NON-PROFIT CREDIT COUNSELING ORGANIZATIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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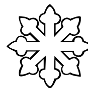

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NON-PROFIT CREDIT COUNSELING ORGANIZATIONS

THURSDAY, NOVEMBER 20, 2003

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:38 p.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
May 06, 2003
OV–4

Houghton Announces Hearing on the Use of Private Collection Agencies To Improve IRS Debt Collection

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on private collection agencies. **The hearing will take place on Tuesday, May 13, 2003, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include the Honorable Mark Everson, Commissioner of the Internal Revenue Service (IRS), and Nina Olson, the National Taxpayer Advocate.

BACKGROUND:

Each year, the IRS collects over $2 trillion in tax revenue from all sources. A small percentage of this amount is assessed, but not collected. The IRS has 10 years to collect newly assessed taxes. Over the past decade, the total inventory of unpaid tax assessments has more than doubled. It has grown from $130 billion in 1992 to over $280 billion in March 2003.

Much of this amount represents tax debts that cannot be collected, due to death or bankruptcy, but the IRS estimates that about $78 billion is collectible. The amount judged to be collectible has grown by 12 percent during the past 2 years, and the inactive portion that the IRS is not currently pursuing has grown by 38 percent. As of March, the IRS had identified over $13 billion in tax debts that can only be collected if the IRS has more resources.

The Bush Administration is highly concerned about the growth in the inventory of uncollected taxes, and the IRS issued a Request for Information that appeared in the Federal Register in January 2002 to seek input from private collection agencies (PCAs) on how PCAs could assist the IRS with its collection efforts, while preserving important taxpayer protections in existing law. Using this information, the Administration developed a proposal that appeared in the fiscal year 2004 budget request for the IRS. Chairman Houghton introduced legislation (H.R. 1169) that would implement the Administration's proposal.

In announcing the hearing, Chairman Houghton stated, "We all know that it is a duty of citizenship to abide by the rules and pay our taxes. Yet, in the event that the rules are not followed, the IRS is unfortunately not able to adequately enforce this obligation due to a lack of funds. Enforcement is inconsistent at best. The Administration is looking for innovative solutions to this problem, and I applaud them for it."

FOCUS OF THE HEARING:

The hearing will focus on the Administration's proposal to use private collection agencies to support the IRS's collection efforts and Chairman Houghton's bill to implement the proposal.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to hearingclerks.waysandmeans@mail.house.gov, along with a fax copy to (202) 225–2610, by the close of business, Tuesday, May 27, 2003. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the Subcommittee on Oversight in room 1136 Longworth House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will refuse sealed-packaged deliveries to all House Office Buildings.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

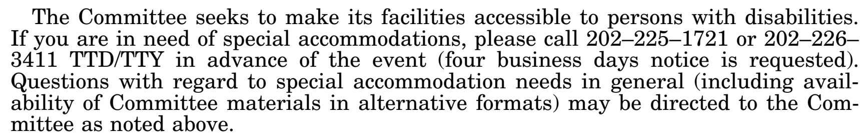
1. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to hearingclerks.waysandmeans@mail.house.gov, along with a fax copy to (202) 225–2610, in WordPerfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Any statements must include a list of all clients, persons, or organizations on whose behalf the witness appears. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.



Chairman HOUGHTON. Well, good afternoon, ladies and gentlemen. I am terribly sorry for the delay. So, on behalf of Mr. Pomeroy, Mr. Sandlin, and myself, we have been doing the work of the Lord. We have been voting, but now we are yours. We are delighted to be here. Thank you, Mr. Everson and Mr. Beales, for being here. The hearing today, as most of you know, will explore the activities of consumer credit counseling agencies. While nonprofit consumer credit counseling organizations provide an important and educational counseling service to consumers who are experiencing financial difficulties, I think I can speak for my associates here—and Ms. Carson has just arrived. Julia, we are delighted to have you here.

Ms. CARSON. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much.

Ms. CARSON. I am glad you let me in here.

Chairman HOUGHTON. I think we are all concerned with reports that they may be taking advantage of their tax-exempt status. In recent months, Federal, State, and consumer watchdog organizations have raised serious questions about the activities of some of these consumer credit counseling agencies. Today, we are going to hear from two Federal agencies that oversee these groups, the Internal Revenue Service (IRS), because most agencies have qualified as nonprofit organizations, and also the Federal Trade Commission (FTC), which regulates the consumer fairness side of their business.

In addition, we are going to hear from a major consumer rights organization about the problems they see with the current activities of credit counseling agencies. Finally, we will hear testimony from two trade associations, and also two of the consumer credit counseling companies themselves. I would note for the record that the Subcommittee invited a number of other individual companies to testify, but except for these two, the others declined to appear.

Our mission here, today, is not to be a judge and a jury, but to explore the evidence in a way that will help us determine whether changes need to be made to existing law and regulatory practices. Now, I am pleased to yield to my good friend, our Ranking Member, Mr. Pomeroy.

[The opening statement of Chairman Houghton follows:]

Opening Statement of the Honorable Amo Houghton, Chairman, and a Representative in Congress from the State of New York

Good afternoon. Our hearing today will explore the activities of consumer credit counseling agencies. While non-profit consumer credit counseling organizations provide an important educational and counseling service to consumers who are experiencing financial difficulties, I am concerned about reports that some groups may be taking advantage of their tax-exempt status.

In recent months, federal, state and consumer watchdog organizations have raised serious questions about the activities of some consumer credit counseling agencies.

Today we will hear from the two federal agencies that oversee these groups, the Internal Revenue Service—because most agencies have qualified as "non-profit" organizations, and the Federal Trade Commission, which regulates the consumer fairness side of their business.

In addition, we will hear from a major consumer rights organization about the problems they see with the current activities of credit counseling agencies. Finally we will have testimony from two trade associations and one of the consumer credit counseling companies. I would note for the record that the Subcommittee invited a number of other individual companies to testify, but except for two, each of them declined to appear.

Our mission here today is not to be a judge and jury, but to explore the evidence and weigh whether changes need to be made in existing law and regulatory practices.

I am now pleased to yield to our ranking Democrat, Mr. Pomeroy.

Mr. POMEROY. I thank the Chairman. Thank you for holding this important hearing. The issue before us is an important one. Consumers, data will show us, are becoming increasingly burdened with debt. Many will need help in terms of how to handle their budgets in light of the debt. If done well, I believe bankruptcy can be avoided—people can get back on their feet, and we can help people in dealing with their debt burden. Clearly, the credit counseling service activity can be very, very important to any number of families in this country.

On the other hand, we are seeing more of an entrepreneurial character in terms of the marketing of these credit counseling services, and they certainly raise questions about what activity is actually being delivered. I know that the IRS and the FTC, our first panel, have urged consumers to seek caution in dealing with credit counseling organizations. They report that some organizations are using questionable practices—maybe even using tax-exempt status to circumvent State and Federal consumer protection laws. It is terribly disconcerting to think that there would be an enterprise masquerading in tax-exempt status, purporting to help consumers, but actually preying upon some of the most vulnerable families in our country in their time of need—facing financial crisis.

You are going to have some outfit parading about, telling people they are helping them, and actually they are just another rip-off. We certainly want to smoke out in this hearing what is behind this kind of activity, who are the good ones, who are the bad ones, and what we can do about it. I am very pleased that you have held this hearing.

I would like to offer testimony, Mr. Chairman, on behalf of a reputable credit counseling agency, the Village Family Service Center of Fargo, North Dakota. The Village Family Service Center is an organization that has provided credit counseling for more than 2 decades. I know the people; I know the operation; I know the reputation. I think they represent perhaps some of the best practices that are out there in this area. Their testimony, I think, is important to us. I would ask unanimous consent that their testimony be included. I thank the Chairman.

[The opening statement of Mr. Pomeroy and insertion follow:]

Opening Statement of the Honorable Earl Pomeroy, a Representative in Congress from the State of North Dakota

American consumers are becoming more and more in debt. This year, Federal Reserve data indicates that credit card debt has reached nearly $700 billion. Our current economic situation, high unemployment rates, uninsured health costs, and lack of financial education have caused a record number of Americans to seek credit counseling services.

Credit counseling services and the debt consolidation industry have grown both in size and in marketing methods to meet this new demand. Unfortunately, some bad actors have surfaced and taken advantage of a largely unregulated system. This potentially gives a bad name to the hundreds of long-standing local organizations that are truly helping those in financial straits.

The Internal Revenue Service has responsibility for overseeing the tax-exempt status of credit counseling organizations to insure that educational and charitable services are provided to consumers. The Federal Trade Commission is responsible for enforcing our consumer protection laws, including the new telemarketing "Do Not Call List."

Together, the IRS and FTC have urged consumers to exercise caution when seeking help from credit counseling organizations. The agencies have reported that some organizations are "using questionable practices" and "using tax-exempt status to circumvent state and federal consumer protection laws." This is just plain unacceptable. The Subcommittee's hearing will help us distinguish between "legitimate" tax-exempt charitable and educational organizations and "fraudulent" entities that no longer deserve our continued federal support.

The Village Family Service Center of Fargo, North Dakota is an organization that has provided non-profit credit counseling services to my constituents for over two decades. I suggest that they provide a model for credit counseling "best practices." I ask that their written statement be included in the Subcommittee's official hearing record.

Finally, I want to thank Chairman Houghton for holding this important, bipartisan hearing. It is timely that we conduct oversight review of this area of the tax-exempt laws and support the IRS and FTC as they proceed.

Statement of Sheri Ekdom, The Village Family Service Center, Consumer Credit Counseling Service of The Village, Fargo, North Dakota

The Village Family Service Center is a private, non-profit, multi-program, human service agency founded in 1891 as The North Dakota Children's Home. The Village is accredited by the Council on Accreditation and serves people in need through 20 offices across North Dakota and Minnesota. The mission of The Village Family Service Center is to improve the quality of life through services designed to strengthen individuals, families, and organizations.

Major programs offered include Pregnancy Counseling and Adoption Services, Big Brother Big Sister Mentoring, Mental Health Counseling, Intensive In-Home Family Based Services, Village Business Institute, Youth Services and The Village Financial Resource Center. The major programs are then tailored to the specific needs of the local community and service area, and smaller unique programs developed.

The Village Family Service Center is governed by a diverse, community-based, volunteer Board of Directors. Board members contribute both their time and expertise to The Village and one hundred percent of the Board of Directors makes charitable financial contributions to support Village services.

The Financial Resource Center includes Consumer Credit Counseling Service (CCCS) programming. The Village has been providing CCCS services and has been a member of the National Foundation for Credit Counseling since the early 70's when the community need for credit counseling and services was first identified. Despite the current changes in the industry, CCCS of The Village has continued to provide confidential, comprehensive, quality financial advice, education and counseling to the communities it serves.

CCCS of The Village encourages people seeking financial guidance to know the difference between responsible and irresponsible agencies. Our agency upholds the best practices in the industry. One hundred percent of clients using our services receive a comprehensive counseling session and a written action plan tailored specifically to their individual situation.

Our goal is to help clients be financially responsible adults and make positive choices to achieve their financial goals. Counselors take clients through an in-depth financial analysis examining their income, expenses, assets and debt—and then help develop a financial action plan specifically suited to their situation.

Debt management programs are only set up only when appropriate for the client. Currently, about 25% of the clients we counsel join the DMP. It is our opinion that agencies whose main focus is debt management rather than counseling and education are not operating in the best interest of a client.

CCCS of The Village challenges people to change their lifestyles so that their values and belief systems reflect in their money choices and decisions. Client goals include improved financial condition, reduced stress, decreased debt, improved credit reports and increased money management skills. Through budget counseling and education, CCCS seeks to assist families in restoring self-reliance, confidence, hope and family well-being while strengthening the economic fabric of the communities we serve.

About 75% of our financial counseling sessions are in-office face-to-face meetings. Counseling is also offered over the telephone or online. These methods have been especially beneficial for those living in rural areas or with disabilities.

CCCS of The Village is diligent in its community outreach and education. We provide financial education through workshops, presentations in the workplace, and one-on-one sessions. We offer several unique education programs designed to help clients make changes in their spending habits and meet their financial goals. CCCS is known in the communities it serves as a trustworthy, non-biased source of financial information.

Clients hear about our services in a variety of ways, however, our greatest referral source is word of mouth through friends and family that have utilized our services. We do not run deceptive ads—promising quick fixes in 20 minutes or less—nor do we rely on a telemarketer to sell someone a program they may not need or fully understand. Our focus is on doing what is best for a client.

Chairman HOUGHTON. Thank you very much. Now we have been joined by Mr. Foley, distinguished Representative from Florida. Would anybody like to make an opening statement? Mr. Foley, would you like to make a statement?

Mr. FOLEY. No, thank you, sir.

Chairman HOUGHTON. All right. How about you, Mr. Sandlin?

Mr. SANDLIN. Mr. Chairman, I rarely get to sit up here this high, so the altitude is affecting me. I can't find the button.

Chairman HOUGHTON. We have some oxygen over here that might help you.

Mr. SANDLIN. I have an opening statement that I would like to submit for the record. Let me just say very briefly that I really appreciate you having this hearing today. Certainly there are legitimate credit counseling groups and agencies in the United States that offer a very valuable service to my constituents, and the folks across the country, and I appreciate that.

However, recently, as has been indicated by my friend Mr. Pomeroy, there has been just a plethora of advertising on television from groups that are little more than a sham, but that indicate that they are there to help the consumers. In fact, they do absolutely nothing for the consumers. They collect funds and don't distribute them properly. They adversely affect the credit ratings of my constituents. They bother them with telephone calls, and I have grave concerns about privacy issues and where some of these groups get the information that they have to call people who are in financial difficulty. I have been very disappointed in those groups, and certainly we need to do something to regulate that, and make sure that people who are in counseling are in counseling.

It is one thing to counsel people about their credit, and talk to them about their budgets, incomes, and outgo. It is another thing to prey upon people who are in difficult situations, just to make sure the credit card companies get paid first and only—and I think that is the point of those groups that are on television. I am very disappointed with that, and I appreciate you having the hearing today.

[The opening statement of Mr. Sandlin follows:]

Opening Statement of the Honorable Max Sandlin, a Representative in Congress from the State of Texas

Mr. Chairman, I would like to thank you for holding today's hearing to examine the operations of non-profit credit counseling organizations.

According to the National Consumer Law Center, nearly nine million people sought the help of credit counseling organizations last year, and at least one million consumers have consolidated their debts with these groups. As consumer debt in America continues to grow and exert increasing pressure on struggling families, it is now more important than ever to scrutinize the operations of non-profit credit counseling organizations.

The Federal Reserve estimates that revolving consumer debt exceeded $700 billion at the end of last year, and notes that household debt has risen to approximately 14% of disposable income. Household debt as a percentage of disposable income has never been higher in our country, which helps explain why, according to the American Bankruptcy Institute, personal bankruptcies in 2003 are projected to surpass last year's record of 1.5 million.

While many credit counseling organizations have existed for decades and provide valuable services to consumers who are having a tough time managing their debts, a few bad apples may be abusing the tax code in an effort to avoid consumer protection laws. Many of the organizations that are now either under investigation or the subject of multiple lawsuits are new participants in the credit counseling industry. In fact, the estimated number of these groups has increased from approximately 200 in 1990 to over 1,000 last year. It appears that several of these groups have exceeded the original mission and intent of credit counseling organizations, and the lack of federal and state regulation of these groups makes congressional and regulatory oversight vitally important.

As we know, non-profit credit counseling organizations qualify for tax-exempt status under section 501(c)(3) of the Internal Revenue Code because they are ostensibly "educational organizations" that "educate consumers about better money management practices" and "promote debt reduction strategies." If a non-profit credit counseling organization is abusing its non-profit status, the I.R.S. needs to vigorously investigate that organization and examine the group's tax-exempt designation. I look forward to Commissioner Everson's testimony on this topic.

I applaud the joint advisory issued last month by the I.R.S., the Federal Trade Commission, and several state regulators that warns people to be wary about the costs of entering into debt management plans. Consumers who are struggling financially need to be careful not to lose even more money to someone offering a quick fix for their credit problems. I look forward to Mr. Beales's testimony this afternoon regarding the ways in which consumers can protect themselves from those credit counseling groups that don't have consumers' best interests at heart.

Paying bills is never easy and is never fun for any of us, but job loss, divorce, or unexpected medical bills can be absolutely devastating for some and force hard-working people to seek debt or credit counseling. Taxpayers struggling with financial problems don't deserve to be taken advantage of by debt counseling groups exploiting gaps in the law, and I again would like to thank Chairman Houghton for holding today's important hearing.

Chairman HOUGHTON. Thank you very much. Well, as I indicated earlier, we are delighted to have Ms. Julia Carson. She is a distinguished Representative from Indiana. I welcome you, Julia, to this hearing. You are here representing your own personal dedication to consumer protection awareness. Maybe you would like to make a brief statement?

Ms. CARSON. I would, thank you very much, Mr. Chairman. I will be very brief, because you have been gracious enough to have the hearing, and to allow me to speak. I thank the Ranking Member, Mr. Pomeroy, for his understanding of this—a major problem in my estimation. I know that the economy essentially caused a lot of financial hardships on Americans, and so, there were people who took advantage of a situation and created—and I noticed that the IRS and the FTC went after—we will call it the unscrupulous kind of operation. It was the kind of issue, and the kind of entity that brought my concern to the House floor. People are creating not-for-profit organizations, calling them "debt counseling," and then hav-

ing another shell corporation, for-profit, sending the money over to that—while people's bills are not getting paid.

You know the situation, Mr. Chairman, better than I do—I won't make a long litany of it. Yet I would encourage the Committee, its leadership especially, to join me in the bill that I introduced. I don't think this could be any more timely. I can never remember the number of the bill. I do know that it affects a great deal of people. The bill is called the Debt Counseling, Debt Consolidation, and Debt Settlement Practices Improvement Act of 2003 (H.R. 3331). It provides a regulatory framework for these culprits that do bad. We have got a lot of good ones out there, Mr. Chairman. We don't want to do a broad stroke on all of them. The bill just gets after the bad ones, and I want to thank those who are already in the forefront of taking care of this. I yield back, Mr. Chairman. Thank you so much for allowing me to come.

[The opening statement of Ms. Carson follows:]

Opening Statement of the Honorable Julia Carson, a Representative in Congress from the State of Indiana

I would like to thank Chairman Houghton and Ranking Member Pomeroy for their graciousness in permitting me to participate in today's hearing, which is on an issue very important to my constituents and myself.

As my colleagues know, this economy has caused financial hardship for many Americans, especially for people trying to manage piles of debt. For a handful of scoundrels to take advantage of consumers seeking financial counseling in their greatest time of need is unconscionable. It is not just consumers who are hurt by the bad apples; **legitimate consumer credit counselors, who are trying to save families and save lives, also bear the brunt in terms of business lost and ruined reputation.** This is why I introduced H.R. 3331, the Debt Counseling, Debt Settlement, and Debt Consolidation Improvements Act, a bill to provide a regulatory framework to the debt management industry. As evidenced by the recent actions of the I.R.S. and the F.T.C., the bill couldn't be timelier.

As household and credit card debt reach all-time highs, more and more Americans are turning to credit counselors for assistance. Many states are reacting to the trend by formulating a diverse array of requirements. New York, Maryland, and California, for instance, have instituted stringent laws regarding debt management organizations. I am pleased the Chairman and this Committee have recognized the urgency of this situation.

Mr. Chairman, hiding behind non-profit status to defraud consumers is outrageous. This is a problem common to every District across the nation. It is my hope that we can work *together* to protect consumers and protect the good work of legitimate credit counseling organizations. I urge my colleagues to consider my bill, H.R. 3331, as a starting point.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Well, thank you very much. Now I would like to introduce Mr. Mark Everson, Commissioner of the IRS, and J. Howard Beales III, Director of the Bureau of Consumer Protection, FTC. Gentlemen, we appreciate your testimony, and Mark, if you would begin.

STATEMENT OF THE HONORABLE MARK EVERSON, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. EVERSON. Thank you, sir. Mr. Chairman, Mr. Pomeroy, Members of the Subcommittee on Oversight, and other——

Chairman HOUGHTON. Do you want to turn your mike on?

Mr. EVERSON. Yes, thank you. Thank you, Mr. Chairman, Mr. Pomeroy, Members of the Subcommittee, and other interested

Members of Congress. Thank you for the opportunity to provide this Subcommittee with information concerning the role of the IRS in regulating the credit counseling industry. I commend this Subcommittee for your interest in this area. We, too, are concerned, and take a dim view of the use of the Tax Code by credit counseling groups to game the system. The potent combination of exemption from income tax, and exemption from consumer protection laws, has, in this instance, encouraged some individuals who are motivated by profit rather than charity.

Let me stress that many credit counseling organizations continue to provide valuable services and meet the requirements for tax exemption. Nevertheless, the operations of a growing number of these organizations no longer reflect what has long been required for tax exemption.

Some unscrupulous organizations now prey on those in financial distress. I want to assure the Subcommittee that the IRS is aggressively pursuing this matter. Currently, we have over 30 organizations at various stages of the examination process. Included in this group are 9 of the top 15 tax-exempt credit counseling organizations, as measured by gross receipts. Moreover, we have in the audit stream, organizations with over 40 percent of the total gross receipts of the tax-exempt portion of this sector. Where warranted, we will revoke the tax-exempt status of these organizations.

At its most basic, section 501(c)(3) provides for the exemption from Federal income taxation of entities organized and operated exclusively for charitable, educational, and certain other purposes. While tax exemption confers significant benefits to an organization, it also comes with responsibilities. This means that an exempt organization must engage primarily in activities that accomplish these charitable purposes, and may not distribute net earnings to insiders, or significantly operate, other than for the benefit of the public.

The organization cannot be run for the benefit of a small group of individuals or for other commercial interests. The IRS and the courts have determined that certain credit counseling organizations can qualify for 501(c)(3) status, provided the organization limits its services to low income customers at low costs, or provides education to the public on how to manage personal finances as its primary activity. There are over 850 section 501(c)(3) credit counseling organizations. Beginning in 2000, we began to see a significant increase in credit counseling applications. In the determination letter area, our specialists traditionally work with applicants to perfect applications, in order to obtain tax-exempt status. Most applications are approved.

However, in the credit counseling area, as we have had to put in place more rigorous procedures, our approval rate for tax exemption status has declined since 2000. As you are aware, there has been an increasing number of allegations of credit counseling abuses, including questionable business relationships, high fees, and little or no education or counseling. The FTC and others have confirmed what we have seen in the applications. Customers now served by the Internet, which appears to be driving much of the growth in the industry, are provided debt management services, not credit counseling. Individual budget assistance and public edu-

cation programs that form the original basis for exemption, have been replaced by promises to restore favorable credit ratings, or to provide commercial debt consolidation services. So, how have we reacted? As indicated in my opening, we are moving aggressively to scrutinize applicants and existing organizations. Our strategy begins by identifying new credit counseling organizations as they seek exemption. At present, we are considering over 40 applications. These applications are identified and assigned to specially trained staff who use their broad investigatory experience to delve deeply into the complex structures and relationships of these organizations.

I have mentioned already that we have also increased the number of examinations. More than 30 organizations and related entities, including some of the largest firms, are at various stages of the examination process. Again, 9 of the top 15 organizations by gross receipts are included in that group, as are organizations with more than 40 percent of the total gross receipts of the sector.

Mr. Chairman, this is an unprecedented effort by the IRS, and one which is fully justified by the risk that continued abuses in this area will broadly undermine our Nation's faith in charitable organizations. The current workload is only the beginning of our compliance effort in this area. By year's end, we expect to follow up on all examination referrals, and implement an approach to identify and classify other high-risk organizations for examinations to commence in 2004. We expect to see significant results in the coming months, and in accord with taxpayer privacy rules, we will publicize the outcome of our efforts. Again, we will revoke exemption where warranted.

Furthermore, because of the magnitude of the problems, we are supporting and partnering with those agencies—like the FTC—whose primary purposes include consumer protection. Let me conclude by saying that I have designated our efforts in the credit counseling area an IRS-wide priority. We will stay on this until we see clear evidence of appropriate reforms within the industry. Thank you.

[The prepared statement of Mr. Everson follows:]

Statement of the Honorable Mark Everson, Commissioner, Internal Revenue Service

Thank you, Mr. Chairman, for the opportunity to provide this Subcommittee with information concerning the role of the Internal Revenue Service (the Service) in regulating the credit counseling industry. I commend the Subcommittee for your interest in this area. Many credit counseling organizations continue to provide valuable services that meet the definitions and requirements of exemption from taxation under section 501(c)(3) of the Internal Revenue Code. However, the operations of a growing number of credit counseling organizations no longer reflect what has long been required for tax exemption. We are concerned that certain of these organizations are now preying on those in financial distress.

I will review our role and the general law relating to charities, the history of tax exemption for credit counseling organizations, recent trends in the area, and our actions to combat what we see as inappropriate activity by some in the sector. As you will see, we are aggressively pursuing this issue with a broad approach that begins with a more in depth determination letter process and includes an enhanced examination program, as well as partnering efforts with the state attorneys general and the Federal Trade Commission.

Background on the Requirements for Tax Exemption under section 501(c)(3)

Role of the Service with respect to tax-exempt organizations: The Service regulates all tax-exempt organizations, of which a subset is described in section 501(c)(3). An organization seeking to be tax exempt under section 501(c)(3) generally is required to apply to the Service for a determination of its status. The organization initiates the process by filing a Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code." The application often is filed in advance of actual operations and can be based on representations about what the organization will do in the future. We review the application to determine whether the organization's proposed activities satisfy the statutory requirements. After we recognize an organization as tax exempt, generally the organization is required to file an annual information return, the Form 990. The Form 990 is a self-reporting mechanism, whereby the organization provides information concerning its current activities, as well as its financial picture. Forms 990 are public documents and we image the forms from section 501(3) organizations making them available to various web sites for public scrutiny. The Service also uses the Form 990 as part of our ongoing effort to ensure compliance with the requirements for tax exemption. Our compliance efforts generally entail additional educational contacts, the review of filed returns and, if warranted, an examination based upon completed operations.

General requirements for tax exemption: In our review of the tax-exempt status of an organization, the Service looks to both statutory and regulatory requirements. At its most basic, section 501(c)(3) provides for the exemption from federal income taxation of entities organized and operated exclusively for charitable, educational, scientific, religious, and certain other purposes. This means that an exempt organization must engage primarily in activities that accomplish charitable purposes. Relieving the poor and distressed generally is considered a charitable purpose. Providing instruction and training for the purpose of improving or developing an individual's capabilities, or educating the public on subjects useful to the individual and beneficial to the community also are considered charitable activities.

An exempt organization also must meet other requirements in order to be described in section 501(c)(3). Chief among these for today's discussion are that the organization must not distribute net earnings to insiders (the prohibition on inurement) and it must operate for the benefit of the public rather than for the benefit of private interests (the prohibition on private benefit). With respect to the private benefit rule, an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization or persons controlled directly or indirectly by such private interests.

History of Tax Exemption for Credit Counseling Organizations

The Service and judiciary have determined that certain credit counseling organizations meet the requirements of section 501(c)(3).[1] Credit counseling organizations may be exempt because of their charitable or educational work. The Service first provided guidance on this issue in 1969, when it addressed standards for credit counseling organizations. In Rev. Rule 69–41, 1–969–2 C.B. 115, we held that the organization cited in the ruling was charitable where it included the following favorable factors: its primary activity was providing educational information to the general public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications; its counseling services were limited to low income customers and individual counseling was provided; the organization's board of directors was representative of the community; and, the organization's work in establishing budget plans and paying customer's bills was a minor portion of its overall activities.

A credit counseling organization may be tax exempt even if it does not limit its clientele to low income individuals where the services provided by the organization are educational in nature. In the 1970's, the courts reversed the Service in its revocation of the exempt status of two organizations that provided credit counseling, but did not limit their services to low-income individuals. See Consumer Counseling Service of Alabama v. United States, 78–2 U.S.T.C. 9660 (D.D.C. 1978) and Credit Counseling Centers of Oklahoma, Inc. v. United States, 79–2 U.S.T.C. 9468 (D.D.C.

[1] This hearing and the allegations of abuse in this area are focused on section 501(c)(3) charitable organizations. We note, however, that credit counseling organizations also can qualify for tax exemption under section 501(c)(4), as social welfare organizations. *See* Rev. Rul. 65–299, 1965–2 C.B. 165. Because contributions under that section are not tax deductible and such organizations are not exempted from consumer protection laws, few credit counseling organizations seek 501(c)(4) status. As a result, we have not seen any significant increase in the number or activity of these organizations, and we have not addressed them in this testimony.

1979). The courts in these cases held that providing information regarding the sound use of consumer credit was educational because it instructs the public on subjects useful to the individual and beneficial to the community. The courts considered the debt management services (the payment plan and creditor intercession) an integral part of the organizations' counseling and education function. Moreover, the debt management services were so minor that even if they were not considered educational in themselves, they were not significant enough to affect the organizations' exempt status. The boards of these organizations were controlled by the public. Finally, the fee structure was not a barrier to exemption because the fees were nominal and were waived where payment would create a financial hardship.

To recap, to be exempt under section 501(c)(3), existing rulings and cases indicate that an organization that provides credit counseling must limit its services to low income customers or must provide education to the public on how to manage personal finances as its primary activity.

