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Peddling Relief, Industry Puts Debtors in a Deeper Hole

By **PETER S. GOODMAN**

PALM BEACH, Fla. — For the companies that promise relief to Americans confronting swelling credit card balances, these are days of lucrative opportunity.

So lucrative, that an industry trade association, the United States Organizations for Bankruptcy Alternatives, recently convened here, in the oceanfront confines of the Four Seasons Resort, to forge deals and plot strategy.

At a well-lubricated evening reception, a steel drum band played [Bob Marley](#) songs as hostesses in skimpy dresses draped leis around the necks of arriving entrepreneurs, some with deep tans.

The debt settlement industry can afford some extravagance. The long [recession](#) has delivered an abundance of customers — debt-saturated Americans, suffering lost jobs and income, sliding toward bankruptcy. The settlement companies typically harvest fees reaching 15 to 20 percent of the credit card balances carried by their customers, and they tend to collect upfront, regardless of whether a customer's debt is actually reduced.

State attorneys general from New York to California and consumer watchdogs like the Better Business Bureau say the industry's proceeds come at the direct expense of financially troubled Americans who are being fleeced of their last dollars with dubious promises.

Consumers rarely emerge from debt settlement programs with their credit card balances eliminated, these critics say, and many wind up worse off, with severely damaged credit, ceaseless threats from collection agents and lawsuits from creditors.

In the Kansas City area, Linda Robertson, 58, rues the day she bought the pitch from a debt settlement company advertising on the radio, promising to spare her from bankruptcy and eliminate her debts. She wound up sending nearly \$4,000 into a special account established under the company's guidance before a credit card company sued her, prompting her to drop out of the program.

By then, her account had only \$1,470 remaining: The debt settlement company had collected the rest in fees. She is now filing for bankruptcy.

"They take advantage of vulnerable people," she said. "When you're desperate and you're trying to get out of debt, they take advantage of you." Debt settlement has swollen to some 2,000 firms, from a niche of perhaps a dozen companies a decade ago, according to trade associations and the Federal Trade Commission, which is completing [new rules](#) aimed at curbing abuses within the industry.

Last year, within the industry's two leading trade associations — the United States Organizations for Bankruptcy Alternatives and the Association of Settlement Companies — some 250 companies collectively had more than 425,000 customers, who had enrolled roughly \$11.7 billion in credit card balances in their programs.

As the industry has grown, so have allegations of unfair practices. Since 2004, at least 21 states have brought at least 128 enforcement actions against debt relief companies, according to the National Association of Attorneys General. [Consumer complaints](#) received by states more than doubled between 2007 and 2009, according to comments filed with the Federal Trade Commission.

"The industry's not legitimate," said Norman Googel, assistant attorney general in West Virginia, which has prosecuted debt settlement companies. "They're targeting a group of people who are already drowning in debt. We're talking about middle-class and lower middle-class people who had incomes, but they were using credit cards to survive."

The industry counters that a few rogue operators have unfairly tarnished the reputations of well-intentioned debt settlement companies that provide a crucial service: liberating Americans from impossible credit card burdens.

With the unemployment rate near [double digits](#) and [6.7 million people](#) out of work for six

months or longer, many have relied on credit cards. By the middle of last year, 6.5 percent of all accounts were at least 30 days past due, up from less than 4 percent in 2005, according to [Moody's Economy.com](#).

Yet a 2005 alteration spurred by the financial industry made it harder for Americans to discharge credit card debts through bankruptcy, generating demand for alternatives like debt settlement.

The Arrangement

The industry casts itself as a victim of a smear campaign orchestrated by the giant **banks** that dominate the credit card trade and aim to hang on to the spoils: interest rates of 20 percent or more and exorbitant late fees.

“We’re the little guys in this,” said John Ansbach, the chief lobbyist for the United States Organizations for Bankruptcy Alternatives, better known as Usoba (pronounced you-SO-buh). “We exist to advocate for consumers. Two and a half billion dollars of unsecured debt has been settled by this industry, so how can you take the position that it has no value?”

But consumer watchdogs and state authorities argue that debt settlement companies generally fail to deliver.

