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BEFORE THE U.S. SENATE COMMITTEE ON COMMERCE, SCIENCE, AND
TRANSPORTATION

Hearing on the Debt Settlement Industry, Kansas City, Missouri

August 12, 2010

Chairman Rockefeller, Senator Hutchison, and Members of the Committee, thank you for allowing me the opportunity to appear before the Committee and testify concerning the conduct of debt settlement industry participants and the impact this predatory industry has had on consumers in Missouri and across the country. I would also like to thank the Committee, and in particular Senator McCaskill, for bringing this Hearing to Missouri. Although we are not alone in this regard, many Missourians have been deceptively lured into the debt settlement scheme. In my capacity as an Assistant Attorney General, I have responded to numerous complaints from Missourians who thought they had found a way to honorably reduce their debt burdens by enrolling in these so-called programs, only to find themselves in worse financial shape than before signing up for relief. I applaud your efforts to address the unfairness and deception inherent in this industry and am honored to share my thoughts and experiences today.

At the Committee's April 22, 2010 hearing, my colleague from the North Carolina Department of Justice, Phil Lehman, provided an excellent overview of the deception and unfairness inherent in the debt settlement industry. Additionally, 41 Attorneys General voiced their support for the FTC prohibition on the collection of advance fees by debt settlers. This was due in no small part to the efforts of our colleagues in the Illinois Attorney General's Office. Many additional consumer

protection groups have also provided their valuable insights, including the Center for Responsible Lending and the National Consumer Law Center. As has been clearly demonstrated by the collective experience and wisdom of the consumer protection community, the debt settlement industry is a menace.

While many consumers can benefit from legitimate financial counseling, debt settlement practices are not aimed at reducing consumer debt. The objectives of debt settlers are to instill a false sense of hope in consumers mired in financial struggles while draining their limited resources.

The debt settlement scheme is fairly consistent. Advertisements reach consumers claiming a given entity can reduce that consumer's debt by 40-50% or more.¹ This message reaches consumers through television, radio, print, and internet media. Stressed consumers are naturally drawn in by the possibility of living "debt free". Consumers' hopes are heightened upon making contact with the debt settler and being informed the settler has a special program, based on unique creditor relationships, that will allow debts to be magically reduced. The consumer is sent a package and signs up for this "program". In many instances, this includes setting up a stand-alone bank account, purportedly for the purpose of paying off reduced debt. What the consumer ultimately discovers is that this account is primarily a vehicle for payments to be made to the debt settler. In the process, the consumer is introduced to two additional entities – the payment processor and the debt settler's bank. As noted by Mr. Lehman in his April 22, 2010 testimony, numerous states enacted prohibitions on debt settlement conduct but in many states these prohibitions only apply if the debt settler directly receives consumer funds. The modern

¹ See e.g., www.creditsolutions.com ("Put us to work for you and settle your unsecured debt by up to 50%.")

debt settlement scheme would likely not be as prevalent without the participation of these processing and banking parties.

Upon setting up the debt settlement bank account, automatic withdrawals from this account then take place. Payments are withdrawn first for the benefit of the debt settler. In my experience, any actual negotiation with creditors occurs, if at all, only after significant fees are extracted by the debt settler. In one recent example involving a Missouri consumer on a fixed income, the debt settlement company withdrew \$1,278.84 as fees before any settlement activity took place. While these fees were being extracted, this consumer was sued on an account she thought was being negotiated. A judgment was lodged against this consumer and we are now working to obtain restitution on her behalf. Unfortunately, this is not an isolated instance. Complaints to the Missouri Attorney General's Office concerning debt settlement practices more than doubled from 2008 to 2009. Complaints in 2010 are on pace to more than triple the number from 2008.

The debt settlement "program" is premised on the debt settlers' claim that a consumer who ceases all payments on unsecured debt will be in a better negotiating position with creditors.² The debt settler will also claim to have developed special relationships with creditors that facilitate reduction of debt. These claims are inherently deceptive. Indeed, many large creditors and/or the collection attorneys who work for them refuse to negotiate with debt settlement entities, a fact that is omitted from debt settlement advertisements.

Even where creditors may deal with a debt settler, the structure of the "program" operates to the detriment of the consumer. The approach of defaulting on unsecured debt

² See e.g., www.netdebt.com ("When your accounts are past due, your creditors become very willing to accept significantly less than the balance owed and will settle the account.")

and ceasing communication with creditors inevitably causes the debtor to incur additional charges that increase the consumer's debt load. These charges can be substantial, including late fees, higher interest rates, attorney fees, and other litigation costs. The debt settlement industry's claims of debt reduction, while deceptive from a macro level, are also unfounded when one looks at any debt they claim to have reduced. In making these claims, debt settlers include the additional, default-related charges incurred by a consumer in calculating the percentage of "reduction" purportedly achieved on behalf of a consumer. For example, a consumer may go into a debt settlement "program" with \$5,000 in debt to a given creditor; cease payments and communication with this creditor; incur additional fees and charges of \$2,500; and the debt settler would claim a 33% "reduction" by negotiating the consumer's debt to the original \$5,000 balance but only after the consumer had paid the debt settler hundreds or thousands of dollars in fees. This practice is predatory and inherently deceptive.

Not surprisingly, and in spite of their claims to the contrary, debt settlement entities do not have track records of settling debts that even approach legitimacy. In one of the cases that illustrate this point, the FTC pursued the National Consumer Council for bogus claims regarding its claimed success rate in reducing consumer debt.³ The court appointed receiver reported that only 1.4% of consumers actually completed the debt settlement "program".

Enforcement actions against debt settlement entities and principals are effective in dealing with the targeted entity. Unfortunately, where one entity's conduct is addressed by enforcement action, many others go unaddressed because enforcement offices do not

³ FTC v National Consumer Council et al., case no. 04-0474, U.S. District Court, Central District of California.

learn of each entity operating within its jurisdiction; because resources do not allow for prosecution of every entity and/or its principals; and because the industry model is lucrative for its participants to the extent that the market is filled with new entrants.

One method of addressing the deceptive nature of this industry has been issued in the FTC's recently enacted Rule prohibiting the collection of advance fees. The FTC has issued a strong Rule in this regard. Additional protective action could include instituting a cap on the total amount of fees that may be collected when negotiating debts on behalf of consumers. Truly comprehensive measures would also address the participation of processing and banking entities. Debt settlement is an unfair and deceptive scheme, the perpetration of which is dependant on individuals and entities that are willing to process the transactions and deliver consumers' money to the scammers.

The debt settlement industry is deserving of the attention this Committee is paying to it. Any action by the Committee that supplements the tools and resources available for the Attorneys General, consumers, and society is welcome.