Recent Trends and Profile of the Credit Counseling Area

Our information systems reflect over 850 credit counseling organizations that have been recognized as tax exempt under section 501(c)(3). In recent years, the Service has seen an increase in applications for tax-exempt status from organizations intending to provide credit counseling services. Among the more recent applicants, we are finding credit counseling organizations that vary from the model approved in the earlier rulings and court cases. We are seeing organizations whose principal activity is selling and administering debt management plans. Often the board of directors is not representative of the community and may be related by family or business ties to the for-profit entities that service and market the debt management plans. The organizations are supported by fees from customers and from credit card companies, and the fees are much higher than those in the rulings or court cases. Finally, it does not appear that significant counseling or education is being provided. As we will discuss, we have modified our application process to deal with this change in circumstances.

In 2002, as we saw an increasing number of allegations of credit counseling abuses, we contacted the Federal Trade Commission for assistance in understanding the developments in the industry. Based on the available information, it appears that customers, served solely by the Internet, are provided debt management—not credit counseling. The individual budget assistance and public education programs that formed the original basis for exemption under section 501(c)(3) have changed. In many cases, these services appear to have been replaced by promises to restore favorable credit ratings or to provide commercial debt consolidation services.

We also learned of the favorable treatment accorded to section 501(c)(3) consumer credit organizations under both federal and state regulatory schemes. Organizations recognized by the Service as described in section 501(c)(3) often are excluded from coverage under FTC rules, as well as state and local consumer protection laws. This exclusion appears to be one of the primary drivers for the increase in the number of these organizations. For example, the Credit Repair Organization Act of 1997 sought to further regulate the practice of organizations involved in "credit repair," a series of activities aimed at improving a customer's credit history. The statute exempted section 501(c)(3) organizations from the provisions of this law. Many state consumer protection laws provide similar treatment for 501(c)(3) organizations. In 1993, for example, the California legislature imposed strict standards on credit service organizations and the credit repair industry. The California statute aims to protect the public from unfair or deceptive advertising and business practices. Most significantly, it does not apply to nonprofit organizations that have received a final determination from the Service that they are exempt under IRC 501(c)(3) and are not private foundations.

Two more recent developments may encourage more credit counseling organizations to seek tax-exempt status. The first is the proposal, under pending bankruptcy legislation, to require credit counseling prior to filing for bankruptcy. Although the Service takes no position on the merits of this proposal, if this becomes law, we expect applications from traditional credit counselors, as well as the new internet based agencies to increase. The second development relates to the recently activated Do Not Call List, with its exemption for charitable solicitations. Again, our purpose here is not to opine on the merits of the solicitation exemption other than to note for the Subcommittee our belief that the additional benefit of exemption under the Do Not Call rules may also motivate certain individuals and organizations to seek section 501(c)(3) status. To the extent that we are concerned about bad actors in the current market, both of these developments will require even more diligence on our part.

Response of the Service

The Service is concerned that the potent combination of exemption from income tax and exemption from consumer protection laws may encourage activity by individuals who are motivated by profit rather than charity. As a result, we are aggressively scrutinizing applicants and existing organizations to ensure that organizations seeking or having tax-exempt status as credit counseling organizations warrant that status. We have designed a comprehensive multi-faceted strategy to address alleged abuses, and commissioned a team to oversee the strategic management of our compliance efforts. Members of this coordinating team include individuals from all functions within the exempt organizations office at the Service, as well as lawyers from the Office of the Chief Counsel.

Determination Letter Process: Our goal is to identify new credit counseling organizations as they seek exemption and ensure they meet all requirements before tax-exempt status is approved. We have established a process where all incoming applications are initially reviewed to identify organizations that provide credit services. All case files are then assigned to staff specially trained in credit counseling, who use a uniform development inquiry letter to fully develop the facts of the case. Where those facts indicate non-compliance, cases are forwarded for additional development to higher graded specialists. These specialists use their broad investigatory experience to delve deeply into the complex structures and relationships of these organizations in order to determine whether they are charitable organizations. Once completed, either favorably or unfavorably, all applications are subject to special review. In addition to carefully scrutinizing individual applications, all credit counseling organizations will be centrally tracked to enable us to accurately determine the number and profile of these organizations, and to better manage and ensure consistent quality treatment.

At present, EO is considering over 40 applications. As we process these applications, we request additional information regarding whether debt management is the organization's primary purpose and the extent to which the organization engages in educational or counseling activities. We also are exploring whether some of these applicants who have contractual relationships with for-profit service providers operate in a manner that improperly benefits private interests.

Examination Process: The Service has increased the number of examinations targeted at tax-exempt credit counseling organizations. At present, over 30 organizations and related entities, including some of the largest firms, are at various stages of the examination process. These organizations represent a significant percentage of the combined gross receipts for the entire tax-exempt credit counseling market. Moreover, the current workload is only the beginning of our compliance effort in this area. By year's end, we expect to follow-up on all examination referrals, and implement an approach to identify and classify other high-risk organizations for examinations to commence in 2004.

As in the determination letter area, specialists have been designated to provide immediate phone or e-mail assistance to examination agents, and already have made visits to assist agents conducting examinations. These examinations focus on specific issues, including: whether the organization provides counseling; who the customers are; the nature of the fee structure; who controls the board and the contracts with the organization; and, whether there is inurement or impermissible private benefit. We expect to see significant results in the coming months, and within the constraints of section 6103, will publicize the outcome of our efforts.

IRS Training: We have taken a number of steps to train our agents and other law enforcement personnel. We published a 50-page Continuing Professional Education text that reviewed the law in the area of credit counseling and provided tools for reviewing applications from new organizations. In addition to the CPE text, in 2002, we held training classes on this issue for specialists who review exemption applications. Several months later, we produced a live interactive training exercise on credit counseling organizations. The presenters included representatives from the Service, a representative from the Federal Trade Commission, and a state charity official. The panel discussed the law with respect to section 501(c)(3) organizations, disclosure concerns, and consumer protection issues. In addition to our employees, attendees included guests from state and local governments and the FTC, who had the opportunity to watch the training and participate in a question and answer session.

Outreach Efforts: The Service has been active in educating the public and reaching out to other law enforcement agencies. We have partnered with the Federal Trade Commission, the National Association of State Charity Officials and other watchdog groups, who have well established channels for disseminating information to consumers, to send out a strong consumer protection message. That message, contained in News Release 2003–120 and Fact Sheet 2003–117, informs the

public that credit counseling organizations using questionable practices may seek tax-exempt status to circumvent state and federal consumer protection laws. It advises consumers to guard against deceptive credit counseling practices by following the tips outlined in the documents. We have publicized these documents and our other credit counseling training materials on the IRS Web site.

In addition to working with consumer protection organizations, we contacted state enforcement officials from Maryland, California, and New York, concerning the issues their states are facing in this area. We also have met with the United States Bankruptcy Trustees Office concerning the previously discussed pending bankruptcy reform legislation.

In addition to working with our counterparts in law enforcement, our outreach efforts include speaking at credit counseling trade association conventions and at the annual meeting of the American Bar Association to inform the credit counseling industry and its attorneys of potential problems in this field and to open a dialog with industry participants.

Conclusion

Because of the changes in the way the credit counseling industry now operates, the Service anticipates the need for continued action to ensure compliance. Let me assure you that we are committed to taking any steps necessary to inform the public of the requirements for tax-exempt status and to ensure that tax-exempt credit counseling organizations comply with all applicable requirements. The public deserves and will receive our protection in the area of credit counseling services.

Chairman HOUGHTON. Thank you very much, and thank you for the strong emphasis on enforcement that you put into effect in the IRS. We have been joined by a very distinguished Member of the Committee on Ways and Means, Mr. Kleczka of Wisconsin. Thank you very much. Have you any statement that you would like to make?

Mr. KLECZKA. No, Mr. Chairman. I am here to listen.

Chairman HOUGHTON. Fine. Now, what I would like to do is turn it over to Mr. Beales, the Director of the Bureau of Consumer Protection, FTC. Mr. Beales, thank you for being here.

STATEMENT OF HOWARD BEALES, DIRECTOR, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION

Mr. BEALES. Thank you, Mr. Chairman, and Members of the Subcommittee. I am pleased to have this opportunity to discuss consumer protection issues in the credit counseling industry. Although the FTC recognizes that credit counseling can provide financially distressed consumers with valuable assistance in managing their money and paying their debts, we are concerned that some firms may be deceiving consumers about who they are, what they do, and how much they charge. The FTC is fighting deceptive credit counseling practices on many fronts, including law enforcement and consumer education.

Today, I would like to focus on a lawsuit we filed in Federal court yesterday against a national organization that promotes itself as a nonprofit credit counseling agency. The complaint names Maryland-based AmeriDebt, Inc., which aggressively advertised itself as a nonprofit dedicated to assisting consumers with their finances. The complaint also names AmeriDebt's former for-profit service provider, DebtWorks, and DebtWorks' owner, Andris Pukke. This case illustrates some of the troubling practices in credit counseling that are before this Subcommittee today. Despite AmeriDebt's claim that it operates for charitable purposes with re-

gard to its 501(c)(3) status, we alleged that AmeriDebt was, in fact, designed to generate profit for affiliated for-profit companies and individuals, including DebtWorks and Mr. Pukke.

In addition, we alleged that the defendants misrepresent the services that AmeriDebt provides to consumers. Instead of teaching consumers about their finances and how to manage debt as claimed, the defendants indiscriminately enroll all of their clients in debt management plans without regard to their particular financial situations.

Debt management plans are payment plans that enable consumers to make one consolidated monthly payment to a credit counselor, which then disburses the money to the consumers' creditors. Many creditors are willing to reduce interest rates or forgo late charges for consumers participating in such a plan, but only if it is administered by a nonprofit credit counseling agency. Depending on a consumer's financial situation, debt management plans can be beneficial, but for certain consumers, other options such as individualized counseling, education, and even bankruptcy, may be better choices.

The key source of consumer injury in the AmeriDebt case is our allegation that the defendants charge consumers an up-front fee for enrolling in a debt management plan, despite advertising claims to the contrary. They collect the fee by keeping consumers' first payment for themselves, instead of disbursing the money to consumers' creditors. AmeriDebt's contracts with consumers refer to this first payment as a contribution. In our view, the fact that approximately 90 percent of AmeriDebt's consumers who are ostensibly on the brink of bankruptcy, nonetheless make a voluntary contribution of several hundred dollars to AmeriDebt, only underscores that these purported contributions are obtained through deception.

The FTC also entered into a settlement with the Ballenger Group, which has serviced AmeriDebt's debt management plan since the beginning of this year. This settlement resolves the FTC's allegations that Ballenger, which has close ties to the other defendants, contributed to the deception in the AmeriDebt case by repeating some of the misrepresentations in telephone calls with consumers. According to the FTC's complaints, Ballenger misrepresented that AmeriDebt is a nonprofit entity, and failed to disclose that the consumers' first payment is retained by AmeriDebt as a fee. The settlement contains strong injunctive relief, and requires Ballenger to pay $750,000 in consumer redress.

In addition to the alleged practices in the AmeriDebt case, we are aware of other practices by some in the credit counseling industry that may violate the FTC Act (1914, 38 Stat. 717, U.S.C. 41–51), or other statutes that we enforce. These practices include failure to abide by telemarketing laws. To the extent that some credit counseling agencies are not bona fide nonprofit organizations, they should be complying with the FTC's telemarketing sales rule, including the new National Do-Not-Call Registry.

We also see failure to pay creditors in a timely manner, or not at all, as a problem. Some credit counseling agencies that offer debt management plans may fail to pay creditors in a timely fashion, or at all. This can result in serious consumer harm, such as late fees that the creditors impose. Others promise results that cannot be

delivered. They promise that they will lower consumers' interest rates, monthly payments, or overall debt, by unrealistic amounts. Some are also making false promises to eliminate accurate but negative information from consumers' credit reports.

We remain concerned about all of these practices, and acting with our law enforcement partners, we will continue to work to protect consumers in this critical area. I thank you for the opportunity to appear today, and I will be happy to respond to your questions.

[The prepared statement of Mr. Beales follows:]

Statement of Howard Beales, Director, Bureau of Consumer Protection, Federal Trade Commission

I. INTRODUCTION

Mister Chairman and Members of the Committee: I am Howard Beales, Director of the Bureau of Consumer Protection of the Federal Trade Commission ("FTC" or "Commission.").[1] I appreciate the opportunity to appear before you today on behalf of the Commission to discuss consumer protection issues raised in the credit counseling industry. This statement will describe the industry generally, discuss various practices by some of its members that raise consumer protection concerns, and summarize FTC law enforcement and educational efforts in this area.

As an initial matter, it is helpful to understand the Commission's role in enforcing laws that bear on the credit counseling industry. As part of its broad mandate to protect consumers, the Commission enforces the Federal Trade Commission Act ("FTC Act"), which prohibits unfair or deceptive acts or practices that are in or affect commerce.[2] The Commission also enforces a number of specific consumer protection statutes, including several relevant to credit counseling, such as the Telemarketing and Consumer Fraud and Abuse Prevention Act,[3] the Credit Repair Organizations Act,[4] and the Gramm Leach Bliley Act.[5]

The FTC Act excludes from the Commission's authority entities that are not organized to carry on business for their own profit or that of their members.[6] Therefore, the Commission does not have jurisdiction under that Act over credit counseling agencies ("CCAs") that are bona fide non-profit organizations.[7] The mere fact that a CCA has received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, however, does not by itself oust the Commission of jurisdiction. The Commission may assert jurisdiction over such an entity if there is an insufficient nexus between the organization's activities and its alleged public purpose, for example, or if its proceeds inure to the benefit of private individuals.[8]

II. THE CREDIT COUNSELING INDUSTRY

The credit counseling industry has been in existence for about 50 years, providing valuable services to innumerable financially distressed consumers. Typically, the work of CCAs on behalf of their consumer clients is both present and future directed: to help debt-strapped consumers to manage their existing financial problems and to teach them better financial management skills for the future. CCAs historically have been relatively small, community-based non-profit organizations providing consumers with individualized advice and assistance. For these services, most traditional CCAs either charge nothing or solicit modest contributions from clients to help defray their expenses. As explained below, CCAs also can be funded by creditors through so-called "Fair Share" contributions.

CCAs have a number of options to offer their financially-distressed clients, depending on the client's individual circumstances, which range from simple advice and guidance on managing finances to (in extreme cases) advising that consulting a bankruptcy attorney may be the consumer's best option. In addition, CCAs, since

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[1] The views expressed in this statement represent the views of the Commission. My oral statement and responses to questions you may have are my own and are not necessarily those of the Commission or any Commissioner.

[2] 15 U.S.C. § 45(a).

[3] 15 U.S.C. §§ 6101–6108.

[4] 15 U.S.C. §§ 1679 et seq.

[5] 15 U.S.C. §§ 6801 et seq.

[6] 15 U.S.C. §§ 44 & 45(a).

[7] Most creditors and some state laws require CCAs to be non-profit entities before they can arrange payment plans for consumers.

[8] *See, e.g.,* College Football Association, 117 F.T.C. 971, 993 (1994).

the industry's inception, have offered to put certain clients into a payment program commonly termed a "debt management plan" ("DMP"). DMPs allow consumers to pay off their unsecured debts, such as credit card balances, by making a single, consolidated monthly payment to the CCA, which then disburses those funds to the creditors of debts covered by the DMP.

When administered properly, DMPs can benefit consumers because some creditors will reduce interest rates and waive certain charges, such as late and over-the-limit fees, for consumers on a plan. Most creditors and some state laws require CCAs to be non-profit entities before they can arrange payment plans for consumers, apparently for the purpose of eliminating the incentive for CCAs to deceive consumers. However, we are concerned that some CCAs may be evading these requirements by setting up non-profit entities that funnel money to for-profit affiliates.

DMPs can also benefit creditors by forestalling consumer bankruptcy. Importantly, traditional CCAs evaluate each client's individual circumstances and needs before deciding whether to enroll that person in a DMP.

DMPs generate revenue for CCAs in two ways. First, creditors voluntarily rebate to CCAs a small percentage of the funds that the organizations disburse to them. These payments are called "Fair Share" contributions. Second, some CCAs solicit "contributions" or "donations" from DMP enrollees, usually consisting of up-front and monthly fees. As discussed later, some CCAs appear to have turned these ostensibly voluntary contributions into *de facto* mandatory fees by automatically deducting money from consumers' payments without adequate disclosure.

In the last decade, the credit counseling industry has experienced dramatic growth, attributable in large part to ballooning consumer debt and the resulting demand for credit counseling to prevent default on that debt. The nature of the industry has also changed. Whereas it was once composed mainly of small, local credit counselors, the last decade has seen the rise of large, high-tech organizations that aggressively market their services to consumers via telemarketing, broadcast and print advertising, and the Internet. These organizations, many of which claim non-profit status, represent a new breed in this industry. Many appear to offer little or no individualized credit counseling, but rather urge all of their clients to enroll in a DMP without consideration of their particular financial situation.

III. CONSUMER PROTECTION ISSUES

Along with these changes in the industry have come complaints about troubling practices, including possible deception about the services offered, poor administration of DMPs, and undisclosed fees associated with DMPs.

The Commission is concerned about deceptive and other illegal practices in which some CCAs may be engaging. Our greatest concern is deception by CCAs about the nature and costs of the services they offer to consumers. The following practices have come to our attention that may violate the FTC Act or other statutes that we enforce:

- *Misrepresentations about fees or "voluntary contributions."* Some CCAs may charge substantial fees (sometimes denominated as "donations" or "voluntary contributions") that they hide from consumers. For example, some CCAs may automatically retain for themselves certain payments consumers make on their DMPs, unless the consumer affirmatively objects. These CCAs may not adequately disclose this fact.
- *Promising results that cannot be delivered.* Some CCAs appear to be marketing DMPs with promises that they will lower consumers' interest rates, monthly payments, or overall debt by an unrealistic or unattainable amount. Some organizations also appear to be exaggerating the amount of money consumers will save by signing up for a DMP, or are promising falsely to eliminate accurate negative information from consumers' credit reports.[9]
- *Abuse of non-profit status.* As noted above, some unscrupulous CCAs misrepresent that they are non-profit to comply with state laws and creditor guidelines regarding the arrangement of payment plans for consumers. In addition, some CCAs appear to use their 501(c)(3) status to convince consumers to enroll in their DMPs and pay fees or make donations. These CCAs may, for example, claim that consumers' "donations" will be used simply to defray the CCA's expenses. Instead, the bulk of the money may be passed through to individuals or for-profit entities with which the CCAs are closely affiliated. Tax-exempt status also may tend to give these fraudulent CCAs a veneer of respectability by

[9] Negative but accurate information cannot be removed from a credit report until the time specified by the Fair Credit Reporting Act has lapsed (generally, seven years after the event occurred). 15 U.S.C. § 1681c.

implying that the CCA is serving a charitable or public purpose. Finally, some consumers may believe that a "non-profit" CCA will charge lower fees than a similar for-profit entity.

- *False advertising regarding credit counseling services.* Some CCAs claim to provide advice and education to consumers on handling their finances, when in fact they may merely enroll all clients indiscriminately in DMPs without any actual counseling.
- *Failure to pay creditors in a timely manner or at all.* Some CCAs may fail to pay creditors in a timely fashion or at all. This failure can result in serious consumer harm, such as from late fees that the creditors impose.
- *Failure to abide by telemarketing laws.* To the extent CCAs are not *bona fide* non-profit organizations, they should be complying with the FTC's Telemarketing Sales Rule, including the new national Do-Not-Call registry.
- *Gramm-Leach-Bliley ("GLB") Privacy and Safeguards.* The Commission is also concerned that some CCAs may not be complying with the privacy and security requirements of the Gramm-Leach-Bliley Act, which apply to financial institutions such as credit counseling organizations.

IV. COMMISSION ACTIONS

The Commission has pursued a vigorous program to halt fraud and deception by those who purport to be able to solve consumers' financial difficulties. For example, last year the Commission filed a lawsuit against Jubilee Financial Services, a debt negotiation company, challenging misrepresentations about the services it offered.[10] The Commission alleged, among other things, that Jubilee made false promises that consumers who enrolled in its debt negotiation program would be able to pay off their debts at a substantially reduced rate; misled consumers about the effects of the program on their credit report; and failed to tell them that, as a result of the program, negative information would likely appear on consumers' reports and stay there for seven years. Instead of extricating themselves from debt, many of Jubilee's victims were left with little alternative but to file for bankruptcy.

Over the past several years, the Commission also has prosecuted numerous cases under the Credit Repair Organizations Act ("CROA"),[11] which prohibits fraudulent practices by organizations that promise to improve consumers' credit histories, such as falsely promising to remove accurate credit information from consumers' credit reports. The Commission has successfully conducted several sweeps of entities allegedly violating CROA, including Operation Eraser[12] and Operation New ID-Bad IDea.[13] Most recently, in August 2003, the Commission reached a settlement with one of the largest credit repair organizations in the United States, through which the defendants agreed to pay more than $1.15 million in consumer redress.[14]

The Commission also has engaged in extensive educational efforts to help consumers spot and avoid credit counseling and credit repair scams. Most recently, the Commission, in conjunction with the Internal Revenue Service and state regulators, issued a joint press release regarding CCAs, urging consumers to be cautious and providing tips for choosing a credit counseling organization.[15] The release advises consumers to pay careful attention to what fees the agency charges, the nature of the services it offers, and the terms of the contract. Consumers should consider

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[10] *See* FTC Press Release, *FTC, States Give "No Credit" to Finance-Related Scams in Latest Joint Law Enforcement Sweep* (Sept. 5, 2002), *available at* http://www.ftc.gov/opa/2002/09/opnocredit.htm. The Commission subsequently settled this matter. The settlement, among other things, banned defendants from advertising, marketing, or providing debt negotiation services. *See* FTC Press Release, *Jubilee Financial Services Defendants Banned from Providing Debt Negotiation Services* (Aug. 29, 2003), *available at* http://www.ftc.gov/opa/2003/08/jubilee.htm. Strictly speaking, Jubilee was not a CCA because it did not offer credit counseling or DMPs; rather, it purported to negotiate settlements of consumers' unsecured debts with the creditors.

[11] 15 U.S.C. §§ 1679 *et seq.*

[12] *See* FTC Press Release, *Credit Repair? Buyer Beware! FTC, States Announce Crackdown On Scams That Bilk Consumers* (Mar. 5, 1998), *available at* http://www.ftc.gov/opa/1998/03/eraser.htm.

[13] *See* FTC Press Release, *Credit Identity Defendants Settle FTC Charges: Promoting False Identification Numbers to Create a "New Credit Identity" Is Illegal* (Oct. 21, 1999), *available at* http://www.ftc.gov/opa/1999/10/badidea.htm.

[14] *See* FTC Press Release, *Nationwide Credit Repair Operation to Pay More than $1.15 Million in Consumer Redress* (Aug. 11, 2003), *available at* http://www.ftc.gov/opa/2003/08/nationwide.htm.

[15] *See* FTC Press Release, *FTC, IRS, and State Regulators Urge Care When Seeking Help from Credit Counseling Organizations* (Oct. 14, 2003), *available at* http://www.ftc.gov/opa/2003/10/ftcirs.htm.

using agencies that offer actual counseling and education and do not simply enroll all clients in DMPs.

The IRS announced at the same time its intention to re-examine certain CCAs with 501(c)(3) status to determine whether they are operating in a manner that complies with the laws and regulations governing tax-exempt status. The IRS also stated that in the future it will examine more rigorously CCAs' 501(c)(3) applications. Specifically, the IRS noted that organizations that place clients on DMPs without significant education and counseling do not qualify for tax-exempt status.[16]

V. CONCLUSION

The Commission recognizes that credit counseling can provide financially distressed consumers with valuable assistance in managing their money and paying their debts, and that many, if not most, CCAs operate honestly and fairly. The Commission is concerned, however, that some firms may be deceiving consumers about who they are, what they do, and how much they charge. The victims of the deception may find themselves in even more dire financial straits than before. The Commission, acting with our law enforcement partners, will continue to work to protect consumers in this critical area.

Chairman HOUGHTON. Thank you very much. I have a couple of questions. Then, Earl, I will turn it over to you. Really, I have questions for Mr. Everson and Mr. Beales. I have two questions for you, Mr. Commissioner. I am interested in the standards that the IRS is going to use to make these evaluations. Maybe you can break that down a little bit. Also, I have always worried about the excessive salaries that are being paid. We have had a number of examples of this, which have poisoned the well for a lot of good companies that have tried to adhere to the level of good discretion.

At what point do these salaries become excessive? Then, Mr. Beales, the question I would like to ask you is, if a voluntary contribution is included in the contract service agreement, isn't this a fee? So, maybe I could turn this over to you, Mr. Everson, and then to Mr. Beales.

Mr. EVERSON. Sure. Mr. Chairman, there is no cookie-cutter model to reach a judgment on these issues, as you can imagine. There is a lot of judgment that needs to be brought to bear. That having been said, there have been standards that have been articulated by the IRS in rulings in the past, and also some that have been validated in the courts that we will look to as we conduct these examinations. What is the nature of the customer base—are these low-income people, deserving people? Are they receiving true counseling, or are they simply receiving packaged products? One of the things that has been happening here, is, as I indicated, an explosion through the use of the Internet. Simple solutions are developed, and there is no real education or exchange whatsoever with the individual who needs the service.

We will look at the organizational structures of the organization, and the relationships with for-profit groups. There is nothing wrong with having a relationship with a for-profit entity. It just needs to be on an arm's length basis, where the price paid for services would be comparable to that which would be normally expected of an organization that is processing services, or whatever it might be. So, I would suggest to you that we have a series of issues that

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[16] *See* Press Release, *IRS Takes Steps to Ensure Credit Counseling Organizations Comply with Requirements for Tax-Exempt Status* (Oct. 17, 2003), *available at* http://www/irs.gov/newsroom/article?0,,id=114575,00.html.

we will look at. They will all be carefully weighed. Before anything as drastic as a pull-back of the exemption status is taken, we will be very careful to make sure that we have considered all the factors.

As to salaries, high salaries, in and of themselves, are not a basis for withdrawing that exemption. Again, they must be considered in the context of geography, comparable organizations in terms of size or scope, and complexity of the work. Yet they certainly are an indicator of a potential problem, should there be a dramatic increase, or should they be out of line for any of those reasons that I have mentioned. So, as we engage in our examinations, those, too, will be considered as indicators of potential problems.

Mr. BEALES. Mr. Chairman, I think the essence of what we have alleged in the AmeriDebt case, is that if you say there is no fee, but your contract has a voluntary contribution that is very poorly disclosed in many instances, or not disclosed at all—that that is, in fact, a fee, and it is deceptive to say you don't charge fees. Restyling it as a contribution, unless consumers clearly know that they are making the contribution, and clearly know that they can choose not to make the contribution and still get service—unless they know those things, it is a fee. It doesn't matter what you call it.

Chairman HOUGHTON. Thank you. Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. I note that your testimony, Mr. Commissioner, says that to qualify under section 501(c)(3), the organization must not distribute net earnings to insiders, must operate for the benefit of the public, not the benefit of private interests, and must not organize for the benefit of private interests such as designated individuals. To the extent that the compensation issue comes into focus, I would expect, at some point, that the compensation levels actually create at least the impression that this is indeed being run for private purpose—the purpose of providing this dimension of compensation to given individuals. Is that correct?

Mr. EVERSON. I agree with that entirely. It has to be very carefully assessed, again, to demonstrate that it is not being run for the benefit of individuals, other insiders, or related parties.

Mr. POMEROY. This information is available for public scrutiny in the Form 990 filed with the IRS. Is that correct?

Mr. EVERSON. The Form 990, yes, would be available.

Mr. POMEROY. So, I have a copy here, then, that is appropriately in the public domain—Cambridge Credit Counseling Corporation. I believe they will be testifying at a later panel. Compensation listed for two individuals, a John Puccio and Richard Puccio, is set at $624,000 each, per year. Now, at $624,000, that looks like it is beyond generous compensation, and indeed, looks like a distribution of earnings for private interests in violation of the 501(c)(3) status. Is this the type of thing that your organization audits, upon the filing of the Form 990?

[The information is being retained in the Committee files.]

Mr. EVERSON. This would be the kind of issue that we would look at. I don't want to comment on a particular case or matter, but a high salary would be a red flag for us to look at.

Mr. POMEROY. The $624,000 salary would, in your notion, be generally deemed to be a fairly high salary?

Mr. EVERSON. Well, let me put it—perhaps I will answer that indirectly. I am paid substantially less than that to do my job.

Mr. POMEROY. Even Members of Congress are paid less than that. Within the last 12 hours, I have been spammed by purported credit companies—these advertising credit counseling services. I would ask that copies of this be submitted into the record, and be given to each witness on the panel. I would like you to give me your evaluation, not necessarily immediately, but as you have a chance to research the companies behind this marketing material, as to their legitimacy under the 501(c)(3) nonprofit credit corporation status. I think the record will show that these materials, again, contain many of the things of concern that you pointed out in your testimony. If they are going to take the trouble to spam me, well, I am going to take the trouble to have them investigated by you. I look forward to getting more information.