In the typical arrangement, the companies direct consumers to set up special accounts and stock them with monthly deposits while skipping their credit card payments. Once balances reach sufficient size, negotiators strike lump-sum settlements with credit card companies that can cut debts in half. The programs generally last two to three years.

“What they don’t tell their customers is when you stop sending the money, creditors get angry,” said Andrew G. Pizer, a staff lawyer at the National Consumer Law Center. “Collection agents call. Sometimes they sue. People think they’re settling their problems and getting some relief, and lo and behold they get slammed with a lawsuit.”

In the case of two debt settlement companies sued last year by New York State, the attorney general alleged that no more than 1 percent of customers gained the services promised by marketers. A Colorado investigation came to a similar conclusion.

The industry’s own figures show that clients typically fail to secure relief. In a survey of its

members, the Association of Settlement Companies found that three years after enrolling, only 34 percent of customers had either completed programs or were still saving for settlements.

“The industry is designed almost as a [Ponzi scheme](#),” said Scott Johnson, chief executive of US Debt Resolve, a debt settlement company based in Dallas, which he portrays as a rare island of integrity in a sea of shady competitors. “Consumers come into these programs and pay thousands of dollars and then nothing happens. What they constantly have to have is more consumers coming into the program to come up with the money for more marketing.”

The Pitch

Linda Robertson knew nothing about the industry she was about to encounter when she picked up the phone at her Missouri home in February 2009 in response to a radio ad.

What she knew was that she could no longer manage even the monthly payments on her roughly \$23,000 in credit card debt.

So much had come apart so quickly.

Before the recession, Ms. Robertson had been living in Phoenix, earning as much as \$8,000 a month as a real estate appraiser. In 2005, she paid \$185,000 for a three-bedroom house with a swimming pool and a yard dotted with hibiscus.

When the real estate business collapsed, she gave up her house to foreclosure and moved in with her son. She got a job as a waitress, earning enough to hang on to her car. She tapped credit cards to pay for gasoline and groceries.

By late 2007, she and her son could no longer afford his apartment. She moved home to Kansas City, where an aunt offered a room. She took a job on the night shift at a factory that makes plastic lids for packaged potato chips, earning \$11.15 an hour.

Still, her credit card balances swelled.

The radio ad offered the services of a company based in Dallas with a soothing name: Financial Freedom of America. It cast itself as an antidote to the breakdown of middle-class life.

“We negotiate the past while you navigate the future,” read a caption on its [Web site](#), next to a photo of a young woman nose-kissing an adorable boy. “The American Dream. It was never

about bailouts or foreclosures. It was always about American values like hard work, ingenuity and looking out for your neighbor.”

When Ms. Robertson called, a customer service representative laid out a plan. Every month, Ms. Robertson would send \$427.93 into a new account. Three years later, she would be debt-free. The representative told her the company would take \$100 a month as an administrative fee, she recalled. His tone was take-charge.

“You talk about a rush-through,” Ms. Robertson said. “I didn’t even get to read the contract. It was all done. I had to sign it on the computer while he was on the phone. Then he called me back in 10 minutes to say it was done. He made me feel like this was the answer to my problems and I wasn’t going to have to face bankruptcy.”

Ms. Robertson made nine payments, according to Financial Freedom. Late last year, a sheriff’s deputy arrived at her door with court papers: One of her creditors, **Capital One**, had filed suit to collect roughly \$5,000.

Panicked, she called Financial Freedom to seek guidance. “They said, ‘Oh, we don’t have any control over that, and you don’t have enough money in your account for us to settle with them,’ ” she recalled.

Her account held only \$1,470, the representative explained, though she had by then deposited more than \$3,700. Financial Freedom had taken the rest for its administrative fees, the company confirmed.

Financial Freedom later negotiated for her to make \$100 monthly payments toward satisfying her debt to the creditor, but Ms. Robertson rejected that arrangement, no longer trusting the company. She demanded her money back.

She also filed a report with the Better Business Bureau in Dallas, adding to a stack of more than 100 consumer complaints lodged against the company. The bureau gives the company a failing grade of F.

Ms. Robertson received \$1,470 back through the closure of her account, and then \$1,120 — half the fees that Financial Freedom collected. Her pending bankruptcy has cost her \$1,500 in legal fees.

