IS CREDIT COUNSELING CHARITABLE???

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At the very time that the value of credit counseling is rapidly deteriorating, the number of people seeking such counseling and the dollars they pay for it are increasing at an equally rapid rate.

The value that people receive from credit counseling falls into four areas:

Diagnosis: When consumers are overwhelmed with debt problems they often turn to a credit counselor to advise them if they need bankruptcy, if they simply need some advice or whether they need the main product the industry has to sell, a debt management plan pursuant to which the client makes payment to the agency each month and the agency doles about the payments to each of the customer's unsecured creditors until they are paid in full.

Concessions: In order to induce consumers to enter into a DMP many creditors have historically provided interest rate and other concessions to DMP participants that they do not provide to consumer debtors with the same profile who are not enrolled in a DMP. For example a typical credit counseling customer with five credit card debts totalling $10,000 might have been provided with interest rate reductions with a value of hundreds or even thousands of dollars if she remains in the program until all of the debt is paid. Recently the value and frequency of these concessions have been significantly reduced.

Collective Payments and Negotiations: When a consumer owes money to multiple creditors she is often overwhelmed by the need to deal separately with each of those creditors. Credit counseling acts as a middleman between the consumer and each of her unsecured creditors and takes some of the complexity out of the equation.

Education and Counseling: Some people who are overwhelmed by debt may benefit from budget and credit education which may be provided to those who need advice only and to those who enter a debt management plan. It is possible that participants in a DMP may be more successful in pursuing that plan if they receive useful education and counseling at the time of the sessions and periodically thereafter.

Approximately five million Americans suffering the agony of financial distress sought services from the credit counseling industry in 2001. One and a half million, the same number that filed bankruptcy petitions that year purchased the primary product the industry has for sale, the debt management plan. Over the past five years the number of people visiting a credit counseling agency has increased by over one hundred percent. The number of customers who purchase a DMP has increased over two hundred percent. This increase is due in part to the explosion in consumer debt and the increased debt load of the average consumer; part of the rest of the increase is attributable to the fact that the industry has made itself more accessible by switching from hour long face to face appointments available weekdays from 9 to 5 to telephone and internet appointments anytime that are much more brief. Prospective bankruptcy legislation would pour another one and a half million people into the credit counseling system by requiring a note for the agency before people may obtain entrance into the bankruptcy arena.

At the very moment that fallout from a sinking economy sends more people to credit counseling, the industry is sinking into an abyss and drowning with it those clients who have financial problems.

Five years ago the bulk of the cost of the service was paid by the clients' creditors; now the bulk of the cost is being borne directly by the client and the average direct cost paid by the customer for a three year DMP is well over $1,000.

Five years ago the 25% of the customers who did not need a DMP but needed some help to get out of financial distress received an hour or so of budget advice for which they paid nothing. Now 80% of the clients visit an agency that provides no such service and the other 20% must pay a fee for that advice and counseling.

Five years ago many creditors provided financially valuable concessions to DMP participants such as reductions in interest and penalty rates and accepted lower installments without extra charges. Now, the value and extent of these concessions have been significantly reduced.

Five years ago the average counseling session lasted about an hour and included extensive budget counseling and education; now the average counseling session lasts fifteen minutes. Five years ago the providers of 80% of the services were organizations committed to financial education; now 80% is provided by a series of new entrants who make no claim to provide education.

Five years ago the system diagnosed its clients and put into DMPs only those clients who would benefit from a DMP. Now, the providers that serve 80% of the clients put nearly everyone into a DMP because it generates the maximum revenue for the provider.

And yet they beat a path to the door, because they are so desperate, because they are not ready for bankruptcy and because they find the advertising enticing.

To understand and evaluate all of this it is necessary to know a bit of the unique history of this industry.

The industry was created in the 1970's by unsecured creditors with two contradictory motives. Their humanitarian motive was to improve the lives of consumer debtors by providing free budgeting advice to those who were in financial trouble but needed only advice to escape debt overload and by inventing the DMP to meet the needs of those customers who were closer to bankruptcy and needed months of regular payment to get out of trouble. Both sets of customers were to receive budgeting advice, education and counseling. The industry was also to provide extrinsic financial education by sending representatives to schools and to unions and service clubs to speak.