[The information follows:]

——Original Message——
Sent: Thursday, November 20, 2003 9:31 am
Subject: Fwd: Take control of your debt Earlpomeroy
From: Linda Cox
To: earlpomeroy
Subject: Take control of your debt Earlpomero
Date: 20 Nov 2003 06:12:55 -0600
Reduce Monthly Payments Up To 70%!
Eliminate High Interest Rates!
Complete FREE Details Here:

We help you find the fastest way out of debt!

Welcome! We offer a full range of debt consolidation services with one goal in mind, to help you get out of debt!

Do you currently have debt from credit cards, hospital bills, personal loans, back taxes, etc? Are Creditors or collection agencies calling? Do you often pay the minimum balance due or use one credit card to pay the monthly payment on another? Sound familiar?

We are here to help you!
"Free" no obligation application to get started today!

- *Reduce you monthly payment by 50% or more!*
- *Reduce or eliminate interest charges*
- *Stop late or over the limit fees*
- *Stop those harrassing phone calls*
- *Consolidate debt into one simple payment!*
- *Bring your accounts to current status*
- *Provide a structured payment schedule*
- *Discreet handling of your account*
- *Professional 1 on 1 service*
- *Put a trained expert on your side*

GET STARTED TODAY!! →

Step 1:

First name | Last name
Address | City
State | Zip
Daytime phone | Evening phone
Best time to call | Email address

Total Amount of Unsecured Debt

Step 2:

Creditor name:*
Balance:*
Debt type:*

"Get Started Now!"

——Original Message——
From: Earl Pomeroy
Sent: Wednesday, November 19, 2003 12:19 PM To: Fremstad, Joel
Subject: Fwd: negotiating lower payments for you
From: Kristina
To: earlpomeroy
Subject: negotiating lower payments for you
Date: Wed, 19 Nov 2003 09:53—0600
Fellow Americans
Credit Problems?
How would you like to have PERFECT Credit?
Credit Reporting Act, You can Fight Back
And Get the Credit That You Deserve!
Click below and Get the Credit You Deserve!
right here for the limited quick approval

National Debt Relievers

Providing you with debt relief without a loan

. . . lower monthly payments by 40%-60%!

FINALLY!

A Debt Consolidation program that works great for non-homeowners or homeowners with poor credit.

We Get Your Creditors OFF YOUR BACK!

- **Free professional help and relief from too much debt!**
- **Lower monthly payments by 40%-60%!**
- **End creditor harassment!**
- **Consolidate bills into one low monthly payment!**

"We settled our credit card debt for just pennies on the dollar. It was fast and easy. Now we're saving money. Thank You!"

SAVINGS VARY FROM 40%-60%

Fill Out This Form

For more information, please fill out the short form below. No cost or obligations.

We cannot respond to requests without proper creditor information. You must have at least $5,000 of total combined debt to qualify.
Personal Information:

First Name :
Last Name :
State :
Home Phone:
Work Phone:
Total amount of unsecured debt:
E-mail:
Can we call you right now?

Click Here To Be Removed From Further Mailings.

If you're not interested, mail this to a friend; they will thank you later
WWW.CARDOFFERS.COM
You are being sent to Debt Saviors Inc.
An industry leader in assisting consumers for over 3 years to Non-Profit Credit Counseling and Debt Management Companies.

Category: **Advertising/Deceptive** Modified: 2/6/2003 1:11:15 PM
Express Consolidation rip-off Del Ray Beach Florida

Company
Express Consolidation
Address:
Nationwide, U.S.A.
Phone Number:

I am under contract with Express Consolidation. At first everything was fine. I started getting phone calls from one of the creditors I am trying to pay off. They advised they never received a proposal from Express. I told Express & they asked for my account info with the creditor & said they would resubmit. For a few months I heard nothing.

I starting receiving new calls from the same creditor. They stated I was 79 days in arrears & a check that Express sent bounced. I had to pay them $155.00 in lieu of $116 that I pd to Express.

I tried calling them, e-mailing, every way I could to contact them. Customer Service had me online for 20 minutes everytime I called. When I finally got through, they advised the bank they use had the wrong acct. # on the checks that went out in Dec. of 2002.

Needless to say, I am very worried that all of this is going to blow up in my face. I am trying to keep this from my husband as he was very upset that I had all these bills to begin with.

Any suggestions? Would you consider them in Breach of contract since their check bounced?I'll take all the advise I can get.

Eileen
Baltimore, Maryland
U.S.A.

[The information follows:]

Internal Revenue Service
January 29, 2004

Hon. Earl Pomeroy
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Pomeroy:

This is in reply to your concern about e-mails you received from two credit counseling organizations, Debt Solutions, Inc. and National Debt Relievers, which you presented to Commissioner Everson at the November 20, 2003 hearing on Credit Counseling. The Commissioner appreciates your bringing this matter to our attention.

We maintain an ongoing examination program to ensure that exempt organizations continue to meet the requirements for tax-exempt status. Whenever we receive information about an organization that raises questions about its continued exempt status, we forward the information to our Exempt Organizations Examination Classification Office in Dallas to determine whether it warrants an examination. Your information has been forwarded to that office.

The Internal Revenue Code includes taxpayer privacy provisions to protect the privacy of tax returns and tax return information of all taxpayers. Accordingly, I cannot comment on what action, if any, we may take regarding the e-mails.

I hope this information is helpful. If you have any questions, or wish to submit any additional information regarding credit counseling organizations please contact me at (202) 622–4725.

Sincerely,

Floyd L. Williams, III

Mr. EVERSON. They are not spamming me for some unknown reason.

Mr. POMEROY. Now, specifically on some of the matters—to get a better handle on what numbers of entities we are dealing with, Commissioner Everson, how many credit counseling organizations have been granted tax-exempt status in the last 6 months? Do you have any idea?

Mr. EVERSON. I don't have a track record in the last 6 months. As I indicated before, there are over 850 that have exempt status now, and if you look at the last 4 years, through 2003, what has happened is, the numbers have gone up, as I indicated. There are about 100 or so each year that we have been granting for the last 4 years—higher than that in some instances.

Mr. POMEROY. Mr. Beales, one would wonder why a credit card company will cut its rate for a group that is obviously handling, on a boilerplate basis, its clients, as opposed to an individual debt management workout framework. Have you seen instances where there is actually some revenues coming back to the intermediary credit management companies—some kind of kickback or rebate from the credit card companies themselves?

Mr. BEALES. Well, that is a fairly common arrangement—that some of the money that the credit card company or other creditor is willing to contribute in order to reduce the debt, goes back to the credit counselor. That is true in the legitimate parts of the industry. It is the way the industry has always operated to some extent—and for some of the credit counseling organizations.

Mr. POMEROY. Do you think that that has created a revenue opportunity that is driving the creation of these sham operations?

Mr. BEALES. Well, I think that is part of it, but I think what drives the sham operations much more, is the money that they can get from consumers.

Mr. POMEROY. Up-front fee payment?

Mr. BEALES. The up-front fee and monthly payments. Particularly where they try to exploit the way the industry has traditionally operated with little or no charge to consumers, with most of the costs being borne by creditors through those payments back to the credit counseling organizations.

Mr. POMEROY. So, you have seen a trend where costs are being shifted to the debtors themselves—increased costs by these entities on the individual seeking their help?

Mr. BEALES. Well, certainly in the case of AmeriDebt and circumstances like that, there are substantial fees to consumers that are not present in the traditional circumstance. That is relatively new in the last couple of years, and in that sense, it is certainly a trend—whether it is a continuing trend is what we are trying to determine.

Mr. POMEROY. This is my last question, Mr. Chairman. You have been generous on me going slightly over time. However, to the extent that something is happening here, we are seeing the creation and the marketing of credit counseling services, beyond what we have ever seen before. We are seeing an increase in questionable entities, it certainly raises at least the appearance that they have figured out how to make some new money in providing this kind of activity to the public. I am just wondering if we have identified where the new fees—or whatever activity is generating the new cash flow for them—are going.

Mr. BEALES. Well, I think you are exactly right—they have figured out a new way. However, I think certainly in the case we just filed, where the new money is coming from the public, it is the consumers who are deceived into participating in the scheme.

Mr. POMEROY. Thank you. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you. Mr. Foley.

Mr. FOLEY. Thank you very much, Mr. Chairman. Again, I commend you for holding the hearing, and I think Mr. Pomeroy hit on it in his opening statement. The most vulnerable are being preyed upon, and I have noticed a proliferation of ads, as was mentioned, for these services. We used to have consumer credit counseling services in West Palm, Florida, which was not-for-profit, and existed and worked so well helping people pull out of their financial jams. However, now it seems like there is an ad a day indicating how they can help relieve the burden of debt for citizens, and it turns out to be a way in which they relieve more money off the citizen, and never help really get to the bottom of it.

How much of a credit counseling organizational operation will be focused on education versus debt management, to be considered not-for-profit? Is there a rule of thumb? For example, is there an inappropriate amount of debt management services that crosses the threshold and could put its tax-exempt status at risk? Mr. Everson.

Mr. EVERSON. I would suggest to you that there is not, again, a hard and fast rule, but there would be a presumption that, what you are suggesting, the creation of a package to work out the debt, would be a relatively small piece of the activities. Traditionally, it has been very much in the education area, working with a couple or a family, reviewing their financial statements, trying to develop a long-term plan. It is not credit repair, per se—credit repair being, taking a look at someone's credit rating, trying to improve that, and developing any specific package. So, it would be a small piece, traditionally.

Mr. FOLEY. I mentioned this point in a hearing we had before. I had a theft occur where somebody had created a credit card and charged merchandise, and then I had the debt collection agency calling me unmercifully, day and night, telling me I owed all this money. What concerns me about some of the credit counseling, is that they are merely substituting those piranhas in my case. They were never civil, and never nice, and as I explained that this was not my debt, they continue to harass.

What concerns me, as I have seen some of these credit counseling services, is that they appear to be changing hats with the debt collectors and doing the same thing—only they are aggregating the

debt and now pursuing the borrower. Where do you draw the line as to what is, and is not, an appropriate activity between closely related nonprofits and for-profits? Is there a way in which you separate those two?

Mr. EVERSON. Again, I think that the test here would be: are the relationships between these two entities something that would pass the test of being at arm's length on a commercial basis? Nothing's wrong with having a relationship with a profit-making entity. That is a supplier of services. Is the price paid for that service a reasonable one? If you were to go to another party and ask for the services, would they charge you a lot less to do the same thing—run your computers, or make telephone calls, or whatever the actual product that is being provided might be?

Mr. FOLEY. You use a comparison based on the market application.

Mr. EVERSON. I think that is really the only fair way to do it, because if it gets out of line, it would clearly indicate that the related party structure has had an impact that is, in fact, not consistent with a charitable tax-exempt status.

Mr. FOLEY. Thank you. Thank you, Mr. Chairman.

Mr. KLECZKA. Mr. Chairman, I will try to be brief. First of all, this is a great hearing. I have not received any constituent complaints on this matter yet. However, I do represent a large segment of the inner city of Milwaukee, Wisconsin, and so, I am assuming some of these folks are working their wares back home, and I will be hearing about it shortly. Let me ask, Mr. Commissioner, how many of these organizations currently exist? What is the——

Mr. EVERSON. It is north of 850, sir.

Mr. KLECZKA. Wow—850. How many do you have under audit at this point?

Mr. EVERSON. Right now we have active audits on 30, and as I indicated, this includes 9 of the top 15 organizations, as measured by gross receipts. Actually, if you look at the total gross receipts for the industry, which is about a billion dollars, plus or minus, last year, we are actually attacking 40 percent of it. That is a very, very large number if you view it against our normal audit rates.

Mr. KLECZKA. Now, we have had some discussion today about fees versus this involuntary contribution. I am assuming that if, in fact, it is an involuntary contribution, there is a fee. At that point, it very possibly would be a taxable event, would it not, Commissioner?

Mr. EVERSON. This is really no different than any other exempt organization. People send their kids to private schools, and they pay a fee for a service provided. A contribution is a voluntary contribution beyond the value of the services provided. So, looking at it in this context, as we have just been discussing, it should not be an exchange for a service provided. If it is, in essence—as Mr. Beales has been indicating—an exchange for a service, then no, that wouldn't constitute a contribution that a taxpayer would deem as tax deductible. It would not be viewed as revenue generating for the entity.

Mr. KLECZKA. If, in fact, it is, in reality, a fee, would it be taxable for that organization?

Mr. EVERSON. Well, that is correct.

Mr. KLECZKA. So, that is——

Mr. EVERSON. So, it would be considered in that construct, yes.

Mr. KLECZKA. So, that is what is going on here.

Mr. EVERSON. That is a portion of what is going on—that is correct.

Mr. KLECZKA. Now, Mr. Beales, since the advent of the do-not-call list, have we seen a whole bunch of these groups pop up so they can come underneath the umbrella of the exemption for charitable groups?

Mr. BEALES. I don't know that we have seen a growth in the number of groups. Certainly the people who claim to be nonprofits are a significant source of the complaints that are coming to us about violations of do-not-call.

Mr. KLECZKA. So, you don't think they are just popping up out of the woods now because of the exemption for charitables under do-not-call?

Mr. BEALES. Well, I think the charitables stick out more, because the background noise of for-profit telemarketing has gotten considerably quieter.

Mr. KLECZKA. It sure has, thank you. I think all Americans are appreciative of that. The last item, Mr. Chairman, is a favor for the Commissioner. I have a constituent who was a former IRS agent, who has a suggestion for saving some money as far as issuing refund checks via the mail versus electronic transfer. Let me ask you to identify it with staff so we can share that and not burden the Committee.

Mr. EVERSON. Thank you. We will take a good look at it.

Mr. KLECZKA. Good. Thank you very much. Mr. Chairman, thank you.

[The information follows:]

January 6, 2004

The Honorable Jerry Kleczka
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Kleczka:

At the recent Ways and Means Oversight Subcommittee hearing on consumer credit agencies, you asked me to consider your constituent's suggestion for saving money on issuing tax refunds. Your constituent suggested that for tax refunds of $25 or less, we either require direct deposit or credit the amount against the next year's taxes. I have had a chance to review this proposal and would like to share my thoughts with you.

On the surface, this proposal appears to have the potential to save the IRS and the Financial Management Service (FMS) money in printing and postage costs. The FMS, which is responsible for printing and mailing the checks, saves $.28 for each payment issued electronically rather than as a paper check. However, it is the practice of the IRS to notify taxpayers if we delay their refunds or otherwise take an action which they did not request. The cost of this notice is similar to the cost of mailing the check. If we were to apply the refund to the future year's tax liability, assuming they did not request the action, we would send the taxpayer a similar notice, and the savings would not materialize. Furthermore, if the taxpayer has met his or her obligation and submitted all required forms and documentation, it would be inappropriate and illegal for the IRS to retain the refund without the taxpayer's consent, even if the purpose is to apply it to future liability.

Regarding a requirement for direct deposit, if a taxpayer does not have a checking or savings account, or does not provide us with routing information, we have no way of making an electronic refund deposit. The IRS does not have the legal authority to require individual taxpayers to maintain an account at a financial institution.

I certainly share your goal to reduce the costs and burdens of paper processing at the IRS and thank you for passing along your constituent's suggestion. If you

would like to discuss this matter further, please contact me or your staff may contact Floyd Williams, Director of Legislative Affairs, at (202) 622–3720.

Sincerely,

Mark W. Everson

Chairman HOUGHTON. All right. Mr. Sandlin.

Mr. SANDLIN. Thank you, Mr. Chairman. Mr. Commissioner, you had said, I believe, the law provides that for these groups to get their tax-exempt status, the organization has to have an educational, charitable, or some other listed purpose on the Code; is that true?

Mr. EVERSON. That is correct.

Mr. SANDLIN. In these particular situations, they are supposed to educate or counsel the consumer concerning the management of their debt, correct?

Mr. EVERSON. That is correct, sir.

Mr. SANDLIN. The organization cannot run this organization for commercial interests, or to benefit a particular individual under the Code?

Mr. EVERSON. Absolutely.

Mr. SANDLIN. It appears to me—and I think we know what we are talking about—that what these two television groups actually do, is attempt to pool credit card debt, as opposed to other types of debt. Is that correct? Would that be fair?

Mr. EVERSON. I will let Mr. Beales——

Mr. SANDLIN. Mr. Beales, it appears to me that the effort by these groups is to take all the credit card debt. That is what they advertise. They say your credit card is too high. They pool that debt, and they work out a payment plan to pay credit card debt, correct?

Mr. BEALES. That is clearly the focus. That is where most consumers get in debt trouble.

Mr. SANDLIN. They don't offer that.

Mr. BEALES. I don't know that it is limited to credit card debt.

Mr. SANDLIN. They don't offer, for example, to combine or consolidate your car payment debt, or your house payment debt, or your open account payment debt down at the dress shop, correct?

Mr. BEALES. The focus is unsecured debt. Your open account debt at the dress shop may be because that is unsecured——

Mr. SANDLIN. Here is my point. Yes, it is open debt, but what they are really doing is, they are taking credit card debt from credit card companies that is unsecured, they are pooling that, and they are making sure you pay your credit card debt. They really don't care if you pay your house payment. They really don't care if you pay your car payment. They really don't care if you pay the dress shop. What they are, is a tool of the credit card companies to make sure that those credit card companies get preferential treatment, that they are paid first, and that they are paid in full to the exclusion of the requirements that the consumer has to pay other unsecured or secured debt. True?

Mr. BEALES. I think the consumer that is in financial trouble should obviously worry about the home first.

Mr. SANDLIN. Right. That is a charming story, and I appreciate that—and certainly they should. What I am saying is that these groups—what they do is take credit card debt, advertise about credit card debt, and pool credit card debt and make sure that consumers use their money to pay credit card debt. That is where the focus is—to make sure that credit card debt payment is made at a reduced rate, at a reduced payment over a certain period of time. They say, you pay this reduced rate over this period of time and your credit cards will be paid off in 60 months, for example. Is that correct?

Mr. BEALES. Yes, but——

Mr. SANDLIN. So, actually, what they are doing is operating this for the benefit of an individual group. They are operating this for the benefit of these individual groups, and, Mr. Commissioner, they really shouldn't have, under that circumstance, tax-exempt status; correct?

Mr. EVERSON. Well, if that is the primary purpose, as you have outlined, I would suggest that they would have great difficulty in sustaining that exemption. Yet, again, I want to say that as we go forward with these examinations, we are going to be very careful to fairly assess the whole picture, and there is nothing wrong with helping people work out a specific plan and helping organize that. It has to be measured against the overall requirements of the education and the counseling.

Mr. SANDLIN. That is right, and that is a good point. That is the whole point of being tax exempt—that they educate and help with the payment of other debt. However, what they are really doing is paying credit card debt. Isn't it true, Mr. Beales, that the credit card companies pay the tax-exempt companies money—they pay them fees and funds for their service?

Mr. BEALES. They do pay them. I don't think you can infer from the fact that it is focused on unsecured debt that it is really a collection mechanism for that debt.

Mr. SANDLIN. Yes, sir, it is exactly a collection mechanism. Now, let me ask you about this. Let me ask you about these contributions. We are indicating that this is a contribution to a charity or to a nonprofit. Now, that is just a fraud, isn't it? This isn't any kind of contribution, is it?

Mr. BEALES. Well, it depends on the circumstances of the particular case, but if that is what you say, then it is a fraud, yes.

Mr. SANDLIN. Well, the check you send down to the church, that is a contribution. The check to the library, that is a contribution. The American Heart Association, American Cancer Association—those are contributions. The check that you send to AmeriDebt, as it advertises on television, that is not a real contribution, is it?

Mr. BEALES. No. That is what we have alleged. That is a fee.

Mr. SANDLIN. I believe I see my light is on. I am out of time. I would like to say, I was shocked by the point, in closing, that Mr. Pomeroy made regarding how the executives here got over $600,000 in fees, and I would like to just point out in closing, that that is even more money than the $430,000 a year Mr. Novelli gets from AARP to help seniors get prescription drugs. With that, I will end my statement. Thank you.

Chairman HOUGHTON. Thank you very much. Well, gentlemen, I really appreciate your testimony here, and your being with us, and we look forward to seeing you again. Thank you.

Mr. EVERSON. Nice to see you as always.

Chairman HOUGHTON. Thank you. Now I would like to call the second panel. The second panel is Deanne Loonin, the staff attorney of the National Consumer Law Center (NCLC) in Boston, Massachusetts; Patrick Boisclair, Chairman of the Board of Trustees, National Foundation for Credit Counseling (NFCC) in Macon, Georgia; David Jones, President of the Association of Independent Consumer Credit Counseling Agencies (AICCCA) in Windermere, Florida; Michael Hall, Chief Executive Officer (CEO), Take Charge America, Incorporated in Phoenix, Arizona; and Montieth Illingworth, corporate spokesperson for the Cambridge Credit Counseling Corporation in Agawam, Massachusetts—who also, as I understand, is accompanied by Chris Viale, Chief Operating Officer of Cambridge Credit Counseling Corporation, also from Agawam, Massachusetts. So, when everybody gets settled—we appreciate your being here. Again, we are sorry we are late in starting. Ms. Loonin, if you would like to start the testimony, we would appreciate it. Thank you very much.

STATEMENT OF DEANNE LOONIN, STAFF ATTORNEY, NATIONAL CONSUMER LAW CENTER, BOSTON, MASSACHUSETTS, AND CONSUMER FEDERATION OF AMERICA

Ms. LOONIN. Thank you, Mr. Chairman. My name is Deanne Loonin, and I am a staff attorney with NCLC in Boston. I thank the Chairman and the Committee Members for inviting us to testify today. I am also testifying on behalf of the Consumer Federation of America, who we partnered with on this issue, and on other issues as well.

We have been following this credit counseling industry for some time, and in particular, we wrote a lot of our findings in a report that we released in April, called Credit Counseling in Crisis. We focused on credit counseling because of the tremendous benefits counseling can provide for many consumers, and because, unfortunately in the current environment, abusive and deceptive practices have made it difficult for consumers to reap these benefits.

When done well, credit counseling can help consumers in financial distress understand their options, develop budgets, and prioritize debt. When done well and properly, both secured and unsecured debt is taken into account. Quality trained credit counselors help those consumers with secured debt figure out whether they can keep their homes and cars, and if not, work with them to help resolve these problems, or make appropriate referrals. They help consumers budget, and determine whether they can afford to pay back unsecured credit card debt, and in many cases, avoid bankruptcy.

Regardless of whether there are for-profits involved in credit counseling, we believe that an ideal scenario is to have a thriving nonprofit counseling sector that works on behalf of consumers whenever possible, without regard to their ability to pay—certainly serving the lowest income and the neediest consumers, and also serving others in the communities through education and outreach.

Their work often benefits creditors as well, but when done well and in keeping with nonprofit status, their primary purpose is charitable and educational. When done well and legitimately as a nonprofit, credit counseling is not a product-driven industry. In other words, it is not about selling debt management plans, but about serving consumers.

This is a picture of credit counseling done well, and there are many agencies out there that fit this bill or that come fairly close. Sadly, and this is what we are focusing on today, there has also been rampant abuse, particularly in the last few years. Since the industry is comprised almost exclusively of tax-exempt nonprofit organizations, this abuse affects taxpayers as well as consumers, many of whom go to credit counselors seeking help, and end up in even greater financial distress. We highlighted a number of these problems in our report, including deceptive practices and excessive costs, but the focus of my short testimony today, as well as my written testimony, is the abuses of nonprofit status. These abuses occur because of the many agencies out there that aggressively advertise, sell debt management plans, and arrange the related services. The multi-service counseling, education, and debt management plan provider is becoming the exception rather than the norm.

Nonprofit status has become, in practice, a requirement to do business in the credit counseling world, and the industry is comprised almost exclusively of 501(c)(3) tax-exempt organizations. The agencies seek tax-exempt status for a variety of reasons, many of which the IRS Commissioner spoke about, including the possibility of exemptions from a number of important consumer protection laws.

This was also mentioned in the October IRS–FTC advisory on this issue. Perhaps most deceptively, agencies use their nonprofit status as a marketing tool. They promote the nonprofit label as a mark of credibility, appealing to consumer trust that nonprofit organizations are above board, and about more than just making money. We detail that in our report, and in fact, in our survey where we spoke with counselors from a wide range of organizations—credit counseling organizations across the country. I was involved in a lot of the survey, and more than once I was told, just in my initial call, that we are a nonprofit organization—and to tell you what that is like, that means we are just like a church. Using nonprofit status as cover, many agencies characterize any fees charged as donations. Similarly, agencies often claim that creditors work with them because they too can write off contributions to the agencies. All too often, this basic scheme is a charade disguising what is, in reality, a business.

The reasons why these agencies really should not have received tax-exempt status in the first place, are detailed more in my written testimony, but just briefly, we focused on two areas. One is what is known as the ban on private inurement, and again, the IRS Commissioner spoke to this particular issue. What we are talking about is agencies that have arrangements with affiliated for-profits where they are profiting from those arrangements inappropriately. There is considerable evidence that this ban is violated by some credit counseling agencies, and that was the focus of the FTC

action yesterday. There are other Attorney General lawsuits that are currently going on—private class actions, and the IRS investigations as well.

The second set of problems relates to the IRS threshold requirements for tax-exempt status. That is, section 501(c)(3) exempts from payment of Federal taxes, groups organized and operated exclusively to accomplish permissible, charitable, or educational purposes. Do credit counseling organizations meet these purposes? Often the answer is no. The clearest problems occur among agencies that do not offer a range of services, have inappropriate ties to for-profit businesses, and aggressively sell debt management plan products—debt management plans. The key abuse in this area is that as they call them, the companies that are selling debt management plans, as opposed to providing multi-services, are steering consumers into those plans regardless of whether they can benefit from those plans or not. Some consumers can benefit from a debt management plan, and this is something that would be good and efficient for those consumers. Many others cannot.

I would just like to close by saying that as we work together to address these problems, it is very important that all of the various players in the industry be at the table. We thank you for having many of them here today, such as consumers and consumer groups like us. Also the creditors—I think it is important to have them as a part of this dialog. They really created this industry in a number of ways many years ago, and can do a lot more to make it a more legitimate and honest industry. In just a minute, you will hear from the agencies themselves. We have already heard from a number of government regulators. I think together we can help weed out the abuses in the industry, and preserve credit counseling as a legitimate option for consumers. Thank you.

[The prepared statement of Ms. Loonin follows:]

Statement of Deanne Loonin, Staff Attorney, National Consumer Law Center, Boston, Massachusetts, and Consumer Federation of America

Mr. Chairman and Members of the Subcommittee, the National Consumer Law Center and the Consumer Federation of America thank you for inviting us to testify today regarding the non-profit credit counseling industry. NCLC offers our testimony here on behalf of our low-income clients and the Consumer Federation of America (CFA). The National Consumer Law Center is a non-profit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations nationwide that represent low-income and elderly individuals on consumer issues. The Consumer Federation of America is a non-profit association of almost 300 pro-consumer groups, which was founded in 1968 to advance the consumer interest through advocacy and education.

LEGITIMATE CREDIT COUNSELING AGENCIES PROVIDE MUCH-NEEDED SERVICES FOR CONSUMERS IN FINANCIAL TROUBLE

Recent abuses by so-called non-profit credit counseling agencies have raised serious questions about the quality and legitimacy of credit counseling services. The National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) highlighted many of these problems in an April 2003 report, *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants.*[1]

[1] The executive summary is attached at the end of this testimony. The full report is available for downloading from either the NCLC web site (www.nclc.org) or the CFA web site (www.consumerfed.org).

The credit counseling industry is at a critical crossroads. Consumer debt (all non-mortgage loans) and credit card debt continues to grow, increasing consumer demand for debt relief. As of June of this year, American consumers held about $700 billion in credit card debt.[2] The effects of the economic recession, especially the loss of jobs and a sharp increase in the number of Americans with inadequate or no health insurance, have combined with the growth in consumer debt to cause a record number of Americans to seek bankruptcy protection.[3]

The need has never been greater to ensure that consumers who seek credit counseling receive quality services. Yet, policymakers are increasingly encouraging or requiring that consumers seek assistance from credit counselors without first taking adequate steps to improve the quality of credit counseling. This type of mandate is included in pending federal bankruptcy reform legislation.[4] States are also increasing traffic at credit counseling agencies by imposing counseling mandates or requiring the disclosure of credit counseling options to consumers.[5]

At the same time that these economic and political pressures have pushed more consumers toward counseling, abuses in the industry have led to serious deterioration in quality and an increase in deceptive and abusive practices. Aggressive firms masquerading as non-profit organizations have been among the credit counseling agencies that are most likely to deceive or to gouge consumers. Massive cuts in creditor funding for agencies has exacerbated this trend, and leaving many well-intentioned organizations without sufficient funding to provide appropriate services. Most creditors have also reduced the economic concessions that they will offer to Americans who enter credit counseling, making it less likely that consumers will successfully complete credit counseling and more likely that they will have to declare bankruptcy.

Despite these trends, we do not believe that the picture is entirely dark. On the contrary, we believe that multi-service credit counseling agencies can provide valuable services for consumers. We also believe that there is a legitimate and important role for non-profit agencies to provide these services.[6] However, if current abuses are allowed to persist, credit counseling services will all too often seriously harm rather than help consumers, leading them deeper into debt.