“I trusted them,” she said. “They sounded like they were going to help me out. It’s a rip-off.”

Financial Freedom’s chief executive, Corey Butcher, rejected that characterization.

“We talked to her multiple times and verified the full details,” he said, adding that his company puts every client through a verification process to validate that they understand the risks — from lawsuits to garnished wages.

Intense and brooding, Mr. Butcher speaks of a personal mission to extricate consumers from credit card debt. But roughly half his customers fail to complete the program, he complained, with most of the cancellations coming within the first six months. He pinned the low completion rate on the same lack of discipline that has fostered many American ailments, from obesity to the foreclosure crisis.

“It comes from a lack of commitment,” Mr. Butcher said. “It’s like going and hiring a personal trainer at a health club. Some people act like they have lost the weight already, when actually they have to go to the gym three days a week, use the treadmill, cut back on their eating. They have to stick with it. At some point, the client has to take responsibility for their circumstance.”

Consumer watchdogs point to another reason customers wind up confused and upset: bogus marketing promises.

In April, the United States Government Accountability Office released a report drawing on undercover agents who posed as prospective customers at 20 debt settlement companies. According to [the report](#), 17 of the 20 firms advised clients to stop paying their credit card bills. Some companies marketed their programs as if they had the imprimatur of the federal government, with one advertising itself as a “national debt relief [stimulus plan](#).” Several claimed that 85 to 100 percent of their customers completed their programs.

“The vast majority of companies provided fraudulent and deceptive information,” said Gregory D. Kutz, managing director of [forensic](#) audits and special investigations at the G.A.O. in testimony before the Senate Commerce Committee during an April hearing.

At the same hearing, Senator Claire McCaskill, a Missouri Democrat, pressed Mr. Ansbach, the Usoba lobbyist, to explain why his organization refused to disclose its membership.

“The leadership in our trade group candidly was concerned that publishing a list of members

ended up being a subpoena list,” Mr. Ansbach said.

“Probably a genuine concern,” Senator McCaskill replied.

The Coming Crackdown

On multiple fronts, state and federal authorities are now taking aim at the industry.

The Federal Trade Commission has proposed banning upfront fees, bringing vociferous lobbying from industry groups. The commission is expected to issue new rules this summer. Senator McCaskill has joined with fellow Democrat [Charles E. Schumer](#) of New York to [sponsor a bill](#) that would cap fees charged by debt settlement companies at 5 percent of the savings recouped by their customers. Legislation in several states, including New York, California and Illinois, would also cap fees. A new consumer protection agency created as part of the financial regulatory reform bill in Congress could further constrain the industry.

The prospect of regulation hung palpably over the trade show at this Atlantic-side resort, tempering the orchid-adorned buffet tables and poolside cocktails with a note of foreboding.

“The current debt settlement business model is going to die,” declared Jeffrey S. Tenenbaum, a lawyer in the Washington firm Venable, addressing a packed ballroom. “The only question is who the executioner is going to be.”

That warning did not dislodge the spirit of expansion. Exhibitors paid as much as \$4,500 for display space to showcase their wares — software to manage accounts, marketing expertise, call centers — to attendees who came for two days of strategy sessions and networking.

Cody Krebs, a senior account executive from Southern California, manned a booth for [LowerMyBills.com](#), whose Internet ads link customers to debt settlement companies. Like many who have entered the industry, he previously sold subprime [mortgages](#). When that business collapsed, he found refuge selling new products to the same set of customers — people with poor credit.

“It’s been tremendous,” he said. “Business has tripled in the last year and a half.”

The threat of regulations makes securing new customers imperative now, before new rules can take effect, said Matthew G. Hearn, whose firm, Mstars of Minneapolis, trains debt settlement

sales staffs. “Do what you have to do to get the deals on the board,” he said, pacing excitedly in front of a podium.

And if some debt settlement companies have gained an unsavory reputation, he added, make that a marketing opportunity.

“We aren’t like them,” Mr. Hearn said. “You need to constantly pitch that. ‘We aren’t bad actors. It’s the ones out there that are.’ ”