶ See, e.g., *FTC v Debt Settlements, Inc.*, No. 1:07-cv-00558RPM (D. Colo., final order Apr. 11, 2008); *FTC v Budget Finance Services, Inc.*, No. 04-12326 (WG4) (D. Mass., final order Mar. 28, 2005); *FTC v. Julee Finance Services, Inc.*, No. 02-6468 ABC (Ex) (C.D. Cal., final order Dec. 12, 2004).

²⁷ See, e.g., *FTC v Debt Settlements, Inc.*, No. 1:07-cv-00558RPM (D. Colo., final order Apr. 11, 2008); *FTC v Budget Finance Services, Inc.*, No. 04-12326 (WG4) (D. Mass. 2005). Some providers are also misrepresenting that their service is part of a government program through the use of such terms as “government bailout” or “stimulus money.” See, e.g., *FTC v Dominant Land LLC*, No. 1:10-cv-00997 (D.D.C., preliminary injunction issued July 8, 2010).

²⁸ See, e.g., *FTC v Debt Settlements, Inc.*, No. 1:07-cv-00558RPM (D. Colo., final order Apr. 11, 2008).

²⁹ See, e.g., *FTC v Home Interactive Systems, Inc.*, No. CV04-0728 GAF JTLx (C.D. Cal., final order July 13, 2005).

³⁰ See, e.g., *FTC v. Connely*, No. SA CV 06-701 DOC (RNBx) (C.D. Cal., final order Oct. 2, 2008); *FTC v. Julee Finance Services, Inc.*, No. 02-6468 ABC (Ex) (C.D. Cal., final order Dec. 12, 2004).

³¹ See, e.g., *Minnesota American Debt Settlements, Inc.*, No. 70-CV-10-4478 (Minn., 4th Dist., filed Feb. 18, 2010); *Illinois Country Debt LLC*, No. 2010-CH-00167 (Ill. 7th Cir., filed Feb. 10, 2010); Press Release, Colorado Attorney General, *Even Companies Settlement with*

C. Debt Negotiation

Debt negotiation companies assert that they can obtain interest rate reductions or other concessions from creditors to lower consumers' monthly payments. Such companies offer market debt negotiation services through so-called automated "bots." Like debt settlement companies, many debt negotiation providers charge significant upfront fees and promise specific results, such as particular interest rate reduction or amount of saving.³² In some cases, the telemarketers of debt negotiation services refer to themselves as "card services" or a "customer service department" during calls with consumers in order to mislead them into believing that the telemarketers are associated with the consumer's credit card company.³³

The FTC has brought nine actions against defendants alleging deceptive debt negotiation practices.³⁴ In each case the Commission alleged that defendants (1) misrepresented that they could reduce consumers' interest payments by specific percentages or minimum amounts, (2) falsely purported to be affiliated, or have close relationships, with consumers' creditors,³⁵ and

Statewide Debt Management and Credit Counseling Regulations (Mar. 12, 2009), available at www.ago.state.co.us/press_detail.cfm?pressID=957.html; *Texas v. CSA-Credit Solutions of America, Inc.*, No. 09-000417 (Dist. Travis Cty, filed Mar. 26, 2009); *Florida v. Boyd*, No. 2008-CA-002909 (Cir. Ct. 4th Cir. Duval Cty, filed Mar. 5, 2008).

³² See *FTC v. Asia Pacific Telecom, Inc.*, No. 10 C 3168 (N.D. Ill., preliminary injunction issued June 17, 2010); *FTC v. JM Aleria et al. v. Inc.*, No. 09-CV-2021 (M.D. Fla., preliminary injunction issued Dec. 31, 2009); *FTC v. E.A. Riefel et al., Inc.*, No. 09-CV-3347 (N.D. Ga., preliminary injunction issued Dec. 17, 2009); *FTC v. 2 145183 Ontario, Inc.*, No. 09-CV-7423 (N.D. Ill., preliminary injunction issued Dec. 17, 2009); *FTC v. S. T. P. e. s. M. g. m. t.*, No. 07-0529 (N.D. Ill., final order May 15, 2009); *FTC v. Gap One Network, Inc.*, No. 8:09-cv-352-T-26-MAP (M.D. Fla., final order March 19, 2009); *FTC v. Debt Solutions, Inc.*, No. 06-0298 JLR (W.D. Wash., final order June 18, 2007).

³³ See cases cited *supra*, note 32.