SUMMARY OF PROBLEMS WITH CREDIT COUNSELING[7]

It is important to note that the credit counseling industry developed in the mid-1960's through the efforts of credit card companies that saw a creative opportunity to recover overdue debts. Creditors created the industry and provided the bulk of the funding needed to keep the agencies in business. At first, most of the agencies were affiliated with the National Foundation for Credit Counseling (NFCC), a national trade organization that prescribes various standards for member organizations.

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[2] Revolving debt, most of which is credit card debt, was $725.6 billion in June 2003, up from $712 billion at the beginning of the year and $667.4 billion at the beginning of 2001. Non-revolving debt (primarily auto and household loans) was $1.04 trillion in June, up from $1.01 trillion at the beginning of the year. Federal Reserve Bulletin, Table 1.55, October 2003.

[3] There were 1,661,996 non-business bankruptcies filed in fiscal year 2003, the highest level ever, and an increase of 7.4 percent from the 1,547,669 filings in fiscal year 2002. American Bankruptcy Institute, November 14, 2003.

[4] Section 106, H.R. 975.

[5] For example, Georgia and North Carolina do not allow lenders to make high cost mortgage loans unless the borrower has received counseling from an approved agency. Ga. Code Ann. § 7–6A–5(7); N.C. Gen. Stat. § 24–1.1E(c)(1). New York requires the lender to provide a notice urging the potential borrower to consider consulting a "qualified independent credit counselor or other experienced financial adviser" and a list of approved counseling agencies. N.Y. Banking Law § 6–1(1). Florida law allows consumers who cannot repay a payday loan to obtain a sixty day repayment grace period, but only if they successfully complete credit counseling by an approved agency during that period. Fla. Stat. Ann. § 560.404.

[6] Non-profit status is technically a state law concept, making an organization eligible for certain benefits, such as state sales, property and income tax exemptions. Although most federal tax-exempt organizations are non-profit, organizing as a non-profit at the state level does not automatically grant the organization exemption from federal income tax. We are focusing on qualifications for federal tax-exempt status, but use the terms "tax-exempt" and "non-profit" interchangeably.

[7] Although not the topic of this testimony, many agencies now offer debt negotiation or settlement services in addition to or instead of debt management plans (DMPs). Negotiation and settlement differ from DMPs mainly because the agencies do not send regular monthly payments to creditors. In fact, they encourage consumers to pay fees to the negotiation firm and not pay their creditors. These agencies generally maintain debtor funds in separate accounts, holding these funds until the agency believes it can settle the entire debt. There are growing concerns about abuses in settlement and negotiation practices.

From the outset, debt management plans (DMPs) were the feature service. Through these plans, a consumer sends the agency a lump sum, which the agency then distributes to credit card companies that the consumer owes money. In return, the consumer is supposed to get a break in the form of creditor agreement to waive fees owed, to eliminate all references to delinquent payments on the consumer's credit reports by "re-aging" the account, and, and in some cases, to lower interest rates. Consumers also gain the convenience of making only one payment to the agency rather than having to deal with multiple creditors on their own. Through the "Fair Share" contribution, creditors voluntarily return to the agency a set percentage of the funds that are disbursed to them.

Debt management plans include unsecured debt only. This is a critical issue because consumers with sparse resources should generally prioritize secured debt, such as home and car loans, over unsecured debt.[8] In addition, DMPs may not even include all unsecured debt.

NCLC and CFA have found that in the last decade, the credit counseling industry has undergone an alarming transformation. Consumer demand for credit counseling has grown, funding to agencies has been sharply reduced, and an aggressive new class of credit counseling agencies has emerged. This new generation has brought some advances, such as flexible hours, electronic payments and easy access to counselors by phone and the Internet. Unfortunately, however, complaints about deceptive practices, improper advice, excessive fees and abuse of non-profit status have grown significantly as this new generation of credit counseling agencies has gained market share.

Key problems highlighted in the NCLC/CFA report include:

- **Deceptive and Misleading Practices:** Among other problems, we described agencies that do not pay consumers' DMP payments on time, that deceptively claim that fees are voluntary, and that do not adequately disclose fees. In many cases, agencies deceptively exaggerate the types of concessions they can get from creditors to get people out of debt.
- **Excessive Costs:** As creditors have reduced funding, some reasonable fee increases are to be expected. However, in an industry that rarely charged for counseling and other services a decade ago, the vast majority of agencies now charge fees for services. At least a few agencies charge as much as a full month's consolidated payment simply to establish an account. Monthly DMP fees and costs for non-DMP services are also growing.
- **Abuses in Non-Profit Status.** This is the focus of our testimony today. The reality is that non-profit agencies are increasingly performing like profit-making enterprises. Many agencies aggressively advertise and sell debt management plans and a range of related services. The multi-service counseling, education, and debt management plan provider is becoming the exception rather than the norm.
- **Decline in Consumer Education and Counseling Options:** Consumer educational services are rapidly declining. Many agencies that claim to provide education and/or counseling merely sell slickly produced, but unhelpful, CD ROMs, videos or internet information. For example, our survey of agencies not affiliated with the National Foundation for Credit Counseling (NFCC) found that only five of the forty agencies surveyed offered services unrelated to DMPs. Among this minority of agencies, four out of five charged for these other services, including books and videos on debt problems.

Although all of these issues are important and in many ways connected, I will focus mainly on issues related to non-profit status since this is the focus of today's hearing.

ABUSES OF NON-PROFIT STATUS

Non-profit status has become, in practice, a requirement to do business in the credit counseling world. The credit counseling industry is comprised almost exclusively of 501(c)(3) tax-exempt organizations.

Credit counseling agencies seek (and get) tax-exempt status for a variety of reasons. This status makes them eligible for exemptions from federal and state corporate income taxes. Most states automatically allow corporations that qualify for federal tax-exempt status to also qualify for state tax exemptions. Non-profit status is also required to get many public and private grants. In addition, creditors have traditionally required non-profit status to initiate Fair Share contributions.

[8] See generally, National Consumer Law Center, *Surviving Debt: A Guide for Consumers* (2002).

Agencies also seek non-profit status in some cases to comply with applicable state laws, some of which require non-profit status as a condition for doing business in the state. In other cases, non-profit status allows agencies to escape the reach of consumer protection laws. Many of these laws, such as federal and state credit repair laws and many state credit counseling laws specifically exempt non-profit organizations. This concern was explicitly noted in the October 2003 joint I.R.S./F.T.C. advisory urging consumers to exercise caution when seeking help from credit counseling organizations. The agencies stated that, "Federal and state regulators are concerned that some credit counseling organizations using questionable practices may seek tax-exempt status in order to circumvent state and federal consumer protection laws."[9]

Perhaps most deceptively, agencies use non-profit status as a marketing tool. They promote the non-profit label as a mark of credibility, appealing to consumer trust that non-profit organizations are "above-board" and about more than just making money. Agencies take great pains to characterize themselves as charitable in 990 tax forms, advertising and promotional materials. For example, many claim to serve the community through education even though, as noted above, they often charge for educational services or simply provide videos and CD ROMs and no individual counseling. More than one agency we contacted as part of our national survey told us that they are a non-profit agency, "just like a church."

Using non-profit status as cover, many agencies characterize any fees charged as "donations." Similarly, agencies often claim that creditors work with them because they too "can write" off contributions to the agencies. All too often, the basic scheme is a charade, disguising what is in reality a business arrangement between creditors and agencies. The truth is that even if they are voluntary, fees paid by consumers for services should not be classified as charitable contributions. Instead, consumers are paying for services. Similarly, the Fair Share arrangements between creditors and agencies are often formal, written agreements that describe how creditors will compensate agencies for helping the creditors collect money owed to them.

Sadly and at great expense to taxpayers and to consumer clients, many credit counseling agencies should never have been able to attain the advantages of tax-exempt/non-profit status. There are two key areas where I.R.S. (and corresponding state laws) are being violated. Each of these is discussed in greater detail below.

1. Improper Ties to For-Profit Businesses

Agencies are not properly non-profit if they are organized or operated to benefit individuals associated with the corporation including directors, officers or members.[10] No part of the net earnings of a § 501(c)(3) organization may inure to the benefit of any private shareholder or individual. This is often called the ban on private inurement and is a basic tenet of I.R.S. tax-exemption requirements.

There is considerable evidence that the ban on private inurement is violated by some credit counseling agencies. Beginning a few years ago, the media began to uncover the extent of this problem, documenting instances of lavish salaries for agency directors and self-dealing in purchasing real estate and in creating close connections with for-profit affiliated businesses such as lenders or payment services.[11]

More recently, these abuses have been the target of public and private lawsuits. For example, both the Missouri and Illinois Attorney General Offices sued AmeriDebt, Debticated and related affiliates and individuals.[12] Among other claims, both suits allege that AmeriDebt and Debticated falsely represent that they are "not for profit" companies. According to the Missouri complaint, the credit counselors are thought of and even referred to as "salesmen" of DMPs and are judged and evaluated in part upon their current week or month's sales and revenues. The complaint further alleges that AmeriDebt and Debticated transfer virtually all tasks and virtually all consumer fees to the related for-profit company DebtWorks. DebtWorks,

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[9] See *"IRS, FTC and State Regulators Urge Care When Seeking Help from Credit Counseling Organizations",* IR–200–20, October 14, 2003.

[10] 26 U.S.C. § 501(c)(3).

[11] See, e.g., Eileen Ambrose, *"Debt Counseling Leads to Deeper Credit Woes",* Baltimore Sun, November 14, 2003; Jennifer Bayot, *"Not-for-Profit Credit Counselors Are Targets of an I.R.S. Inquiry",* New York Times, October 14, 2003; Caroline E. Mayer, *Easing the Credit Crunch?,* Washington Post, November 4, 2001 at H01. Also *see* Massachusetts Senate Committee on Post Audit and Oversight, *Losing Credibility: Troubling Trends in the Consumer Credit Counseling Industry in Massachusetts,* July 2002.

[12] The Illinois suit was filed in February 2003 and the Missouri suit in September 2003. For a copy of the Missouri complaint, *see* http://ago.missouri.gov/lawsuits2003/091103ameridebt.pdf. For a detailed discussion of a private lawsuit with similar allegations against Debticated, *see* Debra E. Blum, *"Checking Upon Credit Charities",* The Chronicle of Philanthropy, August 21, 2003.

according to the Missouri Attorney General, prepares proposals to creditors for consumers, communicates proposals to creditors, obtains consumers' approval for changes, and responds to consumer calls. The suit further alleges that the agencies falsely represent that they provide consumer credit counseling.

Interestingly, AmeriDebt announced in October 2003 that it would lay off most of its workers and stop seeking new customers because of negative publicity.

A Massachusetts Attorney General action focuses on another way in which "non-profit" agencies have linked up with for-profit businesses to generate profits. In this case against Integrated Credit Solutions and Flagship Capital Services Corporation, the Massachusetts Attorney General alleges that Integrated, a for-profit telemarketer, solicits business for the non-profit Lighthouse Foundation.[13] According to the complaint, Integrated induces consumers to pay exorbitant "enrollment" and "education" fees to Integrated, a for-profit telemarketer, in order to receive credit counseling from Lighthouse, which purports to be independent and non-profit.

To the extent the allegations discussed above are true, these agencies should have their non-profit status revoked and/or should be sanctioned appropriately.

Related abuses involve unreasonable compensation and other benefits that are directed by the non-profit agencies to directors and officers. In our report, we described non-profit agencies that were paying directors salaries and related benefits worth over $400,000 annually. These troubling practices raise serious warning signs that agencies may be operating more to benefit themselves than the public. In addition, this is an area where I.R.S. has the power to sanction offending agencies.[14]

2. Many Credit Counseling Agencies Do Not Meet Threshold I.R.S. Tax-Exempt Requirements

This second set of problems relates to the I.R.S. threshold requirements for tax-exempt status. Section 501(c)(3) exempts from payment of federal taxes groups organized and operated exclusively to accomplish permissible charitable, educational, religions, literary or scientific purposes. Organizations must limit their purposes to one or more of these categories and must not engage, other than as an insubstantial part of their activities, in activities that do not further one or more of these purposes.

The clearest problems occur among agencies that do not offer a range of services, have inappropriate ties to for-profit businesses as noted above, and aggressively sell DMP products. However, the question is relevant even beyond these most egregious offenders, primarily because of the close ties between credit counseling agencies and creditors. Credit counseling agencies can provide benefits for both consumers and creditors. However, an agency's primary concern, in all instances, should be providing the most appropriate services for consumers.

It should be clear that an agency that primarily or exclusively sells DMPs is not providing a charitable service or product. This conclusion was affirmed in the October 2003 I.R.S/FTC statement that organizations that offer only DMP services, without significant education and counseling, ". . . would not qualify for tax-exempt status."[15]

A DMP is a structured way to help consumers pay back unsecured debt. DMPs work well for some people, but not for everyone. In today's climate, creditors offer fairly limited concessions for consumers on DMPs. These limited concessions may be sufficient to allow some people to avoid defaulting on debt and to restore good credit. For others, it is just a dead end. It can prolong difficult financial circumstances, ruin a consumer's credit record, create innumerable difficulties and tensions at work and at home, and delay or stop a consumer from taking actions that might be more beneficial, such as negotiating individually with creditors or declaring bankruptcy. The exclusive focus on unsecured debt may also lead consumers to fall farther behind on secured priority debts such as mortgages or car loans. The consequences are severe, including possible foreclosure or car repossession.

The key abuse that can occur when an agency with non-profits status is operating as a for-profit is that it will steer consumers into DMPs regardless of whether this is the best choice for them. The agencies do this because it makes financial sense for them, although not necessarily for consumers. DMPs bring in revenue and the

[13] This lawsuit was filed in December 2002. See *"AG Reilly Sues Telemarketer Accused of Using Deceptive and Misleading Tactics to Sell Credit Counseling Services to Consumers",* Press Release, December 19, 2002. Available at: http://www.ago.state.ma.us/press—rel/ics.asp?searchStr=1.

[14] 26 U.S.C. § 4958 (I.R.S. "intermediate sanctions" rule).

[15] See *"IRS, FTC and State Regulators Urge Care When Seeking Help from Credit Counseling Organizations",* IR–2003–120, October 14, 2003.

agencies exist to bring in revenue. This may be a legitimate business if done well and honestly, but there is nothing "non-profit" or charitable about it.

Over the years, the close ties between creditors and credit counselors have been questioned in a few court decisions, but for the most part upheld.[16] The problem is that these decisions derive from earlier days when the vast majority of credit counselors provided a wide range of services, rarely charged consumers, and were able to receive sufficient funds from creditors to fund other aspects of their services.

A more recent decision addresses the same issues in the context of the current credit counseling environment. In deciding that an NFCC-affiliated agency was not entitled to a charitable tax exemption, the Supreme Judicial Court of Maine found that the agency provided benefits to creditors that were not merely incidental to its charitable purposes.[17] The court noted the magnitude of the amounts collected for creditors and that the creditors paid Fair Share.[18]

The Maine Court recognized that the traditional model is no longer the norm. For the most part, however, courts and regulatory agencies have yet to catch up. The agencies have continued to get tax-exempt status despite the huge transformation in the industry toward national, aggressive agencies that often function as virtual for-profit business and are in "business" to sell a particular product—a DMP.

Thus, the threshold requirement for tax-exempt status is in serious doubt in many cases. It is not always clear whether an agency is primarily charitable. The picture is clouded even further by unscrupulous agencies' efforts to disguise themselves. There is a lot of money at stake in the credit counseling industry. Disguised for-profit agencies will go to great lengths to hide the true nature of their businesses.

In many cases, the real picture can be uncovered simply by calling agencies and asking about their services, particularly about any non-DMP counseling and educational services. We did this as part of our national survey and the results were often astounding. Nearly all of the "counselors" at the non-NFCC agencies we contacted by phone were surprised by inquires about courses or other consumer education resources. When asked this question, one counselor simply said, "We consolidate credit cards. That's it." Another incorrectly said that no agency in the country offers classes. It is important to note, in contrast, that most agencies affiliated with the NFCC and some others still strive to provide some type of educational services. However, even among NFCC agencies, in-person presentations by counselors declined by 16.2% from 2000 to 2001.[19]

Regulatory agencies should also focus on the content and quality of any education offerings. Does the agency simply sell cookie-cutter "CD ROMS," videos and other materials? Does the agency have evidence that consumers have used these materials, have learned more about effective debt management, and, most importantly, have changed their behavior? Do they charge for these materials and, if so, how much?

WHERE DO WE GO FROM HERE? VISION FOR THE FUTURE

There have been many developments and responses, just in the past year, that have addressed abuses in the industry. As noted above, the I.R.S., F.T.C. and state regulators issued a joint October 2003 advisory warning consumers about potential problems with credit counselors. The I.R.S. also issued a report earlier this year examining abuses in the credit counseling and credit repair industries.[20]

Public and private lawsuits, some of which were described above, have targeted key abuses. In addition several states have passed new laws meant to address abuses. However, some of these new laws either exclude "non-profit" agencies from regulation or confine the industry to non-profits without doing additional investigation as to whether the non-profit status of agencies that are operating is legitimate. In addition, to date, most of these laws have been inadequately enforced.

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[16] For example, in a key 1979 decision, the U.S. Tax Court disagreed with I.R.S revocation of tax-exempt status for a credit counseling agency. *Consumer Credit Counseling Service of Alabama, Inc. v. U.S.,* 78–2 U.S.T.C. P 9660, 1978 WL 4548 (D.D.C. 1978). The court was persuaded that the agency's DMP services were merely "adjunct" to its counseling functions. The court also considered the fact that the agency charged only a nominal fee and that the community education and counseling assistance programs were the agency's primary activities.

[17] *Credit Counseling Centers, Inc. v. City of South Portland,* 814 A. 2d 458 (Maine 2003).

[18] A dissenting judge argued that any benefit provided to creditors is incidental and that it is not clear in any case that creditors receive a benefit since they receive only a portion of the money already owed to them. See *Id.*

[19] Statistics provided with permission from the National Foundation for Credit Counseling. Data is derived from the 2001 Member Activity Report.

[20] Debra Cowen and Debra Kawecki, *"Credit Counseling Organizations",* CPE 2004–1 (January 9, 2003). As of November 2003, available at www.irs.ustreas.gov/pub/irs-tege/eotopica04.pdf.

Many sectors of the industry have also responded to the abuses that exist. For example, two of the key trade associations, the National Foundation for Credit Counseling and the Association of Independent Consumer Credit Counseling Agencies (AICCCA) have developed joint best practices standards. These standards are meant to foster self-policing of the industry. Although important, it is unclear to what extent the associations enforce these standards. In any case, the possible penalties include revocation of association membership only, with no effective recourse for consumers. In general, we believe that best practices standards can be positive if rigorously enforced, but are not a substitute for effective federal and state laws.

Creditors have also begun to respond to these problems, but in contradictory ways that have had more of a negative than positive effect so far. For example, instead of contributing a flat amount to all agencies, several major creditors now link the amount of their contribution to the fulfillment of multiple requirements by agencies. In conjunction with lowering Fair Share contributions and making them more conditional, creditors have begun imposing restrictive standards that agencies must meet before they will accept proposed DMPs. Some of these new creditor-imposed conditions and requirements could help limit some of industry abuses. This is most likely to occur if these requirements are focused on increasing the affordability and range of options that are available to consumers and the quality of credit counseling. For example, conditioning creditor contributions on agencies' willingness to charge reasonable fees could lead some agencies to lower their fees, benefiting both consumers and creditors. However, until very recently, creditors have focused only on their bottom line costs by making deep, across-the-board funding cuts. Despite that fact that creditors have abandoned this unilateral approach and say that they are trying to properly fund effective agencies, the overall trend in the Fair Share has been down. This trend hurts the good agencies and the consumers who need access to quality credit counseling.

Moreover, creditor policies have increased administrative overhead and reduced options at counseling agencies. In addition, creditor requirements have tended to reward the agencies that provide a high number of DMPs at low cost. This has helped to fuel the growth in high-cost, low-quality "mills" that are focused only on getting as many people as possible into DMPs.[21]

In addition to these existing responses, much more needs to be done. It is particularly critical that the I.R.S. and state charitable regulators follow up on the October 2003 advisory and take disciplinary action against offending agencies, including, if necessary, revoking agencies' non-profit status. Only through proper enforcement can a legitimate non-profit credit counseling sector flourish.

We believe that credit counseling can be a viable choice for many consumers. We also believe that scrupulous credit counseling agencies can properly meet non-profit standards. However, these goals will not be reached by federal and state regulatory enforcement alone. Agencies and creditors must also work to preserve the credibility of credit counseling and non-profit credit counseling in particular. Among other changes, non-profit credit counseling agencies must avoid undue reliance on creditor funding. Agencies can and are diversifying funding. Many receive funding from HUD or from foundations to provide housing counseling to first-time homebuyers and homeowners in distress.[22] Others receive local funding to help seniors, for example, understand long-term care options and how to budget on a fixed income.

The fact that agencies are funded by creditors is not intrinsically a violation of I.R.S. rules. The key question is whether the agencies are working primarily for the creditors or for the consumers. As one way of addressing this very real conflict in the industry, we recommend that new laws regulating credit counseling place an explicit fiduciary duty on agencies to their consumer clients.

In addition, it is important to emphasize that legitimate non-profit credit counselors can charge fees in some cases. However, these fees must be reasonable and imposed without undermining the charitable purposes of the agency. Whenever pos-

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[21] This attitude is exemplified by the comments of Fritz Elmendorf of the Consumer Bankers Association to the *Chicago Tribune:* "There have been cutbacks by some banks, particularly related to general budget tightening, but also because the services were not seen as providing a direct return by lowering credit losses. At the same time there are payment plan 'mills' coming in with lower fees than the traditional fair-share arrangements. They're trying to gain market share. They help you rehabilitate the customer, and it costs you less." Janet Kidd Stewart, *"Debt Management and Counseling Services Are Multiplying as Consumer Loans Mount, But Not All Are Working in the Clients' Best Interest",* Chicago Tribune, February 23, 2003.

[22] Housing counseling funding, in particular, is limited and credit counseling agencies are in competition with non-profit HUD-certified housing counselors. Traditional housing counseling agencies, for the most part, do not receive Fair Share funding and generally do not charge for services.

sible, agencies should strive to charge fees on sliding scales so that the neediest consumers can still receive assistance.

In order to restore consumer confidence in the industry, it is also critical that the agencies and creditors operate more transparently. Financial arrangements, including Fair Share, must be disclosed. Fee scales should be honestly disclosed and not deceptively described as voluntary or donative. Agencies should also disclose their client retention rates annually—the proportion of consumers who do not successfully complete DMPs. And finally, non-profit agencies must counsel clients, provide education, and advise consumers on the full range of options.

The creditor role in bringing about change is just as critical. Creditors should immediately take steps to encourage the improvement and expansion of effective credit counseling options for consumers who would not benefit from a DMP. This step alone will insure that agencies are meeting the educational requirements that non-profit status demands. Creditors should also increase financial support to credit counseling agencies, especially to improve credit counseling options for consumers who are unlikely to benefit from a DMP.

Citigroup took a hopeful step in this regard when it notified agencies on November 4th that it will be replacing its Fair Share donation with lump sum charitable donations, which could be used for counseling and client education.[23] This could have the positive long-term effect of decreasing a major incentive for agencies to inappropriate enroll consumers in DMPs. However, this move could also prove to be hollow and counterproductive if Citigroup doesn't increase the actual amount it provides to effective agencies, allowing these agencies to hire additional staff to assist in providing and increasing counseling efforts. Otherwise, the agencies will be stuck simply trying to process DMPs and maintain the status quo, especially over the short-term.

Creditors should also reverse the current trend toward reducing the concessions they offer to consumers who enter a DMP, especially regarding lower interest rates. This will help improve the retention rates in credit counseling and decrease the number of former DMP clients who end up in bankruptcy. Creditors should also work together to develop consistent administrative and payment requirements, thus reducing agency overhead and ensuring that more funds are used to assist consumers. In addition, creditors should immediately stop providing funding to agencies that charge high fees or are employing deceptive or misleading marketing practices.

Finally, to promote these goals, there is a need for greater regulation to ensure that consumer rights are protected and that victims can seek redress in the courts. We are in the process of developing detailed recommendations.

Among other provisions, we call for a limited registration system requiring an agency to register as a debt management or debt settlement provider in each state where it is doing business. Only agencies that are properly registered should be allowed to perform services in that state. At the time of filing for registration, all agencies should be required to furnish a cash or surety bond.

We also recommend that the following *written* disclosures be given to consumers before initial enrollment for any service with the agency:

- Percentage and amount of funding the agency receives from creditors (as defined).
- Disclosure of any other financial arrangement the agency has with any lender or other provider of financial services.
- Disclosure of the various types of services offered by the agency.
- A statement that debt management and debt settlement plans are not suitable for everyone and that consumers can request information about other options, including bankruptcy. **(This disclosure must appear in all advertisements as well.)**
- A statement that debt management and debt settlement plans do not include secured debt, including a brief description of the most common types of secured debt such as mortgages and car loans.
- Existence of the surety bond.
- Statement that the agency cannot require donations. **(This statement must appear in all advertisements as well.)**

We recommend that the following disclosures be given to all consumers before initiating debt management or debt settlement services:

[23] Letter from Citigroup, November 4, 2003. On file with the Consumer Federation of America and the National Consumer Law Center.

- Full disclosure of all services to be provided and any up-front and ongoing fees to be charged for services **("fees" includes both mandatory and voluntary fees).**
- An estimate of the length of time required to complete services, the types of concessions offered by major creditors, and estimated amounts of concessions throughout the entire period of the plan.

Agencies should be required to give consumers enrolling in debt management plans copies of written contracts that include certain critical information. Among other substantive provisions, we recommend that all contracts contain a right to cancel without obligation within a prescribed period of time after initial enrollment. A separate notice of the right to cancel must be provided at the time the contract is signed. In any case, either party should be allowed to cancel with proper notice. In addition, we believe that all contracts must include a full disclosure of services to be provided and all fees that will be charged.

We believe the law should include strong standards to ensure that only consumers that can benefit from a DMP are enrolled. In order to make this assessment, agencies should be required to evaluate the consumer's household budget, including types and amounts of debt.

New regulations should also specify minimum requirements for counselor training and reasonable fee limits for services. It is important to require agencies to maintain consumer funds in separate trust accounts and not commingle these accounts with operating accounts.

At a minimum, the recommended prohibition of the following practices:

- False and/or deceptive advertising.
- Agencies should be prohibited from paying referrals to customers who bring in new customers.
- Agencies should be prohibited from purchasing debts from consumers and other third parties.
- Agencies should be prohibited from making loans to consumers and from profiting in any way or receiving any compensation from referring consumers to lenders and other creditors.
- Agencies should be prohibited from compensating employees or contractors based on any formula that provides commissions or incentives tied to the numbers of consumers enrolled in debt settlement or debt management plans.

In order to ensure that these laws are meaningful, we call for strong remedy provisions including the voiding of contracts that are not in compliance and a private right of action for consumers to enforce the law, including provision for actual damages, treble or appropriate statutory damages, attorney's fees, and injunctive relief. Record keeping requirements are also critical to ensure that regulators can track trends in the industry and address abuses.

In a time of economic uncertainty and growing debt, it is increasingly important to preserve credit counseling as an option to help consumers deal with debilitating debt problems. The services are not appropriate for all consumers, but can provide a much-needed safety net for many. This vision of a thriving credit counseling sector is possible only as long as the services provided are quality services, appropriate services, and to the extent offered by non-profit organizations, truly charitable and educational in nature.

Thank you for the opportunity to testify today.

Chairman HOUGHTON. Thank you very much, Ms. Loonin. Mr. Boisclair.

STATEMENT OF W. PATRICK BOISCLAIR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONSUMER CREDIT COUNSELING SERVICE OF MIDDLE GEORGIA, MACON, GEORGIA, AND CHAIRMAN, BOARD OF TRUSTEES, NATIONAL FOUNDATION FOR CREDIT COUNSELING, INC., SILVER SPRING, MARYLAND

Mr. BOISCLAIR. Good afternoon, Chairman Houghton and distinguished Members of the Subcommittee. I am Pat Boisclair, and I am pleased to speak to the Subcommittee today as Chairman of the Board of Trustees for NFCC. The NFCC is the Nation's longest

serving and largest credit counseling organization, with 135 nonprofit members who collectively operate more than 1,000 community-based offices nationwide, mostly known as consumer credit counseling services.

Since 1977, I have also served as President and Chief Executive Officer of Consumer Credit Counseling Service of Middle Georgia, a nonprofit community-based agency which has been a member of the NFCC since 1971—as the Nation's original nonprofit credit counselors. We have witnessed a great deal of undisciplined change in the credit counseling industry, some of which has already been described today by the FTC, IRS, and NCLC.

Some of these changes have brought service delivery improvements to the industry. Other changes have paved the way for unprecedented abuses of consumers by some of the new debt service operators. Yet amidst the marketplace confusion and current abuses within the service sector, the NFCC continues to govern its members through rigorous certification and accreditation standards that require our members to live up to their nonprofit status, and serve the consumers professionally, and with compassion. Members of NFCC offer free, low-cost education and counseling services to help consumers learn better money management and credit management skills.