The creditors' profit driven motive sought to stem the tide of defaults, bankruptcy and write offs so that their businesses would be more profitable, to create a collective collection agency that would appear to be client centered.

Creditors created the industry to deal collectively with the multiplicity of creditors whose very multiplicity was drowning the consumer. To entice over-extended borrowers into this system many creditors provided concessions in interest and penalties and installments better than they would provide to a consumer with the same profile who was not in a DMP program.

To fund the industry many creditors agreed to pay back to each agency fifteen percent of what the creditor received from that agency on behalf of the clients, much as the creditors did by contract with more traditional collection agencies. Many of the new entrants became part of the CCCS family and were members of the NFCC which owned the trademark and name and enforced geographical and other restrictions.

Some CCCS family members were independent organizations and others were adjuncts to United-Way-funded Family and Children Service Agencies. Some were small and some large. Because the industry was created by creditors some of the agencies viewed the creditor as their primary focus and looked down upon the debtor. In fact, the CCCS family fit in four categories: competent and client centered; competent and creditor centered; incompetent and client centered; and incompetent and creditor centered.

The board of the NFCC was initially a mix of creditors and agencies; the chairmanship rotated between these two groups, but the real power in the early years was in the hands of the creditors. The credit counseling industry was launched as an adjunct of the credit granting industry that would provide help to those customers who got in over their heads and would provide education to them and to the community in general, and would reduce defaults and bankruptcies. By use of voluntary contributions and by their involvement in the governance of the NFCC the creditors kept a great deal of control but had created a vehicle that had a number of elements of independence and a façade of independence.

In the 1990's competitors of the CCCS family of agencies challenged the NFCC structure by bringing an anti trust action against the CCCS entities, the major creditors and the NFCC. A settlement was reached which required a new configuration for the NFCC in which non NFCC members were allowed on the board, creditor control was reduced and the playing field in the industry was leveled. More recently a group of larger agencies within the NFCC family advocated for and won a structure in which creditors played a much decreased role. Most recently the organization changed its name to National Foundation for Credit Counseling and responded to member criticism by transferring more power from creditors to service providers.

Consumer groups have always been very critical of the industry for a number of reasons including the unwillingness to advise clients that bankruptcy might be their best choice and the failure to divulge the role of creditors. In response to this criticism the FTC issued an order requiring clearer disclosure.

As the glut of credit card debt led to increased defaults, the number of people visiting the agencies sky rocketed. The competent agencies began to see an excess of revenue over expense. This was dealt with in a variety of ways. Some paid very high salaries to their executives, some set up educational foundations; some provided for expansion and some improved the quality of their educational programming.

In the mid 1990's CCCS agencies and others realized that the face to face long interview excluded many people from the debt counseling market and began to experiment with telephone and internet counseling sessions.

The increase in customers and the opportunity for "profit" brought a series of changes that have devastated the industry.

New players such as Genus entered the field, switched to telephone, lowered costs, and kept interviews short. It has been alleged that Genus found innovative ways to siphon money out of the non profit to related for profits. Next came Ameridebt and Cambridge and others who have been alleged to charge high fees but offer little in the way of education. It is said that in 2001 the top five players spent many millions of dollars on very effective advertising. They have taken the lion's share of the new customers.

These new entries made little effort at careful diagnosis and put nearly everyone into a DMP since that was the revenue generating product. This caused distress among the creditors, particularly those that had been granting concessions, since they believed that many of the people that the new entries attracted with their advertising were among their better customers. They did not want to pay fair share to the referral agency and they did not want to provide concessions for the customer who they felt had been inappropriately put into a DMP.

At this same time changes were occurring within the credit card industry as it exploded in growth and began to lend larger amounts to historic customers and began to lend to customers who previously had been denied credit. All of this was accompanied by an extraordinary concentration and oligopolization. The top fifteen credit card lenders had less that fifty percent of the market in 1990; by 2001 the top five had seventy percent of that much larger market. The combination of increased lending, concentration, increased defaults and rapid entry into the credit counseling market of new players led creditors to examine fair share more carefully. The fair share was a significant expense item and presented an opportunity for cuts with short term impunity; they saw fair share as too rich since there were so many entries. They took a meat ax approach and began cutting fair share and increasing eligibility requirements for DMP and reduced or eliminated concessions.