³⁴ See Appendix A (items 1, 3, 4, 5, 7, 8, 9, 10, and 14).

³⁵ See cases cited *supra*, note 32.

(3) violated the TSR's Do Not Call provisions, among other T

³⁶ See cases cited *in part*, note 32.

³⁷ Press Release, FTC, *FTC Issues Final Rule to Protect Consumers in Debt Collection* (July 29, 2010), available at www.ftc.gov/opa/2010/07/tsr.shtm. Commissioner Rosch dissented from the Commission decision.

³⁸ Comments were submitted by: 35 industry representatives, 10 industry trade associations and groups, 26 consumer groups and legal services offices, six law enforcement organizations, three professors, two labor unions, the Uniform Law Commission, the Responsible Debt Relief Institute, the Better Business Bureau, and 236 individual consumers. The public comments are available at www.ftc.gov/os/comments/tsrdebtrelief/index.shtm.

³⁹ A transcript of the forum is available at www.ftc.gov/bcp/rulemaking/tsr/tsr-debtrelief/index.shtm. After the forum, Commission staff sent letters to industry trade associations and individual debt relief providers that had submitted public comments, soliciting follow-up information in connection with certain issues that arose at the forum. The letters are posted at www.ftc.gov/os/comments/tsrdebtrelief/index.shtm. Sixteen organizations responded and provided data.

- prohibits any telemarketer or seller of debt relief services from requesting or receiving payment until it produces the promised services and provides proof documenting this fact to the consumer
- mandates certain additional disclosures and prohibits misrepresentations in the telemarketing of debt relief services; and
- extends the existing protections of the TSR to inbound debt relief calls, i.e., those where consumers call a telemarketer in response to a general media or direct mail advertisement.⁴⁰

As to its scope, the Final Rule covers telemarketers of for-profit debt relief services, including credit counseling, debt settlement, and debt negotiation services. Because the FTC Act exempts nonprofit entities from the agency's jurisdiction under that Act, and the Telemarketing Act incorporates the FTC Act exemptions, the TSR generally does not apply to such entities. However, companies falsely claiming nonprofit status are subject to both the FTC Act and the TSR.

The Final Rule specifies that fees for debt relief services may not be collected until:

- the debt relief provider successfully renegotiates, settles, reduces, or otherwise changes the

⁴⁰ Outbound calls to solicit the purchase of debt relief services are already subject to the TSR.

result of the agreement negotiated by the debt relief provider.

To ensure that debt relief providers do not front-load their fees if a consumer has enrolled multiple debts in one debt relief program, the Final Rule specifies how debt relief providers may collect the fee for each settled debt. First, the provider's fee for a single debt must be in proportion to the total fee that would be charged if all of the debts had been settled.

Alternatively, if the provider bases its fee on the percentage of what the consumer saves as a result of using its services, the percentage charged must be the same for each of the consumer's debts.

Another new provision of the Final Rule will allow debt relief companies to require that consumers set aside their fees and savings for payment to creditors in a "dedicated account."

However, providers may only require a dedicated account as long as five conditions are met:

- the dedicated account is maintained at an insured financial institution;
- the consumer owns the funds (including any interest accrued);
- the consumer can withdraw the funds at any time without penalty;
- the provider does not own or control or have any affiliation with the company administering the account, and

welfare of our troops and public safety personnel in a time of crisis.

The Commission encourages wide circulation of all of its educational resources and makes bulk orders available free of charge, including shipping. We provide FTC materials to state attorneys general and other local law enforcement entities, consumer groups, and nonprofit organizations, who in turn distribute them directly to consumers. In addition, media outlets – online, print, and broadcast – routinely cite our materials and point to our guidance when covering debt-related news stories.

VI. Conclusion

The FTC appreciates the opportunity to describe its work to protect consumers from deceptive and abusive conduct in the marketing of debt relief services. Stopping the marketers of debt relief services who prey on consumers facing financial hardship is among the FTC's highest priorities, and we will continue our aggressive law enforcement and educational programs in this area.

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13. ~~EB~~ *t*, No. 1:07-cv-00558-RPM (D. Colo., final order p. 11, 2008) (debt settlement), ~~tu~~ www.ftc.gov/os/caselist/0623140/index.shtm
14. ~~EB~~ *.*, No. CV06-0298 (W.D. Wash., final order June 18, 2007) (debt negotiation), ~~tu~~ www.ftc.gov/os/caselist/0523002/0523002.shtm
15. *E* v. *L*