Our community service model also allows for interaction and cross-referrals with other local support services, such as family counseling, crisis lines, and legal aid, to help our clients with other underlying issues that may affect their finances. Only consumers in need of intervention with creditors are recommended for formal debt repayment plans, including concessions such as reduced monthly payments, waived late fees, and lowered interest rates. This has been, and continues to be, the holistic approach to service that NFCC members offer consumers who contact their offices.

Over the past decade, we have seen some unsavory results from the unbridled changes in the credit counseling arena. Now, consolidated telemarketing phone centers have led to centralized, single-focus, debt prorating companies, some of whom masquerade as nonprofit credit counseling agencies. Instead of a holistic approach to counseling, these organizations have focused only on the revenue-generating aspects of our service sector—debt repayment plans.

What they offer is a simple 15-minute, quick-fix question and answer session touted as a cure for consumers' ailing fiscal health. Many consumers are talked into debt repayment plans loaded with high fees. The more people these agencies sign up in debt plans, the more money they make. In some cases, basic budget counseling should have shown a consumer how to solve their own problems, but they were not offered that advice. These new providers play by their own rules not governed by local and independent boards of directors. For them, there are no checks and balances to ensure that their practices are fair, consumer-focused, and untainted by improper relationships, and shell transactions that enrich their executives and related for-profit companies.

We are pleased that government officials and consumer advocates are beginning to realize what we have witnessed for sometime: that these unscrupulous players have declared open season on consumers. Members of NFCC believe that it is ethically and

morally wrong to take advantage of vulnerable consumers, and to violate an organization's nonprofit status by failing to offer financial education and counseling. We are committed to our mission of improving the financial knowledge and money management skills of consumers.

We also believe that the creditor community should share in the social responsibility, and should continue to provide resources to help support financial rehabilitation of our shared customer—the consumer. Yet given the current state of the industry, we also need the intervention of consumer advocates, government legislators, and regulators, to help protect consumers and preserve reputable credit counseling agencies.

Our members, who serve small and large communities across the country, have for more than 50 years provided valuable service that has held families together through job losses, medical emergencies, domestic disputes, and other critical times. With your support, we hope to be around for years to come. Thank you once again for the opportunity to represent the NFCC here today.

[The prepared statement of Mr. Boisclair follows:]

Statement of W. Patrick Boisclair, Chairman, Board of Trustees, National Foundation for Credit Counseling, Inc., Silver Spring, Maryland, and President, Chief Executive Officer, Consumer Credit Counseling Service of Middle Georgia, Macon, Georgia

Good afternoon to the Honorable Chairman of the Committee on Ways & Means Subcommittee on Oversight Congressman Amo Houghton and to all of the distinguished Members of the US House of Representatives who are represented on this Subcommittee. I, W. Patrick Boisclair, am pleased to come before this Subcommittee today as Chairman of the Board of Trustees for the National Foundation for Credit Counseling, Inc.®, which I will refer to as the NFCC throughout my testimony. I am also pleased to join you as a practitioner, having served since 1977, as President & CEO of Consumer Credit Counseling Service of Middle Georgia, also known as CCCS of Middle Georgia, a nonprofit community-based agency which has been a member of the NFCC since 1971.

I am pleased to represent the nation's original and largest credit counseling organization, NFCC and its 135 nonprofit members who collectively operate more than 1,000 community-based offices nationwide. I am also here to represent the interests of the many consumers in need of financial education and debt relief who live in our communities and your congressional districts. Through my testimony over the next five minutes, I hope to provide you with greater insight on the undisciplined changes in the credit counseling industry. I also hope to share with you the impact of these changes on consumers who are seeking help to regain control of their financial situation and the reputable nonprofit credit counseling agencies that provide them with responsible, quality services.

As many of you know, consumer credit has been one of the major fuels of our economy since the post World War II era, when it was introduced as a means of addressing some of the financial and social problems that existed for military families. But some of the originators of this financial tool soon realized that many people did not know how to properly use credit, and families and individuals began to default on their debts. Their remedy was the creation of the NFCC, which was established in the 1950's as the National Foundation for Consumer Credit. For clarification purposes, the NFCC changed its name in 2000 to the National Foundation for Credit Counseling.

The NFCC initially monitored legislative and regulatory activity for its retail credit members, such as J.C. Penney and Sears. The NFCC also conducted public awareness campaigns on credit and provided children and families with educational classroom materials to help them understand the proper use of credit as a family financial planning tool.

During the early 1960's, the increasing use of credit resulted in the establishment of NFCC's original nonprofit charter members, known as Consumer Credit Counseling Service in their local communities. These agencies began to offer educational programs and counseling to consumers on managing and overcoming debt. They also

ignited a growing grassroots movement of agencies, all whom were NFCC members. These agencies were also the early pioneers who fought the battles to get creditors to help support financial rehabilitation of their clients through nonprofit counseling services.

A decade later the credit industry began to experience radical changes as more retailers and banks extended credit to more consumers. Industry conditions were further impacted in the 1970's by revisions in the Bankruptcy laws and the recession of the 1980's. Many creditors responded to these market and legal changes by extending more educational services and debt relief resources to their customers through the credit counseling industry. For NFCC member agencies this increased support brought the creditors and credit counseling agencies together to serve the needs of their mutual customer, the consumer. There was a shared commitment to customer service between the two parties that formed a strong safety net for people who had lost control of their financial situations.

During the 1980's, the strong show of support from creditors came in many forms, including assistance to help NFCC agencies professionalize, modernize and expand their services. More consumers received free financial management advice and educational services to help consumers learn better money management skills to get out of deep debt on their own and stay of out debt trouble in the future. Consumers experiencing issues that our members were not trained to address were referred to other local support services to help with underlying issues such as unemployment, abuse, addictions, medical issues and bankruptcy advice. Only those in need of intervention with creditors were offered formal debt repayment plans which sometimes included concessions ranging from reduced monthly payments to waived late fees and lowered interest rates.

This has been, and continues to be, the holistic approach to service that NFCC members offer consumers who contact their offices. These services are provided in-person, by telephone and in some cases over the internet and by mail.

The early1990's ushered in another era of change for the credit industry and the credit counseling industry. A decade later, we are seeing the unsavory results of the new phenomenon that began to unfold as executives from other industries moved into the nonprofit credit counseling industry. The deregulation of the telecommunications industry aided their cause and the creation of new phone counseling-only centers.

Some of these new independent agencies sought to join the NFCC, but chose not to live up to our membership standards and we said, thanks but no thanks. Consequently several of these agencies sought legal redress in the mid-1990's and challenged the relationship between creditors and NFCC members—agencies that demonstrated high standards and customer success. In the lawsuit, one agency alleged that the creditors and the NFCC conspired together to create a monopoly for NFCC members and to keep others out of the counseling business. While they sued their way into the doors of creditors, they continue to choose not to meet our governing standards and we continue to require adherence to high standards as a condition for membership.

The onset of these consolidated telemarketing phone centers has led to centralized, single-focused, debt prorating companies, some of whom masquerade as nonprofit credit counseling services. Instead of a holistic approach to counseling, some have become experts at skimming off the most profitable aspect of counseling services; debt repayment plans. Their claims: "and you too can get help in just minutes." It all starts with a 15-minute, one size fits all, quick-fix counseling session touted as a cure for the consumer's ailing fiscal health. Many consumers soon learn that they have been talked into a debt repayment plan or consolidation loan, loaded with high fees, when in some cases the consumer could have solved their own debt situation after receiving budget counseling advice.

Some have abandoned true financial education and counseling altogether. Others have changed the quality of service for the worse and are driven by quantity, versus quality. The more people they sign up on debt repayment plans, the more money they rake in from excessive consumer fees and creditor contributions to fatten their bottom lines. And since they don't have local offices, consumers who seek customer service to resolve account issues are at the mercy of telemarketers and telephone recordings. As a result, some consumers can't get through to a person to find out why their payments have not been received by their creditors.

This is becoming common practice with many of the new national providers that only offer phone services. Many of these agencies are not governed by local and independent Boards of Directors who ensure that their practices are fair, consumer focused and untainted by improper relationships and shell transactions that enrich their executives and for-profit companies.

The abuses and excesses of these alleged nonprofit agencies have resulted in the counseling industry's own figures like the Enron's, WorldCom's and Tyco's of the for-profit sector, which are now turning this industry on its head. Their deceptive practices injure consumers, the NFCC and all other reputable credit counseling agencies that provide excellent services and that are true to their nonprofit 501 (c) (3) designations.

There are many factors that set NFCC members apart from other organizations. To name a few, we believe it is ethically and morally wrong to take advantage of vulnerable consumers and to violate one's nonprofit status by failing to offer financial education and budget counseling services to consumers. Secondly, we have safeguards that govern our members' operations and services through membership standards, consumer protection standards, third-party accreditation services and trained and certified counselors. These protocols govern how our members operate and must be followed by any agency that joins the NFCC.

Many of the new debt service providers operate by their own rules and don't see the need to practice high standards that protect consumers. NFCC members see things differently, and it is our goal to bring to the attention of government officials, consumer advocates, creditors, and all affected parties, that these unscrupulous players have declared open season on consumers. The assaults include multi-million dollar advertising campaigns that bombard consumers 24-hours-a-day, excessively high fees that add to a consumer's burden and affect payments to creditors, poor or no customer service and no accountability for the agencies' operations and services.

Many of the new players have contributed to marketplace confusion and some have even attempted to trade on our NFCC and CCCS trademarks. While this is problematic for us, unconscionable harm is being done to uninformed consumers who ultimately become the victims of these new players' deceptive and irresponsible practices.

As NFCC members, we are committed to our social responsibility to improve the financial knowledge and money management skills of consumers. We also believe that the creditor community shares in this social responsibility, which can be accomplished through consumer education at the point when their customers are facing financial and debt problems. But given the current state of the counseling industry, we also need the intervention of consumer advocates and government legislators and regulators to help protect consumers and to help preserve reputable credit counseling agencies.

We must protect our ability to maintain and grow our agencies. But we need the help of government officials to attack the money trail of some of these new players and take the excessive profitability out of this industry. As a result, some of them will go away. Consumers need to know that they can still turn to true nonprofit services for fair and objective advice that is appropriate for their situation. We need your help to restore the respect and trust of the credit counseling industry that NFCC and its members have built over the past 50 plus years. Without this help, the true community service agency model will not survive and many consumers will suffer.

Our physical presence in local communities places our members in a unique position that allows them to look across the landscape of America to see the financial strain of ordinary and sometimes not so ordinary people. We're also right there in the heart of your congressional districts to see that many students and families get off to a good financial start as they prepare to purchase their first automobile or home.

In fact, our members, which serve small and large communities across the country, have for more than 50 years, provided valuable services that have held families together through job losses, medical emergencies, domestic disputes and other critical times. With your support, we hope to be around for years to come.

We look forward to working with Congress, federal and state regulators, consumer advocates, creditors and others to help shape a national dialogue and to establish policies and guidelines that will protect consumers from predatory debt service providers and that will sustain the long-standing, reputable credit counseling agencies in our industry. Thank you once again for this opportunity to represent the NFCC and the consumers we serve.

Chairman HOUGHTON. Thank you, Mr. Boisclair. Mr. Jones.

STATEMENT OF DAVID C. JONES, PRESIDENT, ASSOCIATION OF INDEPENDENT CONSUMER CREDIT COUNSELING AGENCIES, FAIRFAX, VIRGINIA

Mr. JONES. Chairman Houghton and Members of the Subcommittee, my name is David Jones, and I am the President of the AICCCA. I appreciate being asked to appear before you today on behalf of the members of our organization. We share your goal of assuring that consumers facing serious debt problems can consult with a nonprofit credit counseling service with the assurance that they will receive responsible and fair assistance. The AICCCA provides for self-regulation of its members through strict membership standards, and a code of practice that is the basis for independent accreditation of each agency.

Further, every counselor must be independently certified by the Institute for Personal Finance. These standards, we believe, are the most rigorous in the industry today. The AICCCA and the NFCC have had effective self-regulation standards in place for many years. It is even probable that the U.S. Department of Justice's Office of the U.S. Trustee is contemplating similar standards for credit counseling under the provisions of the pending bankruptcy reform legislation.

As the availability of unsecured credit has grown over the past decade, so have default rates and the demand for credit counseling. To meet this demand, there have been many new nonprofit credit counseling agencies entering the industry. This growth in unsecured debt has led to the same growth in consumers repaying their debt through debt management plans through credit counseling agencies.

Credit card issuers have been inundated by delinquencies and by debt management plan proposals made to help consumers get back on track with their family finances. The numbers of consumers seeking debt management plan help have resulted in credit grantors being unwilling to continue to provide fair-share contributions to the credit counseling agencies at the level that were common only 10 years ago.

Fifteen percent fair-share, then, has declined to an average of 6 percent today. Agencies could offer responsible credit counseling, consumer education, and debt management plans when they were needed to consumers, at no cost when they received 15 percent from creditors. They find themselves today unable to provide these services free at 6 percent. They have, therefore, been forced to pass on the costs to the consumer, or to reduce services—or both.

Today, debt management plans are very rarely free to the consumer. Credit counseling and education remain largely free services, but they are supported almost completely by revenues generated by debt management plans. As the demand for credit counseling grew, some saw the possibility of providing the service largely to generate profit. Some have developed services that have required substantial fees or voluntary contributions from the consumer.

While these actions may be entirely legal, some have seen them as predatory. As consumers and consumer advocates have complained, some have introduced new laws designed to limit fees and offer consumer protection. These laws today represent a patchwork

quilt of regulations across the country; sometimes they are even conflicting.

Although well meaning, some of them are also so severe as to actually prohibit the supply of responsible services to the citizens that they were designed to protect. The bill, H.R. 3331, was introduced in the House recently, and the Senate may be considering its own bill. The National Conference of Commissioners on Uniform State Laws has undertaken the development of a consumer debt management act designed to be enacted by the States.

In addition, the bankruptcy reform legislation approved by the House in March still awaits Senate action. All of these legislative actions, combined with those from the States, portend a staggering level of regulation for this industry. The AICCCA recognizes the need for strong consumer protection. The interests of vulnerable citizens must come first.

These protections should be considered carefully and coordinated with State regulations so that relatively small but essential credit counseling services are not driven out of existence in the process. The AICCCA stands ready to assist the Subcommittee on Oversight as this inquiry continues, and I want to thank you very much for allowing me to speak today.

[The prepared statement of Mr. Jones follows:]

Statement of David C. Jones, President, Association of Independent Consumer Credit Counseling Agencies, Fairfax, Virginia

Chairman Houghton and members of the Subcommittee, for the past four years I have served as President of the Association of Independent Consumer Credit Counseling Agencies (AICCCA). I am the retired President of a prominent consumer credit counseling and education services company. I have been associated with the credit counseling industry for the past seven years. Prior to that, I was President and CEO of a software development and consulting company. I spent much of my career at Lockheed Corporation and ended my tenure there as Vice President of Marketing. I currently dedicate my efforts to improving credit counseling and consumer education throughout the industry. I hold BS, MBA, and Ph.D. degrees and I am a graduate of the Brookings Institution Center for Public Policy Education.

On behalf of AICCCA's members, I want to thank the Subcommittee for inviting me to provide our views to you today. We share and support the Subcommittee's goal of assuring that consumers facing substantial debt problems can consult with a non-profit credit counseling agency with the knowledge that they will receive assistance based on their own best interests, and not the best interest of the agency.

AICCCA FOUNDING AND STANDARDS

The AICCCA was formed in May of 1993 to support independent credit counseling agencies nationwide. It currently has 50 members serving over 750,000 clients repaying their unsecured debts through legitimate debt management plans. Together, these agencies annually return over $3.2 billion in consumer payments to the nation's creditors. The AICCCA has championed fair pricing, stringent ethical guidelines, and consumer protection standards governing the activities of its members. Three years ago, the AICCCA instituted independent agency accreditation requirements through the International Standards Organization. That accreditation to ISO–9001 includes thorough annual Code of Practice audits and represents the most rigorous, independent, audit-based accreditation and oversight in our industry today. Our current Code of Practice is attached to this testimony as an Appendix.

The AICCCA provides for self-regulation of its member agencies through strict membership standards and a Code of Practice that is the basis for independent accreditation by the International Standards Organization under ISO–9001. This independent third-party accreditation, combined with an equally independent certification of all agency counselors by the Institute for Personal Finance-AFCPE, provides significant assurances for consumers needing counseling services that they will be treated fairly and competently. The National Foundation for Credit Counseling (NFCC) has similar requirements for its members. However, the many agen-

cies that do not belong to either of these associations are not bound by such rigorous standards.

AN INDUSTRY FACING UNPRECEDENTED CHALLENGES

Traditionally, credit counseling has been supplied by non-profit agencies that offer debt-burdened consumers family budget counseling and personal finance education, as well as direct intervention with creditors to obtain their consent to a workout plan to pay down debt on an affordable schedule. Only those consumers who would benefit from a debt management plan and who were likely to successfully complete it were enrolled. This service was supplied largely free to consumers and was supported in large part by creditors who routinely returned 15% of the funds forwarded to them by the agency as a "fair share" contribution. As credit cards and other forms of unsecured consumer credit proliferated, so did the number of borrowers experiencing repayment difficulty. Greater demand for credit counseling spawned more credit counseling companies. With a bigger marketplace, some of the new agencies began to view the development of debt management plans as a source of profit. Consequently, creditors began to see many more proposals for debt management plans to the extent that the traditional contribution amounts became quite large expenditures.

With large fair share expenditures beginning to become noticeable on their income statements, and with many more questionable debt management plans being received, creditors began to reduce the percentages paid to the credit counseling agencies. All creditors gradually adopted that practice. The result today is an average fair share contribution of only about six percent, or about a sixty percent reduction over the past seven years. In addition, creditors have cut back significantly on interest rate reductions or other concessions to borrowers enrolling in debt management plans, making these plans less attractive and more difficult to fund for debtors in danger of bankruptcy.

The effect of reduced fair share support has been twofold. To survive, credit counseling agencies have had to reduce traditional services or they have had to pass more of the costs for providing services on to consumers, or both. More recently, creditors have increasingly recognized that agencies which emphasize debt management plans and charge excessive fees are not operating in the best interests of either consumers or creditors and have terminated fair share contributions for such agencies. However, these agencies can afford to carry on without such creditor support and can stay in business so long as they can get their debt management plans accepted. It is not clear whether creditors could simply refuse to accept their plans, or whether additional regulatory support is required to avoid antitrust issues. Meanwhile, consumers who feel dissatisfied with or even exploited by a particular credit counseling agency and who switch to another often find that federal banking regulations bar them from receiving another "re-age" on their accounts, leaving them hopelessly past due on payments and often triggering a bankruptcy filing.

Compounding the challenges for counseling agencies have been the requirements imposed by creditors to use Electronic Funds Transfer, electronic transmission of proposals, and a plethora of varying creditor performance measurement systems that agencies have to respond to so that they can continue to receive fair share contributions. While these requirements make sense for individual creditors, they have collectively placed a substantial administrative compliance burden on counseling agencies; AICCCA is currently holding discussions with major creditors regarding the extent to which such requirements can at least be made uniform.

Add to this new set of requirements the legislative actions by states that wish to protect their citizens from unscrupulous agencies, and the industry is even more overwhelmed. Recent examples are New York and Maryland, which have passed well-meaning laws requiring very high bonding levels. In New York, a bond of $250,000 is prescribed and in Maryland the required bond is $350,000, which can be reduced under some circumstances. A medium-sized credit counseling agency usually can't get a $250,000 bond, much less afford to pay for it. This is compounded by the requirement to post similar bonds in multiple states. This means that services from some responsible credit counseling agencies are being denied to the very citizens that these laws were meant to protect. The agencies that may abuse the trust of these citizens are sometimes the only ones who can surmount these bonding hurdles and therefore their services are the only ones available for many of those consumers; some have become the largest agencies in the country.

These borderline agencies concentrate their efforts where they can receive the most profit: enrolling consumers in debt management plans. Some pay little attention to the need for effective credit counseling and consumer education. Consumers who don't need or can't qualify for a debt management plan may get little if any

help in these cases—or worse, they may be enrolled in a debt management plan that they cannot complete. Some of these agencies have also established for-profit entities that provide "back office" services to the non-profit. In some cases, the principals of the non-profit may be principals of the for-profit. Such agencies also usually have large advertising budgets designed to provide an ample stream of prospects for their services. In many cases, their fees or requested (but often required) voluntary contributions are very large, sometimes equal to the client's total first month's payment to all creditors. Continuing monthly maintenance fees are also frequently high by industry standards. These initial and monthly fees or contributions from consumers obviate the need for support from creditors and are sufficient to fuel the advertising costs as well as the services expense for the associated for-profit. While these practices depart significantly from traditional ethical industry practices, they may not be considered illegal in many jurisdictions. They also may or may not violate IRS standards that govern their non-profit status.

The reduction of fair share contributions from creditors combined with increasing operational costs has led to the industry-wide need for additional monetary support directly from consumers in order to continue to offer credit counseling services. The need for the availability of quality credit counseling to debt-burdened consumers continues to increase as evidenced by unprecedented levels of personal bankruptcy filings. Very low interest rates and the availability of affordable second mortgages or home refinancing have allowed consumers to take the equity from their homes to consolidate their other bills. This situation, which appears to be advantageous for consumers today, could bode ill for the future if many find themselves in difficulty again due to poor spending and saving habits that result in even larger levels of debt. Some of these consumers will not only be debt-burdened yet again but will be at risk of losing their homes to foreclosure and even more vulnerable to the practices of some predatory credit counseling agencies.

REGULATION IN FLUX

The current regulatory landscape represents a patchwork quilt of differing and sometimes conflicting laws in some states. The industry, almost completely non-profit due to state law requirements, is subject to FTC regulations and IRS scrutiny. AICCCA believes it is important to maintain the industry's non-profit status. Allowing for-profit agencies to operate would place even more emphasis on income-generating activities while abandoning traditional education and counseling—unless pervasive regulation and supervision were put in place to assure that consumers' best interests were served.

The state regulations are not generally well administered, leaving law-abiding agencies to strain for compliance while those who ignore the law operate without penalty, and apparently sometimes even without official notice or sanction. The IRS oversight may also be lax, as many borderline agencies appear to be continuing practices that may be in conflict with tax-exempt regulations. This situation has not escaped the notice of the press, the U.S. Congress, and some state legislators. New laws have been introduced in Maryland, California, and Maine, and increased state administration efforts have been noted in other states. However, many state laws seek to strictly and unrealistically limit fees and impose unreasonable surety bonding requirements. These well-meaning statutes often serve to reduce the ethical services available to their citizens rather than protect them. As previously noted, bonding levels are so high in some states that the majority of credit counseling agencies cannot secure them. Large borderline agencies can secure them and questionable practices such as selling useless add-ons or referring the consumer to a loan company allow them to operate within fee guidelines if they decide to comply with the statutes. Some continue to operate outside of the statutes in defiance of them and go undetected, or at least unpunished.

This situation has attracted the attention of the National Conference of Commissioners on Uniform State Laws (NCCUSL). A new committee to draft a uniform Consumer Debt Management Act was convened last week in Chicago, and I attended that initial meeting. This drafting effort is intended to erase the consumer abuses by some agencies while not harming those agencies that seek to serve consumers appropriately. At its base is a rigorous licensing requirement designed to ensure consumer protection, and hopefully this process will produce a uniform state law proposal that meets that goal without placing undue burdens on ethical non-profit counseling agencies. This committee is led by Judge William C. Hillman of the United States Bankruptcy Court in Boston and is supported by prominent commissioners from across the country. Such a uniform statute, if enacted by the states, could provide the consumer protections that are badly needed. Thoughtful federal legislation could very well accomplish the same end. This Subcommittee may find

discussions with Judge Hillman and the drafting committee helpful. What would not be helpful to the credit counseling industry would be to move from a situation of weak and inadequately enforced state regulation to one of excessive, duplicative and conflicting state and federal regulation.

The recent introduction of HR 3331 by Congresswoman Julia Carson is an attempt to control counseling industry abuses. However as this legislation is not preemptive, the burden of dual state and federal regulation should this bill be enacted would be staggering. In addition, rather than providing for regulatory control of industry practices, HR 3331 specifies a variety of litigation causes of action and penalties that could bankrupt the industry altogether. Federal legislation may or may not be required depending upon state actions and strict enforcement and oversight activity by the IRS. It must also be remembered that the pending bankruptcy reform legislation, passed by the House in March and awaiting Senate action, would have the beneficial effect of empowering the Department of Justice's Executive Office of U.S. Trustee to establish minimum standards for agencies approved for bankruptcy pre-counseling for the Nation's most needy consumers.

CONCLUSION

We recognize the need for strong consumer protections in the credit counseling industry. The interests of these vulnerable citizens must come first and must not be overshadowed by the for-profit interests of a few who seek to take undue advantage of their personal financial situations. But Congress should not rush to impose new federal regulation until effective enforcement of existing law has been tried. And any federal intervention must be carefully coordinated with the rapidly evolving state regulatory regime to avoid driving small but beneficial agencies out of existence.

The AICCCA stands ready to assist the Oversight Subcommittee as this inquiry continues. Thank you again for this opportunity to testify today.

Appendix—Current AICCCA Code of Practice

Code of Practice

Addendum to the ISO 9001:2000 Standard

for

Consumer Credit Counseling Agencies

October 8, 2003

CODE OF PRACTICE ADDENDUM TO ISO 900

Consumer Credit Counseling Code of Practice

1. INTRODUCTION

This document has been produced in cooperation with BVQi-NA and the Association of Independent Consumer Credit Counseling Agencies (AICCCA), with the knowledge and review of major creditors to provide a universal Code of Practice for Consumer Credit Counseling Agencies. This Code of Practice is viewed as a customer specific requirement and shall be an integral part of the audit for those seeking ISO 9001 certification under its requirements. The document is intended to comply with credit lenders certification requirements. Consumer credit counseling agencies seeking this endorsement must achieve ISO 9001 certification and satisfy the requirements of this Code of Practice.

ISO Registration to this Code of Practice. Any ISO-certified independent registrar must agree to audit all consumer credit counseling agencies seeking their registration services to this Code of Practice regardless of their affiliation to any association and will refuse to issue certificates to such credit counseling agencies without their compliance to this Code of Practice.

This Code of Practice document has been created by AICCCA in conjunction with major creditors and an ISO registrar. The AICCCA Board of Trustees maintains proprietary responsibility for the control, ownership, and approval of this document and any subsequent revisions.

Where a service directly affecting the critical elements of the counseling function and/or the Debt Management Program is to be subcontracted, that subcontractor shall comply with this Code of Practice. If non-counseling elements are subcontracted, those vendor subcontracts will be audited to ensure that the contractual relationship embodies adequate controls with respect to the requirements of this Code of Practice. Critical credit counseling elements must be performed by a non-profit

entity and are defined as all activities that are performed by qualified counselors and client service activities that are not specifically related to payment processing.

This Code of Practice does not apply to Debt Settlement activities that may be performed by a credit counseling agency.

Compliance with the principles included within this Code of Practice does not absolve the individual consumer credit counseling organization from meeting and/or exceeding their legal responsibilities and the requirements of all state and federal laws relevant to the services or products offered.

2. REFERENCES

Reference shall be made to the following documents and all relevant updates and amendments as applicable:

- ISO9001—Quality Management System requirements.
- IRC 501 (c)(3)—Internal Revenue Code of the United States.
- All state and local regulations, codes, and other legal and customer requirements governing the conduct of business and consumer credit counseling agencies' activities.

3. INDUSTRY DEFINITIONS

The following definitions apply to this Code of Practice In addition to the definitions given in the ISO 9001 standard:

Industry

Consumer credit counseling agencies, clients, credit lending organizations, trade associations, and subcontractors.

Agency

The entity seeking registration pursuant to this Code of Practice.

Business Day

Any day that the nation's banks are open for business.

Client

The customer for whom a consumer credit counseling agency provides service.

Creditor

The credit lending entities.

Critical Credit Counseling Activities (performed by non-profit entities)

All activities that are performed by qualified counselors and client service activities that are not specifically related to payment processing (see Non-Critical Credit Counseling Activities below). These activities are subject to full ISO audit.

Non-Critical Credit Counseling Activities (may be performed by subcontract)

Activities that need not be performed by qualified counselors or client services personnel such as payment processing (i.e., proposal processing, client payment receipt and distribution, changes to client payments, creditor payment receipt, and answering creditor issues about client payments) or other vendor relationships (e.g., telephone service, software, payroll, etc.). These activities, if subcontracted, are subject to ISO audit of the contract only. If not subcontracted, these activities are subject to a full ISO audit.

Counselor

Certified consumer credit counseling agency personnel who provide guidance and assistance to the client.

Education

Any service or product provided to improve the consumer's knowledge of personal financial management that is provided over—and-above the enrollment process, whether the benefiting consumer actually enrolls in a debt management program or not.

Service

The counseling and coordination and other support provided by the consumer credit counseling agency on behalf of the client and creditor.

Standard

Refers to the ISO 9001 Quality Standard

Subcontractor

A third party who has been contracted by a consumer credit counseling agency to provide a service, product, or support to the agency.

