National Conference of Commissioners on Uniform State Laws

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December 16, 2002

Commissioner William C. Hillman
United States Bankruptcy Court
Room 1101, 10 Causeway Street
Boston, MA 02222

Re: Report to Study Committee on Consumer Debt Counseling

Dear Commissioner Hillman:

As we discussed, I have undertaken to serve as unofficial reporter for the Study Committee on Consumer Debt Counseling, and this letter contains my report. I hope that you and the members of the committee find it helpful in deciding whether to recommend to the Committee on Scope and Program that the Conference undertake a drafting project. It would be most helpful if the committee could make a recommendation in time for it to be considered at the 2003 Mid-Year Meeting on January 10.

1. Introduction.

The term "consumer credit counseling" (I use this term rather than "consumer debt counseling" because it seems to be more common in practice) refers to the services provided by consumer credit counselors – primarily, help with planning budgets and managing debts. There are basically three types of consumers who contact counselors: Those who need advice on budgeting but are not seriously at risk of defaulting on their obligations, those who are sufficiently at risk of defaulting that they would be helped by entering into a debt management plan (DMP), and those whose problems are so profound that they should be referred elsewhere (*e.g.*, bankruptcy court, a suicide prevention service).

The DMP, which is at the heart of the credit-counseling process, is a quasi-Chapter 13 plan. Before determining whether a DMP is appropriate, a competent counselor will obtain detailed financial information from the consumer, help the consumer prepare a realistic monthly budget, and give practical advice on ways to avoid excess spending. If the consumer is an appropriate candidate, the counselor will prepare a DMP that includes all unsecured debt and will ask the creditors to make interest-rate concessions. The goal is to place the consumer in a plan that he or she has a realistic chance of successfully completing. The consumer will be required to make a single monthly payment to the counselor's agency, and the agency will forward the appropriate amount to each creditor.

Even at its best, a DMP may not be as advantageous economically as a Chapter 13 bankruptcy plan. Like a Chapter 13 plan, a DMP establishes a repayment scheme that is funded by future earnings, and the trustee's role in a Chapter 13 plan is similar to the role of the counselor's agency when it comes to administering the plan (*i.e.*, collecting and disbursing funds). However, there are many dissimilarities. A DMP requires the voluntary cooperation of the creditors and typically requires repayment of 100% of the debt; a Chapter 13 plan does not require creditor cooperation and unsecured debts can be reduced as long as the debtor is devoting all projected disposable income to the plan. A Chapter 13 plan is ordinarily completed in three years, although the court can approve an extension of up to two more years for cause; a typical DMP lasts more than four years. Finally, there is no automatic stay with a DMP and no process for obtaining a legally enforceable discharge. Despite any economic disadvantages, a consumer who successfully completes a DMP avoids the stigma of bankruptcy and gains whatever intangible benefits come with working one's way out of debt.

2. The Consumer Credit Counseling Industry.

Today, consumer credit counseling services are generally carried out by nonprofit organizations, many of which are affiliated with one of two dominant trade associations. The National Foundation for Consumer Credit (NFCC), the older and larger of the two, grants its "Member NFCC" seal to affiliated agencies – typically operating under the name Consumer Credit Counseling Service, which is owned by NFCC – that adhere to its accreditation standards. It currently has about 150 affiliates, and they operate about 1,300 community-based agency offices across the country. These offices assist roughly 1.5 million households annually. In 2001, about $2.5 billion was returned to creditors through NFCC's affiliated agencies (estimates of the return for the consumer credit counseling industry as a whole are in the range of $8 billion). The other trade association, the Association of Independent Consumer Credit Counseling Agencies (AICCCA), is newer and has a smaller number of affiliated agencies, but its affiliates provide counseling services to over 1 million consumers annually. The AICCCA has also adopted a set of standards for its member agencies. I have attached copies of the NFCC and AICCCA standards because they may provide insights regarding the kinds of issues that a uniform state act should address.

Anecdotal information indicates that the NFCC agencies tend to act more slowly and deliberately than other agencies, to more often meet face-to-face with consumers, and in some ways to act more like social service agencies than businesses. The newer companies tend to use mass-market advertising to reach consumers and to more commonly communicate with them by telephone or via the Internet. I have not, however, seen any information indicating that the clients of NFCC's affiliated agencies have a higher success rate in completing DMPs. According to Consumer Reports, a confidential member-activity report prepared by NFCC indicated that of 273,473 debt-workout cases closed by its affiliated agencies in 1999, only 21% of the clients successfully completed their DMP.