The traditional CCCS agencies were hard hit by these changes. The reduction in concessions made the DMP less valuable to all clients and tipped the scales to make bankruptcy a better option than a DMP for some customers. Those that had charged no fees to the client began to charge them and those that already had fees increased them. The newer entries increased their charges extraordinarily and increased their advertising as well. Market share among the agencies was transformed as the CCCS entities went from 80% of the market to 20% of the market over five years. There have been mergers among CCCS agencies and there has been greater efficiency. In some cases efficiency has become a code word for the elimination of education and counseling. All providers have looked for ways to keep people in DMP's longer. The larger players in the market, CCCS and non-CCCS have entered into agreements with the largest credit granters by which creditor proves direct referrals of customers to the agency. In return the agency charges a lower fair share amount on that account.

More recently some creditors have become aware that their meat ax approach causes them problems and have begun to do more fine tuning. They have begun to pay a sliding scale to agencies depending on various criteria including the following:

- Efficiency in providing dollars and information.
- Efficiency in putting into DMP's only those that the creditor thinks belongs there.
- Telephone, internet or face to face interview.
- Preclusion of those who siphon off the money but to them it may not be a killer because the fees are so high.

Various states, including Maine, California and Maryland have recently turned their attention to the industry in an effort to provide more effective regulation. In 2002 the National Conference of Commissioners on Uniform State Law began a project for a model statute governing the industry. Hon. William Hillman is the chair and Michael Greenfield a dean among the consumer protection faculty is the Reporter.

For a number of reasons nearly all players in the industry are organized as non profit corporations and seek and obtain an exemption from Federal taxes pursuant to section 501(c)(3) of the Internal Revenue Code. After years of ignoring various kinds of abuses by companies such as Genus and the like and Cambridge and perhaps and allegedly Ameridebt, the Internal Revenue Service issued a directive to watch the industry more closely and the American Bar Association Tax Section is preparing a program on the abuses of 501(c)(3) in the credit counseling industry. Among the abuses that may be occurring are siphoning off the excess of revenue over expenses through use of affiliated for profit service providers and charging very high rates and not providing any diagnostic or educational services to clients.

Recently the Consumer Federation of American and the National Consumer Law Center issued an extensive and insightful evaluation and report regarding the industry. Their recommendations provide a blueprint for state and local government, for the IRS, for the credit counseling industry and for the financial institution industry.

1. The Internal Revenue Service should aggressively enforce existing standards for non-profit credit counseling organizations. The I.R.S. should also use its power to impose "intermediate sanctions" on agencies that pay unreasonable or excessive compensation to individuals associated with the agencies.

2. Congress and the states should enact laws that would directly address abuses by credit counseling agencies. Among other provisions, the law should:

    - Prohibit false or misleading advertising and referral fees.
    - Require credit counseling agencies to better inform consumers about fees, the sources of agency funding, the unsuitability of DMPs for many consumers, and other options that consumers should consider, such as bankruptcy.
    - Prohibit agencies from receiving a fee for service from consumers until all creditors have approved a DMP.

- Give consumers three days to cancel an agreement with a credit counseling agency without obligation.
- Cap fees charged by agencies at $50 for enrollment or set-up. Allow only reasonable monthly charges.
- Require agencies to prominently disclose all financial arrangements with lenders or financial service providers.
- Provide consumers with the right to enforce the law in court.

3. Credit counseling trade associations should set strong, public "best practice standards" and provide for vigorous, independent enforcement of these standards. They should also require that all of their members disclose the "retention" rates of consumers who enter debt consolidation programs. Trade associations and individual agencies should work to diversify agency funding and decrease agency reliance on creditor funding. This will improve the financial stability of these agencies and decrease the potential conflicts-of-interest that currently exist.

4. Creditors should increase financial support to credit counseling agencies, especially to improve credit counseling options for consumers who are unlikely to benefit from DMPs. Creditors should also reverse the trend toward reducing the concessions they offer to consumers who enter DMPs, and immediately stop funding and doing business with agencies that charge high fees, function as virtual for-profit organizations and employ deceptive or misleading marketing practices.

More recently the Permanent Investigation Sub Committee of the United States Senate Committee on Government Relations decided to initiate hearings into the state of the credit card industry. Their concerns are heightened by the fact that the pending bankruptcy legislation requires that potential bankruptcy debtors visit a credit counseling agency before they are authorized to file for bankruptcy.