4. CODE OF PRACTICE REQUIREMENTS

The sub-clause numbers of this Code of Practice are not related to the sub-clause numbers of ISO 9001. Each sub-clause requirement is in addition to the ISO 9001 standard shall be complied with and be integral to the ISO 9001 Quality System and applies to all organizations seeking compliance to the Code of Practice. Procedures must be controlled and processes must be audited to demonstrate conformance to this Code of Practice.

This Code of Practice requires that documentation of the interaction and sequence of processes include those processes that are subcontracted except for those defined as Non-Critical Credit Counseling Activities. This documentation shall include a description of services that are provided and the legal description of the company providing those services.

5. ACCESS TO SERVICE

The consumer credit counseling agency's management shall define and document its policy and procedures for a client's access to service. There shall be objective evidence of conformance to demonstrate the following:

A. The consumer credit counseling agency stands ready to serve all clients who seek service regardless of:
   1. A client's ability to pay
   2. The creditors owed
   3. The dollar amount owed.

B. The consumer credit counseling agency shall provide service, or at minimum acknowledgement of the request for service, within two business days of receipt of the request, service at times convenient to the client, and service through means that are convenient to potential and existing clients.

6. COMMUNITY EDUCATION

The consumer credit counseling agency shall establish and maintain records of activities which address the support of or conduct of community education on issues related to consumer credit and money management. Records shall be maintained documenting the extent to which community education has been delivered.

7. COUNSELOR TRAINING

The consumer credit counseling agency shall establish and maintain documented records in accordance to ISO standards which address the qualifications and training of counselors. The consumer credit counseling agency shall be able to demonstrate that counselors are:

A. Adequately trained to meet the needs of the organization
B. Certified by a qualified independent authority as identified by AICCCA or the National Foundation for Credit Counseling (NFCC)
C. Each counselor must begin the certification process within six months of hire and complete it within 12 months of hire.

8. SERVICE RESOURCES

The consumer credit counseling agency shall determine and provide the resources needed to:

A. Fulfill the client's service requirements
B. Fulfill the creditor's service requirements.

9. SERVICE REQUIREMENTS

The consumer credit counseling agency shall be able to demonstrate that:

A. Counselors conduct comprehensive interviews, to include, at a minimum:
   1. The client's complete financial position (e.g. assets, liabilities, income, and expenses)
   2. Identify and explore the root cause of the client's financial situation.

B. Counselors develop a solution which is optimum for both the client and the creditors, to include:
   1. Possible alternatives such as liquidation or leveraging of assets
   2. Financial counseling to clients who do not need payment assistance
   3. Providing a DMP to clients as an alternative to bankruptcy
   4. Advise client to close all credit lines with consideration for business or employment related purposes
   5. Encouragement to avoid additional debt while the client is improving their financial situation
   6. Communicate the consequences that obtaining new revolving debt has on the success of the DMP

7. Identification of additional relevant community resources, which may include: family counseling, mental health counseling, and/or addiction treatment and counseling.

C. Provide the client with a documented evaluation of his/her financial status to include a recommended plan of action which addresses the identified issues.

D. Service shall be provided with documented disclosure to clients regarding the:
1. Fee structure for services provided: if a fee is not charged for the service, then any contribution requested by the agency from the client must be clearly identified and noted that it is voluntary
2. Creditors support of the consumer credit counseling agency through fair share contributions
3. Potential impact on the client's personal credit report
4. Client's responsibility to monitor financial statements/reports from creditors and the consumer credit counseling agency, to verify their accuracy, and to detect and report discrepancies.

10. COMPENSATION AND FEES

The consumer credit counseling agency shall maintain documented evidence that demonstrates its ability to maintain a low fee structure for services, with specific focus upon:

A. Compensation is not paid to the counselor based upon the outcome of the counseling process.

B. Fees, voluntary contributions, or requested donations from clients for the enrollment into a Debt Management Plan (DMP) do not exceed the lesser of $75 or the maximum fee allowed by law in the state of residence of the client

C. Fees, voluntary contributions, or requested donations from clients for the maintenance of a DMP do not exceed the lesser of $50 or the maximum fee allowed by law in the state of residence of the client

D. Fairshare payments to the agency are voluntary contributions directly from creditors and are not considered part of B. and C. above.

11. FISCAL INTEGRITY

The consumer credit counseling agency shall define, document and demonstrate procedures regarding their policies on financial disciplines and fiscal integrity to include, at a minimum:

A. An annual certified audit by an independent certified public accountant is conducted of all trust and operational books and records

B. Accurate accounting and records of all clients' deposits and debits to creditors are maintained throughout the life of the DMP

C. Funds received from clients for a DMP must be disbursed to the creditors no later than 15 days from receipt of valid funds, or by scheduled disbursement date, whichever is later.

12. LEGAL STATUS AND GOVERNANCE

The consumer credit counseling agency shall define and document their legal status, such that:

A. The consumer credit counseling agency is a non-profit organization which complies with Internal Revenue Code of the United States, IRC 501(c)(3) requirements

B. The consumer credit counseling agency is licensed in all states in which it conducts business as required by law

C. The consumer credit counseling agency has a diverse governing Board, the composition of which represents the interests of all its constituents

D. The consumer credit counseling agency shall have a majority of members of their governance Board who are not employed by the agency; will not benefit financially, directly or indirectly, from the outcomes of counseling sessions with clients; and who are not related by blood or marriage to other board members or employees of the consumer credit counseling agency.

13. COMPLAINT/CONFLICT RESOLUTION

The consumer credit counseling agency shall respond to all consumer complaints within five (5) business days and will take necessary action to resolve the complaint in a timely manner. Records of the complaint and disposition shall be maintained.

Chairman HOUGHTON. Thank you, Mr. Jones. Mr. Hall.

STATEMENT OF MICHAEL HALL, FOUNDER AND CHIEF EXECUTIVE OFFICER, TAKE CHARGE AMERICA, INC., PHOENIX, ARIZONA

Mr. HALL. Thank you, Mr. Chairman, Members of the Subcommittee. I appreciate very much the opportunity to appear before you today, and I am honored to be here. My name is Michael Hall. I am the founder and chief executive officer of Take Charge America, Inc., one of the Nation's oldest and largest nonprofit credit counseling agencies. It is a member in good standing of the American Association of Debt Management Organizations (AADMO), and the AICCCA. Take Charge America provides credit counseling and/or debt management services and educational programs to nearly 200 American households annually. In addition, through the management of nearly 65,000 debt management programs, the company returns over $500 million annually to the national economy.

The cornerstones of the company are consistent excellence in customer service, unwavering integrity, and leading-edge technology in educational programs. Our 428 employees are fully dedicated to our charitable mission of helping consumers become financially literate, financially stable, and ultimately financially independent. Millions of dollars are committed to our educational endeavors each year, and we believe that the reach and depth of our program is unsurpassed in the industry. Our offerings include a wealth of web-based articles and materials, and our Take Charge America software, which we believe is basically the best financial software available anywhere.

We have established and endowed the Take Charge America Institute for Consumer Financial Education and Research, at the University of Arizona, for the purpose of developing research-based financial education programs. Through a series of grants to Montana State University, we have developed a model financial literacy program for high school students and teachers. We sponsored university-based credit counseling centers for college students, a nationwide intercollegiate competition, and personal financial management. Our own budget doctor makes personal appearances at schools and before community groups—and the list goes on.

My purpose in testifying here today is fourfold. First, I hope to shed some light on the problem contributing to the current state of our industry. Second, I am here to carry the message to the Subcommittee that the nonprofit model is the correct model for our industry. Third, I strongly encourage the continuous, aggressive IRS oversight of the industry's nonprofit charitable activities. Finally, I support the strengthening of consumer protection laws that would provide strong deterrence to agencies violating consumer trust.

The vast majority of nonprofit credit counseling agencies are doing a good job. Undeniably, there are a number of companies operating on the ethical fringes that do not share our commitment to charitable service. These companies are sometimes characterized by questionable advertising practices, by initial fees that amount to hundreds or even thousands of dollars, and by the practice of contracting customer service to for-profit backend servicing organizations that leave nonprofit entities as little more than a front for obtaining weary customers.

Fortunately, recent actions by the FTC and the IRS have forced several of the biggest offenders to consider their practices. Yet offenders still exist, and their lack of ethics has left consumers confused and distrustful of all credit counseling agencies. Nonprofit credit counseling agencies provide a low-cost opportunity for distressed consumers to keep their promises to creditors, reduce their debt, and restore their self-esteem and creditworthiness. More importantly, however, nonprofit status of credit counseling agencies provides the motivation and financial resources for the most essential and long-lasting of our contributions: education and financial literacy for all Americans who seek our assistance.

In the for-profit environment, the emphasis on education would be lost, as most for-profit agencies would seek to discontinue educational programs altogether or charge fees for such services that are beyond what most financially stressed households are able to bear. In contrast, Take Charge America is able to provide budget planning advice, access to educational materials on matters related to personal finance, and a copy of our Take Charge America personal financial management software to over 100,000 financially distressed American households each year—totally free of charge.

We are also able to waive the normally modest fees charged for debt management plans for consumers who are simply unable to pay. We do these things to fulfill our nonprofit mission. For-profit entities cannot be expected to view the needs of consumers with the same charitable outlook.

In conclusion, we commend the inquiries of this Subcommittee, the IRS, and other Federal agencies involved in the effort to fix the shortcomings of the nonprofit credit counseling industry. Continued recognition of the nonprofit status of credit counseling agencies meeting the requirements of 501(c)(3) is crucial for the millions of financially distressed American households who turn to the credit counseling agency to provide affordable assistance in finding ways to avoid personal bankruptcy, restore financial stability, and honor their financial commitments.

We encourage the IRS to expand its audit of the charitable activities of credit counseling organizations, thereby discouraging the uncharitable and predatory practices of some industry members. Aggressive scrutiny by the IRS will strengthen our industry and improve access of financially troubled consumers to affordable and consistently reliable financial literacy education, and other financial counseling and debt management solutions. Thank you very much for allowing me to be here today.

[The prepared statement of Mr. Hall follows:]

Statement of Michael Hall, Founder and Chief Executive Officer, Take Charge America, Inc., Phoenix, Arizona

Mr. Chairman, Members of the Subcommittee:

Thank you very much for inviting me to appear before you today. I am honored to be here.

My name is Michael Hall and I am the founder and CEO of Take Charge America, Inc., (TCA) one of the nation's oldest and largest nonprofit credit counseling agencies. Our 428 employees provide financial counseling and financial literacy educational programs free of charge to any consumer who seeks our assistance. Known until recently as Credit Counselors of America, Inc., TCA provides credit counseling and/or debt management and educational services to nearly 200,000 American households annually. In addition, through the management of nearly 65,000 debt

management programs, the company returns nearly $500 million annually to the national economy. The cornerstones of the company are consistent excellence in customer service, unwavering integrity, and leading edge technology and educational programs.

We are fully dedicated to our charitable mission of helping consumers become financially literate, financially stable, and ultimately, financially independent. Millions of dollars are committed to our educational endeavors each year and we believe that the reach and the depth of our programs is unsurpassed in the industry. Our offerings include a wealth of web-based articles and materials and our Take Charge America software, which we believe is simply the best personal financial management software available anywhere.

In furtherance of our universal goal of financial literacy for all consumers, we have established and endowed the Take Charge America Institute for Consumer Financial Education and Research at the University of Arizona, which we expect to become the preeminent center in the nation for the development of research-based financial education programs. Through a series of grants to Montana State University, we have developed a model financial literacy program for high school students and teachers. We sponsor a university-based credit counseling center for college students and a nationwide intercollegiate competition in personal financial management. Our own Budget Doctor makes personal appearances at schools and before community groups. In collaboration with a nationally known video production group, we are developing a video series in personal financial management for high school and college students, and the list goes on and on.

My purpose in testifying here today is four-fold:

- First, I hope to shed some light on the problems contributing to the current state of our industry;
- Second, I am here to carry the message to the subcommittee that the nonprofit model is the correct model for the industry;
- Third, in order to protect consumers as well as the genuine nonprofit activities of the many credit counseling agencies that are truly committed to the charitable purpose of improving financial literacy for all Americans, I strongly encourage the continuous aggressive IRS oversight of the industry's nonprofit charitable activities; and
- Finally, I support the strengthening of consumer protection laws that would provide strong deterrents to agencies violating the consumers' trust.

The Problems of the Nonprofit Credit Counseling Industry

The vast majority of nonprofit credit counseling agencies are doing an admirable job. Undeniably, there are a number of companies operating on the ethical fringes that do not share our commitment to charitable service. These companies are sometimes characterized by questionable advertising practices, by initial fees that amount to hundreds or even thousands of dollars, and by the practice of contracting customer service to for-profit servicing shops that leave the nonprofit entity as little more than a front for obtaining unwary customers. The existence of these practices has led to much of the public criticism of our industry, which in many cases, is well deserved. Fortunately, recent actions by the FTC and the IRS have forced several of the biggest offenders to reconsider their practices. Yet, offenders still exist and their lack of ethics has left consumers confused and distrustful of all credit counseling agencies.

Preserve the Nonprofit Model for Qualifying and Conforming Credit Counseling Agencies

I believe that the IRS initially granted nonprofit status to the credit counseling industry with the following specific goals in mind:

1. To create a mechanism through which financially distressed consumers could obtain affordable financial counseling, budget counseling and debt management services;
2. To provide financially distressed consumers with an alternative to bankruptcy and thereby facilitate the annual return of billions of "at risk" dollars to the national economy that translate into substantial tax revenues for the U.S. Treasury; and
3. To provide a financial incentive to counseling agencies qualifying for nonprofit status to invest in the development of financial literacy programs and educational materials, and to subsequently provide these programs and materials to financially distressed consumers, students of all ages and the general public.

In light of the economic downturn over the past few years, these goals are more appropriate than ever. Revolving consumer debt exceeded $700 billion at the conclu-

sion of 2002. Over the last 12 months, consumer bankruptcy filings have increased by about 10% over the record-setting pace of the prior year.

Nonprofit credit counseling agencies provide a low-cost opportunity for distressed consumers to keep their promises to creditors, reduce their debt and restore their self-esteem and credit worthiness. More importantly, however, the nonprofit status of credit counseling agencies provides the motivation and financial resources for the most essential and long-lasting of our contributions—education and financial literacy for all Americans who seek our assistance.

In a for-profit environment, the emphasis on education would be lost as most for profit agencies would either seek to discontinue educational programs altogether or would, in an attempt to turn educational services into corporate profit centers, charge fees for such services that are beyond what most financially distressed households are able to bear. Indeed, in a for profit environment, households most in need of educational opportunities are those who are least likely to be able to pay for such services.

In contrast, because of the financial capacity enabled through its tax-exempt status, TCA is able to provide budget planning advice, access to educational materials on matters related to personal finance, budgeting and the wise use of credit, along with a copy of the TCA personal financial management software to over 100,000 financially distressed American households each year, totally free of charge. We are also able to waive the normally modest fees charged for debt management plans for those consumers who are simply unable to pay. We do these things to fulfill our non-profit mission. For profit entities cannot be expected to view the needs of consumers with the same charitable outlook.

Strengthen Consumer Protection Laws

As industry leaders, we are strong proponents of consumer friendly federal legislation, directed specifically at protecting the interests of vulnerable, financially distressed American households and furthering the ability of the non-profit credit counseling community to deliver meaningful, life-changing educational and counseling services to those households.

Conclusion

We commend the inquiries of this subcommittee, the IRS and other federal agencies involved in the effort to fix the shortcomings of the non-profit credit counseling industry.

Continued recognition of the non-profit status of credit counseling agencies meeting the requirements of Section 501 (c)(3) of the Internal Revenue Code is crucial for the millions of financially distressed American households who turn to credit counseling agencies to provide education on matters related to personal financial management and provide affordable assistance in finding ways to avoid personal bankruptcy, restore financial stability and honor their financial commitments.

We believe that the existing legislative and regulatory framework is more than adequate for assessing the legitimacy of individual agency 501 (c)(3) status. We encourage the IRS to expand its audits of the charitable activities of credit counseling organizations, thereby discouraging the uncharitable and predatory practices of some industry members.

Inasmuch as creditors typically require tax-exempt status as a condition of accepting an agency's debt management proposals, the revocation of this special status for the few abusive organizations would permanently discourage unscrupulous industry practices. Aggressive scrutiny of charitable status by the IRS will strengthen our industry and improve access of financially troubled consumers to affordable and consistently reliable financial literacy education and other financial counseling and debt management solutions.

Thank you for allowing me to address you on this critically important subject.

Chairman HOUGHTON. Thank you, Mr. Hall. Mr. Illingworth.

STATEMENT OF MONTIETH M. ILLINGWORTH, SPOKESMAN, CAMBRIDGE CREDIT COUNSELING CORP., AGAWAM, MASSACHUSETTS; ACCOMPANIED BY CHRIS VIALE, CHIEF OPERATING OFFICER, CAMBRIDGE CREDIT COUNSELING CORP.

Mr. ILLINGWORTH. Thank you, Mr. Chairman. On behalf of Cambridge Credit Counseling Corporation, I want to express my

appreciation to you, Mr. Chairman, and to the Subcommittee, for this opportunity to appear before you today and offer our insights on credit counseling industry reform. We have been calling for this kind of open, balanced, and fair-minded dialog for at least a year now, and, to be frank, it has sometimes been a solitary mission.

We see ourselves as not only up against an institutionalized monopoly with a firm grip on the industry, but also against an old-style monopolistic thinking that seeks to squash all competition, limit consumer choice, and exclude new innovative solutions to the growing problem of indebtedness. In that mindset, is the view that any company in this business that has had financial and client success providing education and credit counseling services must be doing something wrong.

Hopefully, then, today's opportunity to share with you why our success on behalf of our clients is in fact a best-practices model for reform. Hopefully, we will be able to demonstrate that because Cambridge Credit Counseling Corp. and its families of companies are licensed, regulated, and annually examined in four States—including the State of New York—our best-practices model has repeatedly stood the test of both time, and regulatory oversight. Hopefully, today we will mark the beginning of the end of the monopoly.

It is what we call the "credit counseling trust," and to us that means it is a new future for consumers—to empower them if we can achieve that. What we would like to do at this point, is walk you through the life and times of a best-practices credit counseling provider. We would also like to suggest that we keep our eyes on the real prize here, which is empowering consumers and serving the consumers. So, let's begin with our mission to educate consumers. We have done that by advocating on consumers' behalf, and we have done that through an ad campaign, and our supporting documents. We have the first of those ads, and we will be running another one next week on the issue of the monopoly. In this advocacy, we have not always been met with open minds.

There has been a focus on the bad apples in this industry, and rightfully so. Those must be isolated, stopped, and, if possible, brought into conformity with a new set of rigorous laws to protect consumers. Yet there has also been wholesale criticism of our organization, because we do not look, act, think, or function like the monopoly that rules this industry; and that monopoly is the NFCC, the AICCCA, the Consumers Federation of America, and the NCLC. That criticism has fixed on the salaries paid to our executives, on the relationship between our nonprofit and for-profit businesses, and how we market ourselves.

We are happy to answer any questions on any one of those issues today, but in our advocacy program, we respectfully ask you—do not let those issues distract you from the real issue of achieving responsible reform. Our core mission is to educate consumers, providing the guidance and tools they need to assess their financial situation, and make the right decision for themselves on how to become debt free. Since we began operations in 1993 in a storefront, Mr. Puccio, a second or third-generation Italian American, built that business by the sweat of his brow—and we will come back to that later. He began in a storefront and he provided educational as-

sistance and counsel to 2 million consumers. Of those, 1.8 million were provided free—I repeat, free—counsel. Very often these were people who did not qualify for the debt management program, and Mr. Viale will explain to you why not.

Today, we continue to receive around 358,000 calls per month—of which we help educate and counsel 31,000 people for free, and enroll a mere 10 percent—a mere 10 percent. So, today we have approximately 90,000 active clients. The success of these programs is clearly demonstrated by the numbers. Thirty-two percent of our clients succeed; they pay off their debts. I defy any organization in this country to match that number. Success is also in the fact that only 2.63 percent of all the clients served have filed for bankruptcy. Our complaint rate of 2 million people counseled is only 574—that is 0.0287 percent, which is probably lower than the local bank in the corner of your town, sir. So, we also provide consumers with a 2.5-hour educational series, workbooks, and a quarterly newsletter. The counseling continues every time the client calls, and that goes on for many, many hours over the life of a program. Mr. Viale can explain to you precisely what happens. Before people enroll in the management program, we also fully disclose our fees verbally and in writing. We provide an example of a contract, and you can see how that is clearly spelled out.

We also believe that if you provide people with incentives for success, they will be more likely to succeed. Our program, the only one of its kind in this country, not duplicated by anyone in this industry, gives back half of all the money received from creditors to our clients, who make six consecutive payments. It is inspiration for them. It is discipline. It works. This can significantly offset the fees that are charged. We have given back $12 million to consumers—$12 million. No one else has done this. Which brings us to the issue of the monopoly. The NFCC, the consumer credit counseling member companies, and the AICCCA control this industry. Their core business rests on a conflict of interest that has taken power from the consumer. The monopoly relies almost solely on fair-share payments from the creditor banks to pay for the services. When their paychecks come from the creditors and not from the consumer, who do you think they are beholden to?

Our business model challenges that monopoly. Mr. Puccio, who came up with this business model, challenges that and shifts the power back to consumers. We empower consumers, not the creditors, to decide for themselves what they are willing to pay in order to achieve their debt management goals. So, we would also like to say this: the choice before us today is not just between understanding who are the good credit counselors and who are the bad ones. In our mind, that is easy to do. The hard part is deciding whether we are going to provide the consumer with a real choice in providers, whether we believe in competitive markets or not, and whether we are going to do everything we can to empower the consumer to succeed with debt management, or dictate to the consumer that all they deserve is what amounts to a social service not much different from when it was started 50 years ago. Our clients tell us that they are tired of being treated like welfare cases. They want respect, they want the tools to succeed, and they are willing to pay for it.

Finally, we would like to call for a summit meeting on the issue, the issue of reform, and bring together all the voices, all the points of view. Frank, open, and fair discussion is far better than the sniping that has been going on in the press, and in the disguise of industry reports that are supposed to be fair and objective. This is a higher public policy, calling to all of us, than the specter of the witch hunt that we see coming over the horizon. Thank you very much for your time and attention.

[The prepared statement of Mr. Illingworth follows:]

Statement of Montieth M. Illingworth, Spokesman, Cambridge Credit Counseling Corp., Agawam, Massachusetts; accompanied by Chris Viale, Chief Operating Officer, Cambridge Credit Counseling Corp.

On behalf of Cambridge Credit Counseling Corp., I first want to express my appreciation to Representative Houghton and to the Subcommittee for this opportunity to appear before you today and share with you our insights into the reform of the credit counseling industry.

We have been calling for this kind of open, balanced and fair-minded dialogue between the public and private sectors on the issue of industry reform for over a year now. To be frank, it has sometimes been a solitary mission. We see ourselves as not only up against an institutionalized monopoly with a firm grip on this industry, but also against old style monopolistic thinking that seeks to squash all competition, to limit consumer choice and exclude new, innovative solutions to the growing problem of consumer indebtedness—a problem which today impacts around 35 million American households.

In that mindset is the view that any company in this business that has had financial and client success providing education and credit counseling services to consumers MUST be doing something illegal or unethical.

Hopefully, then, today is our opportunity to share with you why Cambridge Credit Counseling's success is, in fact, a best practices model for industry reform.

Hopefully, we will be able to demonstrate to you that Cambridge and its family of companies are licensed, regulated and annually examined in four states—including New York which has the most stringent regulations governing financial services in this country—our best practices model has repeatedly stood the test of both time and regulatory oversight.

Hopefully, we will show you that we have found the "secret sauce" for delivering consumer benefit at a fair and reasonable cost—proven by the fact that to date over 200,000 consumers have chosen Cambridge Credit Counseling to help them get out of debt and enjoyed some $12 million in funds that we rebate back to them through our unique Good Payer program.

And hopefully, today will mark the beginning of the end of the monopoly—what we call the "Credit Counseling Trust"—and a new future for consumers desperate for empowerment to become debt free.

What we would like to do at this point is walk you through the life and times of a best practices credit counseling provider. We also want to suggest keeping our eyes on the real prize here—how we can all best serve consumers. The success of our organization should therefore not be the issue today. The success and empowerment of our clients and how we helped enable that is the issue.

Let's begin with the commitment to our mission to educate consumers. Most recently that has meant advocating on consumers' behalf. For over a year now we have called for responsible reform by reaching out to government and to consumer and public interest groups and in a series of ads placed in *The New York Times, The Washington Post, American Banker* and *USA Today*.

In our advocacy we have not always been met with open minds. There has been a focus on the "bad apples" of this industry, and rightfully so. Those "worst of class" providers must be isolated, stopped and if possible brought into conformity with a newly formed set of rigorous laws and regulations protecting the consumer. But there has also been wholesale criticism of our organization because we don't look, act, think or function like the dominant providers controlled by the "Credit Counseling Trust", namely, the National Foundation for Credit Counseling, the Association of Independent Credit Counseling Companies Agencies, Consumer Federation of America and the National Consumer Law Center.

That criticism has fixed on the salaries paid to our executives, on the relationship between our non-profit and for profit businesses, and how we market our services. We are happy to answer any questions on those subjects. But our advocacy program,

and our appearance here, respectfully asks that you not let that distract you from the real issues of achieving responsible reform. We think they are "best practices" for the future of this industry. And it's these best practices we want to focus on next.

Cambridge Credit Counseling's Best Practices

Our core mission is to educate consumers with the guidance and tools they need to assess their financial situation and make the right decision on how to become debt free.

Since we began operations in 1993 in a storefront we have provided educational assistance and counsel to some 2 million consumers. Of those, 1.8 million were provided FREE—I repeat FREE—counsel. Very often these are people who didn't qualify for a debt management program.

Today, we continue to receive around 35,000 calls per month of which we help educate and counsel around 31,000 people for free and enroll a mere 10 percent. And so, today we have approximately 90,000 active clients in debt management programs.

The success of those programs is clearly demonstrated by the numbers:

- The success is also in the fact that only 2.63 percent of all the clients served have filed for bankruptcy. And do know that we do everything we can to prevent people from falling into bankruptcy, which includes a special "Hardship Program" that helps when clients can't pay on time or afford the monthly amount due.
- And the success is in the fact that out of the close to 2 million people counseled there have only been 574 complaints—a rate of.0287 percent—lower than your average commercial bank we would venture.

The education and counseling doesn't end at the point of enrollment. We provide consumers with a two and one half hour educational series, with workbooks along with a quarterly newsletter. And the counseling continues every time a client has a question or concern, of which there are many, and our trained and certified counselors are there to help them. We invite any and all of you to walk through our Agawam, Massachusetts office any day of the week and listen to the counselors and you'll see what we mean—often it is a problem with a creditor or a bill collector.

Before people enroll in a debt management program we fully disclose all fees and charges, verbally and in writing.

We also believe that if you provide people incentives for succeeding they'll be more motivated to succeed. Our Good Payer program, the only one of its kind in the country, gives back fully half of all the monies we collect from creditors to our qualified clients when they make six consecutive payments. These rebates also can significantly offset the fees we charge—a subject that we know is of likely concern to you today.

Cambridge Credit Counseling charges a program design fee equal to one month's payment. Much of that is offset by the Good Payer rebate. As such, in an industry study we commissioned with Economists Inc. of Washington DC, our fees were found to "fall within the range" of other credit counseling companies and in several cases were lower. The report went on the say that because of the "many additional services" we provide consumers Cambridge Credit will "increase competition" which may lead to "lower prices and/or higher quality services for consumers."

Which brings us to how we acquire our clients. On average, 1,500 consumers a month call us looking to switch from other credit counseling agencies. Their number one compliant is poor service. Referrals from current clients, very happy ones, result in 30% of new clients most months. Another 25% come from our extensive educational outreach programs and debt management seminars we hold with groups as the Basketball Hall of Fame and College Bowling USA and with numerous high schools, community centers and colleges such as Amherst and the University of Massachusetts all at a cost of over one million dollars this year. The remaining 50% come from our own marketing communications.

There is a lot of aggressive marketing going on and we're sure you want to ask us about that today. First, please know that we don't telemarket. We have an awareness campaign on television and in print that leaves it up to the consumer to call us. Second, and most importantly, please know that not one creditor bank or government agency refers business to us. We mention this because dozens upon dozens of banks and government entities refer consumers to the Credit Counseling Trust who monopolize this industry.

Which brings us to the issue of that monopoly. The NFCC, their Consumer Credit Counseling member companies and the AICCCA, together control this industry. But their core business model rests on a conflict of interest that has taken power from

the consumer. The monopoly relies almost solely on fair share payments from the creditor banks to pay for their services. When their paychecks come from the creditors, and not the consumer, to whom do you think they are beholden? Our business model challenges that monopoly and shifts power back to consumers. We empower consumers—not the creditors—to decide themselves what they are willing to pay for in order to achieve their debt management goals. For the many thousands of consumers who have chosen Cambridge Credit it is clear that they are voting for freedom both from their debts and from the monopoly.

We have provided the Subcommittee an accompanying document that provides far more detail on all of these points and on the best practices they represent. We hope you will find that of interest.