At an earlier time, consumer credit counseling agencies were funded primarily through creditor contributions – referred to as each creditor's "fair share" – of around 15% of the revenues returned. More recently, however, average creditor contributions have fallen below 10%. As a consequence, more agencies are charging consumers a fee for their services. Moreover, creditors today are apparently less willing than before to make concessions in order to facilitate DMPs. Anecdotally, it appears that this may be because higher levels of consumer debt and aggressive advertising campaigns have brought about a rapid increase in the number of consumers seeking help, many of whom enter into DMPs even though they are not serious default risks. Why should a creditor make a concession if it may be paid in full anyway?

The influx of consumers will only accelerate if the proposed Bankruptcy Abuse Prevention and Consumer Protection Act is adopted. Section 106(a) of the Act (a copy of the relevant provisions of the Act is attached) requires, with certain exceptions, that " an individual may not be a debtor under this title unless that individual has, during the 180-day period preceding the date of filing of the petition of that individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted that individual in performing a related budget analysis." (An earlier version of the Act required that a debtor make a good-faith attempt to comply with a DMP created through an approved consumer credit counselor but this was dropped, apparently out of concern that the industry could not handle the demand.) Section 106(e)(1(c)(2) of the Act, which deals with trustee or administrator approval of credit counseling agencies, provides as follows:

> To be approved by the United States trustee or bankruptcy administrator, a credit counseling agency shall, at a minimum,
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> (A) be a nonprofit budget and credit counseling agency, the majority of the board of directors of which--
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> (i) are not employed by the agency; and
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> (ii) will not directly or indirectly benefit financially from the outcome of a credit counseling session;
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> (B) if a fee is charged for counseling services, charge a reasonable fee, and provide services without regard to ability to pay the fee;
>
> (C) provide for safekeeping and payment of client funds, including an annual audit of the trust accounts and appropriate employee bonding;

(D) provide full disclosures to clients, including funding sources, counselor qualifications, possible impact on credit reports, and any costs of such program that will be paid by the debtor and how such costs will be paid;

(E) provide adequate counseling with respect to client credit problems that includes an analysis of their current situation, what brought them to that financial status, and how they can develop a plan to handle the problem without incurring negative amortization of their debts;

(F) provide trained counselors who receive no commissions or bonuses based on the counseling session outcome, and who have adequate experience, and have been adequately trained to provide counseling services to individuals in financial difficulty, including the matters described in subparagraph (E);

(G) demonstrate adequate experience and background in providing credit counseling; and

(H) have adequate financial resources to provide continuing support services for budgeting plans over the life of any repayment plan.

Although by no means complete, these standards illustrate some of the issues that would have to be dealt with in a uniform state act.

3. Areas of Abuse.

Anecdotal information indicates that there are three basic types of credit counseling agencies: Those that do a decent amount of fair, relatively high quality, counseling; those that take and disburse money honestly but don't really provide good advice; and those that are dishonest. The problem with the second category – honest agencies that don't give good advice – is that consumers can easily make decisions that are not in their best interests. For example, a consumer whose real goal is to protect a house or car might pay so much to unsecured creditors under a DMP that he or she falls so far behind in making house or car payments that a Chapter 13 bankruptcy is no longer viable. Another common problem arises when a counselor carelessly advises a consumer to stop paying bills to consumers and start making a monthly payment to the agency before the creditors have agreed to the plan. Unlike bankruptcy, seeking help from a counselor does not invoke an automatic stay, and when the payments don't come in the creditors turn to their normal collection practices. Yet another problem may arise because the typical agency only makes disbursements once a month. Unless carefully told of the consequences, a consumer may not realize the importance of rearranging the due dates with creditors, and this can result in the incursion of late fees that could easily have been avoided. Finally, the fact that creditors pay agencies a percentage of returned revenues creates an inherent conflict of interest, and even honest counselors may tend to place consumers in plans that have little realistic chance of success when bankruptcy would have been a better alternative.

Anecdotes regarding dishonest practices are numerous, and appalling. Some agencies, although themselves nonprofit, generate revenues for their principals by steering consumers to affiliated for-profit companies that make high-interest debt consolidation or home equity loans. Other agencies charge fees that are so steep that they almost guarantee that the plan will fail, and they pay out the money collected from this practice in the form of lavish salaries. Still other agencies buy lists of debt-laden consumers from mortgage and other financial companies and then use high-pressure sales tactics to get them to sign up. At the bottom of the barrel are the agencies that fail to actually disburse the monthly payments that they receive from consumers.