We would like to say this: the choice before us today is not just between understanding who are the good credit counselors and the bad ones. In our mind that's easy to do. The hard part is deciding if we're going to provide the consumer a real choice in providers, whether we believe in competitive markets or not. And it's whether we're going to do everything we can to empower the consumer to succeed with debt management or dictate to the consumer that all they deserve is what amounts to a social service not much different in form or content than it was when it started 50 years ago. What our clients tell us is that they are tired of being treated like welfare cases. They want respect, they want the tools to succeed, and they are willing to pay for it.

Finally, we would like to call for a summit meeting on the issue of reform and bring together all voices, all points of view, to air and debate the issues. Frank open and fair discussion is far better than the sniping that has been going on in the press and in the disguise of "industry reports." This is a higher public policy calling for all of us than the specter of the witch-hunt we see coming over the horizon.

Thank you for your time and attention.

Chairman HOUGHTON. Thank you, Mr. Illingworth. Also, thank you, Ms. Loonin, and gentlemen, for your testimony. The reason we are here is that there are a couple of sour apples, and we are not trying to criticize the credit counseling industry. It is a good industry. There are fine people, like yourselves, and we appreciate you being here. It does not do us any good just to wink at these practices and do nothing about them, so what we are trying to do is to understand what we in Congress can do. Do we lean on the IRS? Is that an administrative function? Or do we create legislation?

Now, let me just ask you a specific question—I have it written down here, Mr. Illingworth, and I am quoting from numbers that we have researched. In 2001, the IRS Form 990 indicates that you had about $54 million in total revenue. Of this, $18 million was paid by clients for initial registration fees, about $23 million was paid by clients for monthly service fees, and about $12 million was paid by creditors based on the money you collected from clients for them. Yet your expenses, including salaries and advertising for debt management and other services, totaled $45 million. So, what this resulted in, is an excess of $8.5 million for just 1 year. Adding this to prior amounts for July 2002, your total net assets or fund balance total about $26 million. So, the question really is: the recipients of your services are essentially supporting the nonprofit through fees. Why don't you charge your clients less instead of operating as a charity, with millions of dollars in gains, at their expense?

Mr. ILLINGWORTH. Sir, the question is, why don't we charge them less?

Chairman HOUGHTON. Right. Why don't you charge your clients less instead of operating as a charity?

Mr. ILLINGWORTH. We understand that our core mission is education, and that our vision is charitable. It involves education and counsel. In order to provide that, plus all of the services that need to be involved in fulfilling that mission, requires a certain amount of infrastructure—infrastructure that is covered by the fees that are charged. The fees that are charged have been found fair and reasonable by all the regulatory authorities that govern us in those States. This is including the IRS, who in all of our submissions—and we have done outside studies as well, sir, with an organization here in Washington—has found, particularly with our rebates, that our fees fall within the range in this industry. So, we think our fees are at a fair, reasonable level, and help us execute our mission.

Chairman HOUGHTON. Well, it just seems the proportions are rather strange. Now, I am not part of this business—I used to be part of another type of business—but you have basically $52 million paid in by clients for monthly services, for creditors as fees, and yet you have very high expenses. I just do not understand that relationship.

Mr. ILLINGWORTH. The relationship between what and what, sir?

Chairman HOUGHTON. In terms of the fees paid in, and also the education of the services, totaling about $45 million.

Mr. ILLINGWORTH. I am sorry, I do not mean to be obtuse, but——

Chairman HOUGHTON. Well, no, it just gets to the excess of $8.5 million for 1 year.

Mr. ILLINGWORTH. The counsel we have been given by our accountants is, to have a reserve is very wise for a nonprofit. We have with us today our counsel from BDO Siedman, and you can pursue that with him if you would like—frankly, that is his area of expertise. So, I would like to suggest that if we are going to delve deeply into this document, the counsel we have been given is to have an excess—to have a reserve is wise, it is responsible to our clients. If you are looking at the degree of excess, I believe the gentleman from the IRS would say, and I believe he did say, that it is not against the law to have more revenues than expenses within the IRS guidelines, and we have reported this every year since our inception.

Chairman HOUGHTON. Could you give me a feeling for the percentage of the revenues that are spent on education? Also, do you charge for any educational counseling services or materials?

Mr. ILLINGWORTH. The first answer is, we do not charge for any of the education we provide. As I mentioned in my testimony, of the 1.8 million people, many hundreds of thousands have been provided counseling and education for free. We also sent those people the video, they can participate in the newsletter, and they can come to our websites. This year, I believe we will—or have—spent $1 million of hard money on a series of educational outreach programs which Mr. Viale can detail for you if you would like.

Chairman HOUGHTON. Okay. Well, thank you very much. Now, we will turn to Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. Mr. Illingworth, are you a member of the firm, Cambridge Credit Counseling Corp.?

Mr. ILLINGWORTH. I am not, sir.

Mr. POMEROY. What do you do?

Mr. ILLINGWORTH. I am an executive at the public relations firm of Ruder Finn in New York.

Mr. POMEROY. So, you are a hired public relations guy talking on behalf of the company?

Mr. ILLINGWORTH. I am a passionate advocate for my client, and I am also in public relations.

Mr. POMEROY. Now, do you know this Richard Puccio?

Mr. ILLINGWORTH. Yes, I do.

Mr. POMEROY. Can you tell us something about the action taken against him by the Securities and Exchange Commission (SEC) which resulted in him being barred for 5 years from the securities industry in 1996?

Mr. ILLINGWORTH. Of course I am aware of that, and the details of that have been represented to me by my client. I am not an expert on precisely what happened, and I think——

Mr. POMEROY. Would you say that it had something to do with the high-pressure, fraudulent sales tactics in disregard of his obligations to customers and their welfare? Was that language from the action taken by the SEC?

Mr. ILLINGWORTH. I recall it is something similar to that, yes.

Mr. POMEROY. Now, the issue of salaries relates somewhat to whether or not we have nonprofits functioning as nonprofits. When compensation levels get to certain points, it appears that it is being run for the proprietary benefit of the individuals receiving compensation. I earlier asked the Commissioner of the IRS about the suspicious $624,000 being paid to John Puccio. Really I misstated it, in some respects, because there are other extremes of income from a related entity that produced yet an additional income stream on this 2001 Form 990, leaving the Puccio brothers with $962,000, roughly, in annual compensation that year. Now, do you acknowledge that that is going to trigger at least an appearance that it should not be fitting under the normal tax-exempt, nonprofit classification under the IRS Code?

Mr. ILLINGWORTH. This is a question for the IRS, sir, not me. The business structure we have, the levels of income that are realized by the senior executives, are all reviewed. They are approved by the regulatory authorities and the States in which they are licensed, and by the IRS, and they have not told us—so, at this point in time——

Mr. POMEROY. Well, I think the Commissioner is rather interested in that level, but he, of course, was circumspect about identifying whether or not particular action of the IRS attaches to any particular individual or firm—as would not be right under confidentiality of the IRS operations. Now, Mr. Viale, you are on the staff, apparently, of Cambridge Credit Counseling Corp.?

Mr. VIALE. I am the Chief Operating Officer.

Mr. POMEROY. On this 2000 filing, it says you were paid $374,000. Is that in the range of your present compensation?

Mr. VIALE. That is correct.

Mr. POMEROY. Mr. Hall, your entity—what is the present name of your entity?

Mr. HALL. Take Charge America.

Mr. POMEROY. Take Charge America.

Mr. HALL. Yes, sir.

Mr. POMEROY. That was previously the Credit Counselors of America?

Mr. HALL. That is correct.

Mr. POMEROY. Now, in 1999, the report shows that you received compensation of $371,000 from Take Charge America?

Mr. HALL. Correct.

Mr. POMEROY. Now, that was 4 years ago. Would the Form 990 reflect that at roughly the present level of your compensation?

Mr. HALL. I believe our current Form 990, our most current one, would reflect about $440,000. I might point out to you, Congressman Pomeroy, that we have a corporate governance policy which takes me out of that process.

Mr. POMEROY. Are you concerned though, as the proprietor of this firm, that this board that is setting your salary might be setting you up for investigation where you could lose your 501(c)(3) status, because——

Mr. HALL. In setting those salaries—we have a very big company. I have 428 employees. We manage over $500 million a year in public funds.

Mr. POMEROY. Your testimony, Mr. Hall, states that for-profit entities cannot be expected to view the needs of consumers with the same charitable outlook as yours, a nonprofit commission.

Mr. HALL. Correct.

Mr. POMEROY. I want to explore the structure you use, because, as I understand it, you also do business in conjunction with for-profit entities that are part of the operation of Take Charge America. Does your credit counseling organization pay another for-profit company to assist you, to help process the debt repayment programs of your clients?

Mr. HALL. Absolutely not. We have never used any back-end operations to provide support to us. We do all of our own customer service and would never consider handing our customer service process over to anybody else.

Mr. POMEROY. Okay, I am going to name several for-profit companies and ask whether your company has ever had any relation to them: Michael A. or Mary E. Hall Family, Limited Liability Co. (LLC); Credit Counseling Information Systems, LLC; Orion Network Enterprises, LLC; Frank and Marilyn Muggeo (M&M) Leasing, Inc.; or Michael A. Hall, Inc.? Have you had dealings with any of those entities?

Mr. HALL. Only with one of them.

Mr. POMEROY. Which one is that?

Mr. HALL. That would be Credit Counseling Information Systems. I had been in the credit counseling business for 40 years, spanning a period of five decades, and for the first 27 years of that period of time, I was involved in the for-profit side of the industry. During that period of time, I developed enterprise software for the credit counseling industry. I developed educational materials and educational software for the industry that preexisted the creation of Credit Counselors of America, which is now Take Charge America. Having good data systems is essential to the operation of our business. The reason that we dealt with Credit Counseling Infor-

mation Systems, is because of the fact that it was the only provider that had the type of data systems that we needed to accomplish our goals.

Mr. POMEROY. So, do you or your family members have an ownership position in Credit Counseling Information Systems?

Mr. HALL. We do.

Mr. POMEROY. You do.

Mr. HALL. Yes, sir.

Mr. POMEROY. So, as the nonprofit Take Charge America pays Credit Counseling Information Systems, is that to your financial benefit?

Mr. HALL. It is.

Mr. POMEROY. What are the amounts of payment that you made to Credit Counseling Information Systems this past year?

Mr. HALL. Approximately $750,000.

Mr. POMEROY. Now, I understand that you have about 100,000 clients, is that correct?

Mr. HALL. We have 65,000 clients—about 63,000 clients currently enrolled in debt management plans. We do interview an additional 120,000 to 130,000 families a year—put them through full interviews. These are not 10- or 15-minute sessions. These are 1-, 2-, or 3-hour sessions, totally free of charge.

Mr. POMEROY. So, you have 63,000 clients and you interview another—how many?

Mr. HALL. Approximately 120,000 to 130,000 households seek out our service.

Mr. POMEROY. You have how many employees?

Mr. HALL. At the current time, 438 employees.

Mr. POMEROY. Now, is your organization paid with checks from your nonprofit, or do you hire that service out?

Mr. HALL. We do not hire any services out.

Mr. POMEROY. So, they come directly from Take Charge America?

Mr. HALL. Correct.

Mr. POMEROY. What kind of time are these clients getting? Now, as I counted, if you have 63,000 active clients and 120,000 others, that is almost 200,000 coming to your enterprise—and you have 438 staff, period. Are you able to give them the kind of individualized counseling that your people are hoping for?

Mr. HALL. Absolutely. We are able to service the volume based on the number of employees that we do have, yes.

Mr. POMEROY. What would be the average time commitment per client?

Mr. HALL. We spend anywhere from a minimum of approximately 45 minutes, to an hour, to a maximum of 2 to 3 hours, depending upon the complexity of the situation.

Mr. POMEROY. I have no more questions at this time, Mr. Chairman. Thank you.

Chairman HOUGHTON. Thank you. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. A couple of questions. Mr. Jones, if I wanted to become a credit counselor, how much schooling would I need? What would I have to do to get the certification—whatever you guys handout?

Mr. JONES. It typically takes somebody about 6 months to pass the test for personal finance.

Mr. KLECZKA. So, you actually give the person a test?

Mr. JONES. Oh, absolutely. It is an independent test, yes.

Mr. KLECZKA. How many pages is this test? Is it true or false?

Mr. JONES. No. There are true or false questions on the test, but there are a number of essay-type questions on the test as well.

Mr. KLECZKA. Then who grades the test? Somebody from your operation?

Mr. JONES. The Institute for Personal Finance.

Mr. KLECZKA. Which is your operation?

Mr. JONES. No, that is an independent certifying body. They use the Association for Financial Counseling and Planning Education.

Mr. KLECZKA. I do not know anything about them, and that is fine. How much am I charged once I am a full-fledged counselor?

Mr. JONES. Sorry?

Mr. KLECZKA. How much are you charged once I am a full-fledged counselor?

Mr. JONES. For the test?

Mr. KLECZKA. For the test, or for the license—or whatever I get.

Mr. JONES. Typically, the agency pays for their counselors to take the test.

Mr. KLECZKA. The employing company, okay.

Mr. JONES. I think $125.

Mr. KLECZKA. Do I have to have an annual certification or license——

Mr. JONES. You have to have continuing education credits, yes.

Mr. KLECZKA. Mr. Hall, which of these two organizations are you a member of?

Mr. HALL. I am a member of AICCCA and AADMO.

Mr. KLECZKA. God love you. I do not know what any of those are. Mr. Jones, are you the AAICIO?

Mr. JONES. I represent the AICCCA members.

Mr. KLECZKA. Ah, the AICCCA—I am sorry. Okay, so then you are a member of his organization, Mr. Hall?

Mr. HALL. I am.

Mr. KLECZKA. Okay, good. I was surprised when the Chairman indicated that Mr. Illingworth, your client, ended up with a profit of $8.5 million. Is that last year? You indicated that it was reserves, and not profit. I just want to give you two examples, and I think I might put into perspective what we are talking about here. Number one, if my church at the end of the year came out with their annual report and indicated contributions were "x" amount, and expenses for hosts and wine and electricity was this amount, and at the end of the year we had $8 million, do you know what would happen? The contributions would drop like a rock.

Another example is United Way of Milwaukee, Wisconsin. If they indicated to any of us when they started their annual appeal that we really need to go out and raise $53 million this year because there are so many hardship cases in Milwaukee—if they said, we got to do so many good things, and by the way, we have $8 million left over from last year—their appeal would drop like a rock. The reason I bring those two examples up is to question how much of

a nonprofit you guys really are, okay? Why do we have to go through this guise of nonprofit? The Commissioner of the IRS told us that what you folks are doing is asking for a contribution. The contribution from your clients is mandatory, not really disclosed, and basically is a fee, all right? So, why do we go through this whole sham of calling you guys nonprofit, when we know you ain't really nonprofit?

I thought, maybe, for a while—and that is when I asked the FTC a question—maybe it has to come under the umbrella of the phone marketing, maybe that was the reason to do that. He said, "No, there has been no jump in these types of groups forming so they could make antagonizing calls to Americans at 6:00 p.m.," and so it just blows my socks. Why do you not just call yourselves what you are: a for-profit business which gets great income for charging fees to poor people who have credit problems. You get a big kickback from the credit companies. You run it like a business, and after you pay your taxes and do things above-board, I do not give two rats whether you are getting $600,000 a year, or $6 million a year.

You are a business like Allen-Bradley, Johnson Controls, Inc., and Boeing. So, why are we doing these machinations and twisting—and now we have got a couple that are under indictment or are being charged? Let's just call a spade a spade, and let's do it right. I know, Ms. Loonin, you are ready to pounce in on this question. You have been chomping at the bit. Respond to me—why don't we do it the right way?

Ms. LOONIN. Well, I certainly agree with wanting to do it the right way. What I would suggest, though, is that theoretically, it is possible to have a complementary sector where you have for-profit businesses that do credit counseling. I am not sure exactly how that would work, given the way the fair-share is structured now, and that sort of thing. What we want to emphasize is that keeping a thriving, legitimate, nonprofit sector is also critical. I know you are not suggesting this, but some have suggested actually, instead——

Mr. KLECZKA. Well, if it is a bona fide nonprofit, I would probably be supportive—but if it is done under a kind of guise or cloak, what is the sense?

Ms. LOONIN. Right. The other point I want to make is, in some cases where maybe we are distracted by the nonprofit versus the for-profit status, that is not the only issue. If there is deception and abuse going on, which is also going on in how we are talking about fees, what the agencies are saying they can give to consumers—that is deception or abuse whether it is in the nonprofit sector or the for-profit sector. So, we have to watch that regardless of who is doing it.

Mr. KLECZKA. Thank you very much.

Chairman HOUGHTON. Okay. Mr. Sandlin.

Mr. SANDLIN. Thank you, Mr. Chairman. To start, Mr. Boisclair, you have a presence in my district: in Paris, in Greenville, in Texarkana, in Mount Pleasant, in Longview—and possibly in other places. I appreciate what you do for folks there. We have nothing but good reports from those citizens. Mr. Hall, I noticed

that with your company, you set up debt management plans for consumers, is that correct?

Mr. HALL. That is part of our business, yes, sir.

Mr. SANDLIN. Now, you also do work for creditors, do you not?

Mr. HALL. Oh, yes, as part of the service we provide to our customers.

Mr. SANDLIN. So, what you are telling me is that the only work you do for them is, by working with consumers, they get a benefit, and that is all the work that you do for creditors?

Mr. HALL. That is correct.

Mr. SANDLIN. So, when you filed your Form 990, when you say you will provide creditors a collection process for otherwise uncollectible balances, that would be in error?

Mr. HALL. No. That has always been a vital function of the debt management industry, Mr. Congressman.

Mr. SANDLIN. So, one of the things that you do is, you act as a collection agency for credit groups, is that correct?

Mr. HALL. We provide, in effect, recovery services. That is part of the plan that anyone in this industry provides.

Mr. SANDLIN. That would not be a tax-exempt function, would it?

Mr. HALL. That is correct, and that is certainly not the focus of our——

Mr. SANDLIN. It is one thing that you do.

Mr. HALL. It is one thing that all of us do.

Mr. SANDLIN. Now, is your company one of the companies that receives a donation or contribution from consumers?

Mr. HALL. No, sir.

Mr. SANDLIN. So, all of the money that you receive from them is shown as a fee?

Mr. HALL. Absolutely.

Mr. SANDLIN. What do they get for that fee?

Mr. HALL. The fee is basically intended to help offset operating costs related to the services that are provided.

Mr. SANDLIN. How is that initial fee figured?

Mr. HALL. The initial fee is actually stratified. Since a variety of State laws that are out there—we charge a different range of fees.

Mr. SANDLIN. The fee is basically a payment to you.

Mr. HALL. It is disclosed as such, and we do not try to veil it as a voluntary contribution. We never have done that. We always quoted our fees as fees, and disclosed them up front.

Mr. SANDLIN. Well, I noticed—and I appreciate that. You show that as taxable income, do you not?

Mr. HALL. Correct.

Mr. SANDLIN. I notice that in 1997, 1998, 1999, and 2000, you show fees, which would be the money that folks send to you. You show a total of over $28 million, and the gross receipts for the services performed at only $42 million. In 2000, it is $12 million, and I am rounding this off as $12,446,630, but $12 million in membership fees and $17 million in receipts for services performed. So, are you telling me that you take out of this total, you take this money, and $28 million out of $42 million goes to you—you only use the

balance, which would be $14 million, for the services that you provide to the consumer? Is that what you are telling me?

Mr. HALL. Sir, I do not recognize those figures as being accurate.

Mr. SANDLIN. I would think that your Form 990 that you filed with the government for 2001 would be accurate.

Mr. HALL. I do not have a copy in front of me, sir. I guess it would be accurate.

Mr. SANDLIN. It would be accurate, okay. That is what the numbers show.

Mr. HALL. The fees are distributed—when we say fees, those are user fees paid by consumers to our company.

Mr. SANDLIN. That is right.

Mr. HALL. The other is fees paid as fair-share by creditors for the services——

Mr. SANDLIN. The money sent to you by consumers as fees is not paid on their debt, is it?

Mr. HALL. That is correct.

Mr. SANDLIN. It is not sent to credit card companies?

Mr. HALL. That is correct.

Mr. SANDLIN. It is not sent to other folks. It is paid to you?

Mr. HALL. That is correct.

Mr. SANDLIN. So, you received $42.9 million for those years, and $28 million went to your company. Now, I was interested in what Mr. Pomeroy asked you. In this last report, of course, when times were a little tougher, you only made $381,000. You said this next report would show $440,000 to you, but last time you showed $381,000 to you for last year, 2001. Mary Hall, I assume, is your wife?

Mr. HALL. Yes.

Mr. SANDLIN. Another $127,000. So, that is $508,000 to you. Norm Hall, $116,000; Kevin Hall, $118,000; Terry Hall, $116,000; and John Hall, $5,000. That totals $355,000. So, the Hall family got $863,000 out of your company, is that correct?

Mr. HALL. Yes, sir. The Hall family has been involved in providing these kinds of services for over 30 years. All the people that you have mentioned there have been involved in our company for 20 years.

Mr. SANDLIN. That is a very good point. The point is, this is not $863,000 divided by 30; this is $863,000 for 1 year, correct?

Mr. HALL. That is correct.

Mr. SANDLIN. Now, do you also have people working for you, not named Hall, who are related to you?

Mr. HALL. No, I do not.

Mr. SANDLIN. You do not have any sons-in-law.

Mr. HALL. Actually, I have two sisters working for me that are not named Hall, yes.

Mr. SANDLIN. Are they paid by your company?

Mr. HALL. They are.

Mr. SANDLIN. So, the Hall family would get the $863,000 that year, plus whatever salaries those folks got.

Mr. HALL. That is correct.

Mr. SANDLIN. Now, I was also interested in answering Mr. Pomeroy. He listed off the names, I wrote them down, of various

companies—for-profits. He listed: Michael A. and Mary Hall Family, LLC; Credit Counseling Information Systems; Orion Network Enterprises; M&M Leasing; and Michael A. Hall, Inc. Correct?

Mr. HALL. Yes.

Mr. SANDLIN. You said you had absolutely no relationship with any of them except Credit Counseling Information Systems, is that correct?

Mr. HALL. All of those corporations preexisted the existence of Take Charge America.

Mr. SANDLIN. That was not the question.

Mr. HALL. We do not have any relationships with any of them, no, sir. I do not even know who Orion is.

Mr. SANDLIN. Orion would not appear in any of your tax returns?

Mr. HALL. I have nothing to do with Orion.

Mr. SANDLIN. I said would Orion appear anywhere in any of your tax returns?

Mr. HALL. No.

Mr. SANDLIN. How about Walking Eagle Communications, Inc.?

Mr. HALL. Yes, it would. That is the survivor to Credit Counseling Information Systems. They were merged a couple of years ago.

Mr. SANDLIN. That is owned by your family, is it not?

Mr. HALL. Correct.

Mr. SANDLIN. Now, among these companies that you say you have no relationship with, would there be any payments to or from those companies—Michael E. Hall, M&M Leasing, Orion, or Michael A. and Mary E. Hall? Would there be any payments to and from those companies to Take Charge America?

Mr. HALL. No, there never has been.

Mr. SANDLIN. Never.

Mr. HALL. Again, I do not know who Orion is.

Mr. SANDLIN. They would not appear on any of your records, or any of your tax returns?

Mr. HALL. No.

Mr. SANDLIN. Would there be any overlapping officers, principals, or key employees between those groups that I just listed?

Mr. HALL. None other than myself.

Mr. SANDLIN. None other than yourself. Are you an officer in Michael A. Hall, Inc.?

Mr. HALL. Michael A. Hall, Inc. is a defunct company. That is when I operated in the for-profit industry from 1971 to 1997—Michael A. Hall, Inc., American Financial Services. We closed that company when I became involved full-time with——

Mr. SANDLIN. Would you have any relationship with M&M Leasing?

Mr. HALL. We do not.

Mr. SANDLIN. Are you an officer or principal, or do you share officers, principals, or employees with that company?

Mr. HALL. Again, M&M Leasing is also a defunct corporation. It served as an auxiliary to the for-profit industry.

Mr. SANDLIN. Those are good comments. Are there any shared officers between those corporations and Take Charge America, Inc.?

Mr. HALL. Those corporations do not exist any longer, Mr. Congressman.

Mr. SANDLIN. I understand that.

Mr. HALL. Only myself.

Mr. SANDLIN. You already said you never heard of Orion?

Mr. HALL. Correct.

Mr. SANDLIN. Credit Counseling Information Systems—you do have shared officers there—employees, agents; is that correct?

Mr. HALL. I do have—there are employees who are employed by Walking Eagle Communications.

Mr. SANDLIN. How many employees would that be?

Mr. HALL. We presently have about 13 or 14 employees involved in enterprise systems development and other software products that are totally unrelated to the business conducted by Take Charge America.

Mr. SANDLIN. You share those employees with Take Charge America?

Mr. HALL. Not in the sense that they would perform work.

Mr. SANDLIN. The employees that you are listing are shown as employees of Take Charge America and Walking Eagle Communication?

Mr. HALL. No. It is a completely different entity.

Mr. SANDLIN. I did not ask if it is an entity. The names, the people—did the people work for both of those organizations?

Mr. HALL. No, sir, they did not.

Mr. SANDLIN. Okay. Do you share any office space, staff, computers, or things like that between any of these entities that I just listed, without going through them again?

Mr. HALL. We do, in some cases under contract, employ people to do development work for which Take Charge America is reimbursed.

Mr. SANDLIN. You share what sort of relationship there? With whom? With any of these companies, Michael A. and Mary E. Hall Family——

Mr. HALL. Only Walking Eagle Communications, Mr. Congressman.

Mr. SANDLIN. Okay. Are you involved in any sale of land between any of the corporations or groups that I mentioned—to or from Take Charge America?

Mr. HALL. None whatsoever.

Mr. SANDLIN. None whatsoever. Never have been?

Mr. HALL. No.

Mr. SANDLIN. Are there any loans or leases between those parties that I mentioned for property, equipment leases, or anything like that from a Hall family business to the nonprofit?

Mr. HALL. There are not.

Mr. SANDLIN. None whatsoever.

Mr. KLECZKA. Would the gentleman yield?

Mr. SANDLIN. Certainly.

Mr. KLECZKA. Something has been bugging me since you mentioned all the Hall salaries, Mr. Sandlin. Could you give me the name of the Hall that is at $5,000?

Mr. HALL. That is John Hall.

Mr. KLECZKA. John? Well, if John's watching us on television, he is going to have a real problem, because everyone else is $116,000, $118,000, or $127,000. Then there is poor old John at $5,000. How old is John?

Mr. HALL. John is about 60.

Mr. KLECZKA. Sixty?

Mr. HALL. Yes.

Mr. KLECZKA. Oh, come on, John.

Mr. HALL. I do not really know what that is, because he is not an employee of the company.

Mr. KLECZKA. Well, if you could help John out at 60, because the rest of them are getting much more.

Mr. SANDLIN. Mr. Chairman, I believe my time is over and I appreciate your allowing me to go over. Thank you very much.

Chairman HOUGHTON. No, not a bit. I would like to ask Mr. Boisclair and Mr. Jones a question. This gets back to the question we had with Mr. Illingworth about Cambridge Credit Counseling Corporation, and I am really interested in the proportions. What I see—and I could be wrong here—is an industry that started out as really a counseling and educational industry, going into the debt management industry, moving away percentage-wise from those things they were originally set up to do, moving toward an entirely different concept.

The program service revenue for Cambridge Credit Counseling Corporation—and this comes out of the Form 990, the last one, which is from August 2001—was $53 million. The excess or the profit was $8.5 million. Also, the carryover from previous years was $17 million. So, you got $53 million coming in, you got a profit of $8.5 million, and you got a carryover from other years that is $17 million. That looks pretty hefty for a nonprofit organization. Explain this to me, will you?

Mr. BOISCLAIR. Well, I cannot explain that. I can tell you that I think it is proper for any nonprofit that can, to function with reserves, but there is a point where reserves become excessive. The true nature of a nonprofit, as our members would define it and as I define it personally, would be if we continued to have excess revenues in—well, we are not going to have those levels anyway. However, if we had excess revenues we would, in our case, reinvest them in the community, in other programs, so that we could reach more people, and maybe even create new programs that we could——

Chairman HOUGHTON. So, you would not be plowing another $8.5 million on top of the $17 million, and putting it in further reserves for next year?

Mr. BOISCLAIR. You are asking me that as the CEO of the nonprofit? No, we would not.

Chairman HOUGHTON. Do you have any comments, Mr. Jones?

Mr. JONES. Well, I would say that that would certainly not be typical of the members of our association at all. Those are very high numbers. I do not know whether they relate to success or not, but this money is the people's money—it belongs to the people of the United States, and it should be used for them. So, I believe our members, if they had those kinds of reserves, would attempt to do

just that—either to reduce fees, or provide more services to them. I do not believe our members typically have those kinds of reserves.

Chairman HOUGHTON. Again, getting back to the original question, in terms of the inside arithmetic in the company, do you see that there is a trend away from the original intent of education and counseling into the debt management process?

Mr. JONES. It certainly appears so, based on those numbers, yes.