4. Issues that Might be Addressed in a Uniform Act.

There are numerous issues that might be addressed in a uniform act regulating the consumer credit counseling industry. Among them (in no particular order):

1) Whether to prohibit for-profit agencies from engaging in counseling. Such a prohibition is fairly common today, and only nonprofit agencies are eligible for approval under the proposed bankruptcy legislation. Nevertheless, the distinction between for-profits and nonprofits may not be tenable. As indicated above, many nonprofits serve as vehicles to funnel money to their principals, either in the form of salaries or by steering consumers to affiliated for-profit loan companies.

2) Whether to address the extent to which insiders are permitted to profit, directly or indirectly, from the operation of the agency, and whether to limit the number of directors who can have ties with the credit industry.

3) Whether to exclude from coverage certain persons that might provide similar services, such as a regulated lending institution or a practicing attorney.

4) Whether to draft licensing requirements for agencies and/or individual counselors or authorize an appropriate state agency to do so. Among the issues in this area is whether to require that counselors be bonded and, if so, whether to establish an amount. A common criticism of today's regulation is that too many states' bond levels were set years ago and are unrealistically low in relation to today's risks. Other issues include whether to require regular audits, either by certified public accountants or by a state agency, whether to require that background information be provided on each of the principals, and whether to require regular on-site inspections.

5) Whether to require that certain information be disclosed to consumers. For example, NFCC affiliated agencies, with the informal approval of the Federal Trade Commission, have a policy of disclosing to consumers that they have an inherent conflict of interest. For another example, disclosure of each element of a fee, with the projected total over the life of the plan, might be an appropriate requirement. Consideration might also be given to requiring that certain information about bankruptcy be provided to consumers.

6) Whether to attempt to identify dishonest or otherwise inappropriate practices and either ban or regulate them. This might be accomplished on a practice-by-practice basis or by adopting general standards of conduct. Thought must be given to whether to create a statutory cause of action for an injured consumer or to leave enforcement up to the attorney general or an appropriate state agency.

7) Whether to resolve the jurisdictional problems that arise when a consumer in one state deals with an agency in another state. For example, the act might require that an out-of-state agency that enters into a contract with a resident consumer obtain a license from the state, appoint the secretary of state as agent for service of process, or otherwise submit to regulation by the state.

8) Whether to impose privacy requirements on agencies that receive sensitive financial information from consumers.

I have attached to this report a survey that gives some information about existing state legislation. I have also attached a copy of an act adopted in Maine in 2000. The Maine act is more comprehensive than most and might provide an appropriate starting point for a drafting committee.

5. Potentially Interested Parties.

Although I have not had any direct contact with the leadership of either NFCC or AICCCA, your earlier draft report indicates that both associations would strongly support efforts to draft and enact a uniform law. Of course, consumer groups will have an interest in any project that we undertake, and the July 18, 2002 letter from Jonathan Sheldon of the National Consumer Law Center is not encouraging. Nevertheless, I have discussed the project at length with Commissioner Michael Ferry of Missouri, who operates Gateway Legal Services in St. Louis, and it is his opinion, after appropriate consultation, that we may not have as much opposition from consumer groups as the Sheldon letter indicates. There are, of course, no guarantees in this regard.

In addition to the consumer and industry groups, any drafting committee that is formed should take immediate steps to identify other interested parties. For example, it would be helpful to have an observer from an attorney general's office that has experience dealing with some of the problems arising out of consumer credit counseling, and an observer from the Maine Office of Consumer Credit Regulation, which administers the new Maine act, would provide a useful perspective. In addition, the major credit card companies will have an interest in the act and should be invited to participate in the process. No doubt other interested persons will emerge if the project proceeds.

6. Analysis Pursuant to Conference Criteria.

In January, 2001, the Conference adopted a Statement of Policy Establishing Criteria and Procedures for Designation and Consideration of Acts (*see* pp. 115-119 of the 2001-2002 Reference Book). I request that each member of the study committee read the Statement and consider the appropriateness of a drafting project in light of both the positive and negative criteria set forth therein. It would be helpful to the members of the Committee on Scope and Program if your final recommendation summarized the views of the study committee members with regard to the criteria.

Again, I hope you and the committee find this report helpful. I wish you the very best in this holiday season.

Warmest Regards,

Bill

William H. Henning
Executive Director

cc: Members, Study Committee on Consumer Debt Counseling