Mr. ILLINGWORTH. Sir, if I can jump in. I think the one thing that is important to consider besides the money and time spent on education and the educational programs for the basketball hall of fame, College Bowl, Emory University, the University of Massachusetts, and the high schools we work in—we are always looking for new ways to invest in education and counseling, in order to further fulfill our mission as a 501(c)(3) corporation. Mr. Viale can explain to you what new things we have on the books, in our planning, in order to do that.

I think the other thing is, part of our mission—part of our responsibility to our clients—is to be there next year for them, and not to disappear. Sir, there are people at this table whose organizations, whose companies, are failing. There are failing credit counselors in the State of California, in the State of Maryland, and all over this country, who cannot fulfill their mission. With fair-share declining as well—which a lot of people are suffering from, including the consumer—God help us that we have this reserve in order to do that. We fully intend to deploy it in this matter.

Chairman HOUGHTON. No, I have been around that barn for 40 years—I understand it. Yet I have not been a part of a nonprofit organization. I have been a part of a for-profit organization. You can build up the reserves, build up the profitability, as long as you are servicing your customer, and they are the people who are determining it. When you are a nonprofit, it is a different element. That is the thing that has concerned all of us. Well, look, you have been nice to be here. I appreciate your wisdom, and I want to thank you very much for taking the time.

I do not know whether I speak for you, Mr. Pomeroy, or you, Mr. Sandlin, but I think we are all concerned about what we have heard today. Consumers need to be treated fairly, as we all know, and the IRS and the FTC need to monitor the activities of these groups. So, therefore, I think that Mr. Pomeroy and myself are going to ask the IRS and the FTC to report back to us in 6 months on their continued activities to ensure the proper conduct of credit counseling agencies. We hope they will be aggressive in their review of this matter. So, I thank you, again, very much. I appreciate your time.

Mr. ILLINGWORTH. Thank you.

Chairman HOUGHTON. Hearing adjourned.

[Whereupon, at 4:35 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Michael Barnhart, Coalition for Responsible Credit Practices

On behalf of the Coalition for Responsible Credit Practices, I want to thank the Subcommittee for this opportunity to share with you our insights on consumer credit and the credit counseling industry.

The Coalition for Responsible Credit Practices is a newly formed, nationwide group of consumer credit counseling agencies and supporting businesses working together for a robust, consumer-friendly credit counseling industry. The Coalition's mission is to promote a vigorous, pro-consumer credit counseling industry that protects consumers from unethical practices *and* unnecessary bankruptcy. The Coalition wants to make sure that as the credit counseling industry continues to grow, it stays strong, competitive, balanced, professional and, above all, beneficial for American consumers.

Putting Consumers First: Broad Review from the Consumer's Perspective

The credit counseling industry needs reform. However, reform that puts consumers first cannot be developed in a vacuum or by a narrow gauged inspection of industry practices and government regulation that ignores how Americans are living, working and borrowing. It cannot be done piecemeal without looking at the parts of the industry including creditor practices.

Pro-consumer changes to current legal and regulatory practices require a broad understanding of the comprehensive consumer experience in securing and managing credit. It is impossible to identify necessary and effective reforms in helping consumers without examining how and why some consumers get into credit trouble in the first place.

One cannot truly understand the credit counseling industry without understanding the integral roles played by consumers, creditors (large and small) and credit counselors.

Solutions that put consumers first must be holistic—helping protect consumers from unethical practices and unnecessary bankruptcy.

The Coalition for Responsible Credit Practices appreciates the opportunity to present issues and solutions from the perspective of what best benefits consumers.

The 1990s: Booming Economy—Booming Debt

During the booming economy of the 1990s consumer debt skyrocketed. In 1990, the average household non-mortgage debt was $8,500. By 2000, it had increased sharply to $14,500. Incredibly, the portion of that related to credit card debt nearly tripled, from $2,985 to over $8,100 per household.

Clearly, the commonly held notion that debt is the product of "bad times" is wrong. Equally clear, something else is going on.

Obviously, consumers are borrowing large amounts of money. Outstanding consumer debt rose from $355 billion in 1980 to a staggering $1.65 trillion in 2001. Consumers owe money to hundreds of thousands of small creditors —doctors, dentists, 'rent to own' furniture outlets and department stores—as well as to a few relatively large national banks and credit card companies.

In his book "Credit Card Nation," author Robert Manning likens the expansion of consumer credit debt in the 1990s to personal "junk bonds." And how are consumers managing their debt load? The evidence suggests that some are not managing it well.

U.S. credit card debt today totals about $700 billion. Late payment fees to creditors have risen from $1.7 billion in 1996 to *$7.3 billion* in 2002, making them the *third* largest source of revenue for credit card companies, trailing only interest and merchant fees.

Today, the average American family is paying about $1,100 a year in interest on its credit cards. Interest rates on bank issued cards range from 4.75% to 35% when the Federal Funds Rate is at 1%, an historic 45-year low.

Paradoxically, credit card issuers mailed *five billion* card offers in 2001, a 20% increase from 2000. Manning notes that throughout the 1990s, "aggressive marketing of consumer credit" posed serious personal and credit problems for small businesses and for college students. In fact, in 1999, the Consumer Federation of America conducted a major news conference about the terrible impact of crushing credit card debt on students, revealing that several even turned to suicide and tragically ended their own lives. Jean Braucher, author of "Options In Consumer Bankruptcy: An American Perspective" concludes that if "creditors persist in aggressive marketing to high-risk debtors, effective legal and social reforms should include better disclosure, financial education in secondary school and, perhaps, even direct regulation of risky creditor practices." (A copy is enclosed.)

Significant and important research is being done on consumer credit. The Coalition strongly recommends that the committee and staff review the important data being reported in works such as: "As We Forgive Our Debtors, Bankruptcy and Consumer Credit in America;" "The Fragile Middle Class;" and "Credit Card Nation." (A bibliography has been enclosed for the Committee's reference and convenience.)

Especially helpful is research published by Demos Public Policy research titled: "Borrowing To Make Ends Meet: The Growth of Credit Card Debt in the '90s." (Copy enclosed.) This article describes numerous practices of creditors that generate increasing consumer debt, including:

- Disclosures that emphasize low introductory interest rates and fail to fully apprise consumers of the true interest and penalty structures of the credit being offered, *see id.* at 41;
- Drastically increasing fees and penalties, including late fees, over-the-limit fees, balance transfer fees and cash advance fees, which are generally borne by the consumers that are least able to handle them, *see id.* at 35–37;
- Indiscriminate and aggressive credit card marketing and solicitation, rising to the level of 5.01 billion credit card solicitations in 2001, *see id.* at 37; and,
- The reduction of minimum payment requirements to very low levels, generally around 2% to 5% of the balance owed, which creates increasing consumer debt and extends the length of time it takes consumers to pay off their credit card debts, while simultaneously generating greater interest income to the credit issuers, *see id.* at 37. As reported in the *Demos* article, it would take a consumer an astonishing 56 years to pay off a $10,000.00 credit card balance at 18% interest by making only the required minimum monthly payments of 2% of the balance, *see id.* at 13.

Consumers in Debt Crisis Need Choices

Consumers experiencing debt crisis have limited alternatives. Some may seek attorneys to aid them with Chapter 7 (debt discharge) or Chapter 13 (repayment plan) bankruptcy. Yet others may borrow against their future by securing a home equity loan. Some consumers are lucky enough to have a family member willing to help. A fraction simply are able to "pull themselves up by their bootstraps" but, unfortunately, most cannot. Consumers being pursued by collection agencies usually find "self help" in coping with their creditors is impossible.

Thousands of American families live better lives because they have the option of choosing to use credit counseling services—resources that serve as many consumers' protection from collection letters and harassing phone calls. Most consumers in debt crisis simply want the phone to stop ringing. Credit counseling is an essential and valuable service. Public policy makers and the industry should work together to ensure that consumers are able to use this vital credit counseling resource.

Credit counseling agencies (CCAs) are now assisting over 1.5 million American households a year manage their debt, save money and avoid bankruptcy. America's credit counseling industry has more than tripled in size within the past decade, and must grow another 40% just to fulfill the requirements of the proposed Federal Bankruptcy Bill.

The credit counseling industry provides services that offer real value to consumers that include debt counseling and debt management plans (DMPs). Agencies provide consumers with valuable expertise on what creditors are willing to accept and what benefits can be achieved. And, they offer efficient, effective ways for consumers to repay debt. The consumer usually deals directly with the CCA and does not understand the creditors' role in the process. As a result, when something goes wrong, even when the consumers' creditor is the cause, the consumer blames the CCA.

Increasingly, consumers are demanding more "customer focus" from credit counseling agencies. Consumers expect CCAs to be as consumer friendly as other businesses and to offer such services as telephone counseling, Internet access, computerized payments and evening and weekend hours. Many traditional CCAs have been slow to meet new customer demands because they are revenue bound by declining "fair share" contributions from the largest creditors.

"Non-profit" CCAs frequently act as agents of banks and credit card companies and hence are creditor driven instead of consumer focused. Many have executives from creditors sitting on their board of directors. In fact, the Federal Trade Commission determined that NFCC affiliated, non-profit CCAs must disclose to consumers that these non-profit CCAs represent the very banks and credit card companies consumers may be seeking protection from. (www.ftc.gov/opa/1997/03/nfcc.htm)

It should be noted that there are literally hundreds of thousands of creditors. Very few creditors, i.e., the largest *100* creditors, account for approximately 98% of all "fair share" paid by creditors to non-profit CCAs. Significantly, though, these few large creditors refuse to pay "fair share" to for-profit CCAs, but also refuse to give debt management benefits to consumers choosing for-profit CCAs. Unsurprisingly, no for-profit CCA exists today because of this industry practice. Also troubling, many CCAs are also finding themselves situated in a position to take the blame for consumer issues that are actually the faults of the consumers' creditors. (Please see enclosed memorandum detailing these issues.)

In an environment of shrinking support from creditors and increasing demand, it is very likely that the non-profit business model is not long for the world.

Few dispute that credit counseling is valuable and positive. Credit counseling agencies not only help consumers manage their debt, save money and avoid bankruptcy, but a recent study indicates that CCAs also help consumers improve their budgeting skills, their ability to afford a new home and their overall financial status, as well as their credit profiles.

According to a Georgetown University study, consumers who received credit counseling reduced their total dollar amount of debt, their total dollar amount of non-mortgage debt and the number of accounts with unresolved balances. Most of them also diminished their use of bank card credit limits and experienced fewer delinquencies.

"And, the large majority of counseled borrowers had significantly fewer accounts, lower debt and fewer delinquencies relative to other borrowers—behavior consistent with the advice provided in credit counseling."

Today, personal debt is spiraling and personal bankruptcies are following suit. Credit counseling agencies are attempting to meet the needs of American consumers. More and more consumers need unbiased credit advice and want a full range of consumer friendly counseling options that include the latest in telephone and Internet counseling.

It is crucial that we preserve credit counseling as an option to help consumers get out of debt as quickly as possible.

The future of the traditional, non-profit CCA is, frankly, dim. The traditional credit counseling agency is too dependent on creditors to give consumers unbiased advice and too revenue strapped to modernize practices and services to meet demand as a true business would to serve and retain customers. For example, most CCAs don't even advertise their services, leaving many consumers unaware that this significant resource is available.

Pro-Consumer Credit Counseling: Consumer Choice, Competition and Federal Regulation

Traditional CCAs are losing market share to the independent agencies. Most of the growth among CCAs is among independent agencies.

Simply put, the non-profit model is no longer viable. It is being rejected by consumers and suffocated by creditors who are investing less and less. There are several crucial steps that must be taken to preserve CCAs and the benefits they bring to consumers and taxpayers:

1. CCAs must become consumer focused and operate like true businesses.

   Competition for consumers among for-profit and non-profit CCAs would provide consumers choice and the industry with incentives to provide consumer focused—not creditor driven—consumer credit counseling.

   The traditional players in the credit counseling industry, such as the consumer credit counseling service members of the National Foundation for Consumer Credit ("NFCC") were created and remain heavily influenced by creditor organizations and are highly dependent upon "fair share" payments from creditors. *See* Stephen Gardner, *Consumer Credit Counseling Services: The Need for Reform and Some Proposals for Change*, Fall 2001/Winter 2002, at 31, 32. Because of their close relationships with creditors, the advice provided to consumers by traditional NFCC member entities is likely to be limited and may be "improper . . . [and] to the direct benefit of some creditors." *See id.* at 31, 33. For instance, organizations that are NFCC members may "not adequately disclose the[ir] collection agency role to consumers who seek and obtain counseling," and often "it is the set policy of some [of these] organizations that they never refer debtors to bankruptcy." *See id.* at 31. It has been alleged that the control of creditors over the NFCC member entities is so great that some creditors will work only with credit counseling agencies that are members of the NFCC and that the NFCC and its member entities have engaged in anti-competitive behavior in violation of antitrust laws. *See In re: Consumer Credit Counseling Services Antitrust Litigation*, No. MDL 97MS233, 1997 U.S. Dist. LEXIS 19669, at *4—*7, 1997 WL 755019, at *2 (D.D.C. Dec. 4, 1997).

   A recent report published by the Consumer Federation of America and National Consumer Law Center highlights the need for the credit counseling industry to elevate its standard of professionalism, and embrace "best practices" that increase consumer benefits and improve customer service and satisfaction. We agree and we believe that regulators, creditors, CCAs and consumer advocates need to work together to find a funding solu-

tion that will work for everyone—especially consumers—while helping the industry continue to grow and flourish.

2. Competition between "non-profit" and market based CCAs would benefit consumers.

   The "non-profit" CCA is only as viable as the level of support they receive from creditors. Without a creditor subsidy, consumers must forgo counseling or pay reasonable fees. Large banks and credit card companies created the credit counseling industry a half-century ago as an alternative way to collect debt from consumers who might otherwise file for personal bankruptcy and gain release from the obligation of repayment. These large creditors created and funded CCAs by providing a subsidy of approximately 15%—allowing CCAs to present themselves as 'non-profits.' In the meantime, American debt is soaring.

   The large creditors are now drastically reducing or eliminating their financial "fair share" support to CCAs, reducing it, on average, to less than 4% of the amounts repaid. There is a vast contingency of smaller creditors who do not pay any fair share—encompassing doctors, lawyers, collection agents, loan companies, local banks, student loan companies, utility companies, credit unions, and small retail stores, just to name a few. And since most smaller creditors pay no fair share, non-profit CCAs are not a sustainable business model. A myriad of differing state laws are causing the cost of compliance to skyrocket while, simultaneously, fees are being "capped" by states. Without competition from market-based companies, consumers will be left on their own to negotiate against some of the largest credit card companies and banks in the world. And, with no revenues being generated by consumers who pay for the services they receive, consumers will not be able to get the key services they need.

   In June of 2003, Howard Beales, Director of the Bureau of Consumer Protection at the FTC, praised the modernization of the consumer credit granting industry from the old model of in-person visits to a local banker. Likewise, modernization in the credit counseling industry is desperately needed in allowing competition among for-profit and non-profits in the best, most efficient manner of financing modern credit counseling services. Creditors—both for-profit and non-profit—have dramatically changed over the last half century. The same cannot be said for the credit counseling industry because for-profits have been banned.

3. Fair Federal regulation that preempts the confusing 50-state patchwork status quo would benefit consumers.

   Practical, consistent federal regulation of CCAs would benefit consumers, creditors and counselors. National rules will protect consumers across the country with consistent standards while providing incentives for industry investment. In some states credit counseling is illegal. Georgia just this year changed their statute outlawing credit counseling. In Kansas, it is still illegal. Federal regulation would be vastly more effective and efficient by overriding the confusing, inconsistent, and unnecessarily expensive state patchwork of laws and creditor mandates.

The Coalition for Responsible Credit Practices believes the industry should hold itself to high standards and employ industry "best practices." This can be achieved through several mechanisms, specifically:

1. Practical, consistent federal regulation.

   National rules would protect consumers across the country and provide incentives for industry investment, while overriding the confusing, inconsistent state patchwork of laws and creditor mandates.

2. Industry-wide adoption of Best Practices.

   Industry trade associations should lead the industry in developing and enforcing policies, and implementing clear, dependable procedural and operating standards, including:

   - Thorough, regular training and certification.
   - Approved, documented standards for proposal processing and program enrollment.
   - Honest, accurate advertising.
   - Full disclosure of funding sources, including percentage from creditor.

3. Further resources pledged to customer service.

   An even legal and regulatory playing field for nonprofit and market-priced credit counseling agencies alike will boost competition within our industry, ultimately benefiting consumers through agency investment in new products and services, such as:

   - Improved efficiency through superior third-party vendors.
   - Faster, easier electronic payment options for consumers and creditors.
   - More convenient counseling services for consumers, like interactive voice response and Internet.

It is also extremely important that creditors make a stronger commitment to customer satisfaction. As previously noted, many consumer complaints about credit counseling are actually the fault of the creditors and beyond the control of the CCA. CCAs and creditors must work together, employing the latest business methods and technological innovations will help the industry exceed consumer expectations.

- Creditors must give full benefits of debt-management plan promptly, including waiver of late fees, within first week of program enrollment.
- CCAs must provide effective, efficient, time flexible counseling sessions.
- Creditors should discontinue collection calls within the first week of program enrollment.
- Creditors must provide timely responses to payment proposals and payment postings.
- Creditors should provide greater availability of creditor representatives.
- CCAs owe consumers unbiased counseling advice.
- Creditors should ensure that credit card statements reflect changes upon debt-management plan enrollment.

The Coalition is committed to preserving and promoting this valuable, vital industry. We hope the Coalition's work will ultimately help millions more Americans manage their credit card debt, save money and avoid bankruptcy. On behalf of our membership, I want to thank the Oversight Subcommittee and offer our assistance in working together for a strong and consumer-oriented service.

Thank you again for this opportunity to submit testimony.

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Summary of Written Statement of Michael Barnhart, Coalition for Responsible Credit Practices

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third largest source of revenue for credit card companies, trailing only interest and merchant fees.

Today, the average American family is paying about $1,100 a year in interest on its credit cards. Interest rates on bank issued cards range from a 4.75% to 35% when the Federal Funds Rate is at 1%, an historic 45-year low.

Paradoxically, credit card issuers mailed *five billion* card offers in 2001, a 20% increase from 2000.

Consumers in Debt Crisis Need Choices

Consumers experiencing debt crisis have limited alternatives. Some may seek attorneys to aid them with Chapter 7 (debt discharge) or Chapter 13 (repayment plan) bankruptcy. Yet others may borrow against their future by securing a home equity loan. Some consumers are lucky enough to have a family member willing to help. A fraction simply are able to "pull themselves up by their bootstraps" but, unfortunately, most cannot.

Credit counseling is an essential and valuable service. Public policy makers and the industry should work together to ensure that consumers are able to use this vital credit counseling resource. Credit counseling agencies (CCAs) are now assisting over 1.5 million American households a year manage their debt, save money and avoid bankruptcy.

Increasingly, consumers are demanding more "customer focus" from credit counseling agencies. Consumers expect CCAs to be as consumer friendly as other businesses and to offer such services as telephone counseling, Internet access, computerized payments and evening and weekend hours. Many traditional CCAs have been slow to meet new customer demands because they are revenue bound by declining "fair share" contributions from the largest creditors.

"Non-profit" CCAs frequently act as agents of banks and credit card companies and hence are creditor driven instead of consumer focused. There are literally hundreds of thousands of creditors. In contrast, very few creditors, i.e., the largest *100* creditors, account for approximately 98% of all "fair share" paid by creditors to non-profit CCAs. The traditional CCA is too dependent on creditors to give consumers unbiased advice and too revenue strapped to modernize practices and services.

The "non-profit" business model is obsolete.

Pro-Consumer Credit Counseling: Consumer Choice, Competition and Federal Regulation

There are several crucial steps that must be taken to preserve CCAs and the benefits they bring to consumers and taxpayers:

1. Creditor Commitment to Consumer Satisfaction. It is extremely important that creditors make a stronger commitment to customer satisfaction. Many consumer complaints about credit counseling are actually the fault of the creditors and beyond the control of the CCA. CCAs and creditors must work together, employing the latest business methods and technological innovations to help the industry exceed consumer expectations.
2. Modernization of Traditional CCAs. CCAs must become consumer focused and operate like true businesses. Competition for consumers among for-profit and non-profit CCAs would provide consumers choice and the industry with incentives to provide consumer focused—not creditor driven—consumer credit counseling.
3. Competition Between "Non-Profit" and Market-Based CCAs. Injecting competition would benefit consumers. Without a creditor subsidy, consumers must forgo counseling or pay reasonable fees. Without competition from market based companies, consumers will be left on their own to negotiate against some of the largest credit card companies and banks in the world.
4. Fair Federal Regulation. The federal government must establish national regulation that preempts the confusing 50-state patchwork status quo would benefit consumers. Practical, consistent federal regulation of CCA would benefit consumers, creditors and counselors.

[Additional attachments are being retained in the Committee files].

Statement of Dewey T. Matherly, Consumer Credit Counseling Service, Inc., Gastonia, North Carolina

Our position on the state of the credit counseling industry is some of the companies have hurt the accredited agencies by practicing services that are not for the good of the client, such as charging outrageous fees and soliciting clients by phone. Our clients are now questioning our practices because of the unscrupulous agencies and we have always been above board and offered budgeting classes and other services that help our clients even if we do not sign them up for debt management. Our revenues continue to decrease because creditors have not been able to distinguish between reputable companies and companies out to make a quick dollar and not provide their clients with all the services they need. Our agency feels that all agencies should have the same regulations and be held to the same standard. We are a part of a committee that is trying to establish a way to regulate the credit counseling industry in our state.

Statement of Jane E. McNamara, GreenPath Debt Solutions, Farmington Hills, Michigan

GreenPath Debt Solutions, a non-profit consumer credit counseling organization headquartered in Farmington Hills, Michigan, appreciates the opportunity to submit this statement. GreenPath applauds the recent actions of the IRS and FTC and of Chairman Houghton and this Subcommittee to combat abuses by so-called credit counseling organizations that misuse their non-profit status, offer consumers bad advice, and engage in unconscionable and deceptive trade practices. We at GreenPath are your allies in this effort.

GreenPath operates 38 full-time branch offices in Michigan, New York, Wisconsin, Illinois, and Arizona and is authorized to conduct business throughout most of the United States. Since its establishment in 1961, GreenPath has sent nearly $1.2 billion to creditors on behalf of more than 200,000 debt management clients. We are accredited by the Council on Accreditation and are members of the National Foundation for Credit Counseling (the "NFCC") and the Better Business Bureau. GreenPath is also a HUD-approved Housing Counseling Agency.

The credit counseling industry is, quite frankly, at a turning point. Now is the time to comprehensively and aggressively address the unconscionable trade practices of phone-based debt prorating companies masquerading as credit counselors, including abuse of their non-profit status. Failure to act could result in an industry dominated by entities more interested in their own well-being than the well-being of vulnerable individuals who turn to credit counseling to avoid financial ruin.

GreenPath, like all members of the NFCC, adheres to rigorous certification and accreditation standards that require us to live up to our nonprofit status and to serve consumers professionally and with compassion. For example, GreenPath offers free and low cost education and counseling services to help consumers learn better money and credit management skills. We work with other local

support services, such as family counselors, crisis lines, and legal aid, to help our clients with other underlying issues that may affect their finances.

Most importantly, only consumers who can benefit from intervention with creditors are recommended for formal debt repayment plans, and those plans cover both secured and unsecured debt and include concessions like reduced monthly payments, waived late fees, and lowered interest rates. GreenPath is governed by a local and independent Board of Directors, which helps ensure that our practices are fair, consumer-focused, and untainted by improper relationships and shell transactions that enrich executives and inure to the benefit of for-profit companies.

This has been, and continues to be, the holistic approach to debt management that GreenPath offers consumers who contact its offices.

Unfortunately, as Mr. Boisclair indicated in his testimony on behalf of the NFCC, there has been recently a disturbing proliferation of unsavory entities calling themselves credit counselors, that are in fact single-focus, debt prorating companies. These entities are not governed by local and independent Boards. Instead of a holistic approach to counseling, these organizations focus only on the revenue generating aspect of our business: debt repayment plans. They relentlessly advertise quick fixes, promise no or low fees, and use the not-for-profit designation to attract or entice unsuspecting consumers.

What they really offer is a brief, quick-fix telephone question and answer session that is touted as a cure for a consumer's ailing fiscal health. Many consumers are talked into a debt repayment plan loaded with high fees, and those plans cover only credit card and unsecured debt, because creditors do not typically pay compensation for payments on auto loans, mortgages, utilities, and other secured debt. The more people these agencies sign up on debt plans, the more money they make. In some cases, basic budget counseling is all consumers need to solve their problems, but that advice is not offered.

GreenPath strongly believes that credit counseling organizations must provide real counseling in order to educate consumers and enhance their financial management skills. A recent study by Georgetown University found that consumers who received credit counseling, but *did not* enroll in a debt management program, significantly improved their credit score and payment behavior over the next three years (relative to consumers who had similar credit risk profiles but did not receive counseling). Counseled consumers:

- Were 38 percent less likely to suffer an account charge-off or file for bankruptcy;
- Averaged 11 fewer delinquencies in the last year of the observation period;
- Increased credit scores by an average of 36 points more than the comparison group; and
- Lowered non-mortgage debt by an average of $14,400 more than the comparison group.

At GreenPath, all our clients receive 60 to 90 minutes of credit counseling by accredited, college educated individuals, including a

personal budget and action plan, regardless of whether they enroll in a debt management program. In fact, unless GreenPath concludes it is a viable alternative, a consumer is not even offered a debt management program. We understand that counseling is all that is needed by some consumers and that others lack the income to make a debt management program workable.

For those individuals whose financial situation dictates a debt management program, GreenPath negotiates with all creditors and includes all types of debt on the management program. Unlike single-focus, debt prorating companies, we assist our clients with all their debts to help them avoid foreclosure on their homes, repossession of their cars, and shutoff of their utilities. We do this even though we receive no additional fee from the consumer and creditors do not provide any financial incentives for handling secured debt. GreenPath paid 11,318 creditors in 2002, and only 1,694 of those creditors contributed funding.

Moreover, unlike national single-focus, debt prorating companies whose toll-free number is the only point of debtor contact, GreenPath provides face-to-face credit counseling service in its local communities. The availability of in-person counseling can be critical. At GreenPath, we have found that the success rate for consumers counseled face-to-face is about 35% higher than for those counseled over the phone.

We are active members of our communities in other ways too. Over the past 12 months, GreenPath counselors have conducted 473 free community education presentations for 4,862 attendees in schools, businesses, churches, and other community organizations. Our local offices have relationships with neighborhood credit unions and banks that enable them to pass on greater benefits to our clients.

Unfortunately, to a debtor in financial straights, all non-profit credit counselors look and sound alike. So by staying true to our values, which include free financial consultations, community involvement, and fully-staffed branch offices, GreenPath is at a severe competitive disadvantage with respect to companies that are little more than debt management program mills staffed by people who provide little or no true counseling. Obviously, our cost structure is much higher than that of a call center, and true credit counselors like GreenPath cannot spend enough on advertising to compete with these operations. It is the consumer who suffers.

GreenPath welcomes government intervention to rid the industry of entities that misuse their nonprofit status to attract customers and charge high fees. Indeed, GreenPath has already aggressively lobbied on a state level toward the same goal. In New York, where GreenPath has been licensed since 1995, we successfully worked with the state legislature and executive branch to close a licensing law loophole which allowed out-of-state credit counselors that did not have a physical presence in New York, including those targeted by the FTC and IRS, to do business without a license. Unlike licensed credit counselors, the State Banking Department had no jurisdiction over the out-of-state entity's business and could not impose disclosure requirements, regulate fees, or monitor the process by which payments are actually made to creditors.

The 2002 law strengthened the Banking Department's ability to protect consumers by giving it jurisdiction over any entity that solicits budget planning business in New York and enters into a budget planning agreement with a New York resident, regardless of its physical location.

The new law also provides the Banking Superintendent with the authority necessary to appropriately oversee all budget planners who do business with New Yorkers. Included among the important enforcement and regulatory tools are requirements that:

- licensees post a bond or deposit of at least $250,000;
- licensees annually submit an independently audited financial statement;
- licensees promptly notify the superintendent of new officers and directors and provide such other information that she may require;
- a budget planner license may be revoked based on a criminal conviction involving moral turpitude or fraud or a civil action involving fraud, misrepresentation or deceit;
- contracts between a planner and debtor must contain certain consumer protection provisions;
- prohibit deceptive advertising and the commingling of monies received from debtors; and
- the superintendent may direct a licensee to adjust unreasonable fees.

Mandated measures such as these, fairly applied to all businesses that hold themselves out to the public as credit counselors, are the best way to rid the industry of those who would exploit vulnerable debtors. Similar enforcement and regulatory tools may serve as a model for the entire country.

GreenPath is dedicated to helping people resolve financial problems and promotes the wise use of credit through counseling and education. Our mission statement says it all: "*Through financial knowledge and expertise, we enable people to enjoy a better quality of life.* "

Like the NFCC, we look forward to working with Congress, federal and state regulators, consumer advocates, creditors and others to help shape a national dialogue that will establish policies and guidelines to protect consumers from predatory debt service providers and that will sustain the long-standing, reputable credit counseling agencies in our industry. Thank you for this opportunity to present our views.

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