Montana State Legislature

Exhibit Number: 1

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BUSINESS & LABOR
EXHIBIT NO. 17
DATE 3/1/05
BILL NO. HB 140

MONTANA LEGISLATION FOR CONSUMER PROTECTION CREDIT COUNSELING AGENCIES

Purpose

The purpose of this legislation is to protect Montana consumers who contract for services with debt management service providers. The legislation is a consumer protection statute.

The Bill is entitled " An act creating a Montana Consumer Debt Management Services Act; requiring licensure of credit counseling services; establishing requirements for debt management plans entered into between consumers and credit counseling services; designating prohibited practices for credit counseling services; and providing remedies and penalties"

The Problem

According to the US Federal Reserve, consumer debt now stands at $2 trillion, of which $750 billion is revolving (credit card) debt. Households with credit cards carry an average debt load of $9,200, compared to $4,300 in 1994. Last year, 1.6 million people filed for bankruptcy, compared to 1.5 million in 2002. These record-high debt levels are resulting in financial disasters for many individuals and families.

Individuals increasingly are turning to credit counseling agencies for financial advice and debt reduction services to help manage their debt. According to a 2002 report released by the National Consumer Law Center and Consumer Federation of America, *(Credit Counseling in Crisis)* nearly nine million people sought the help of credit counseling organizations during the previous year, and at least one million consumers consolidated their debts through credit counseling organizations.

Unfortunately, as more consumers seek financial advice, more are falling prey to aggressive marketing tactics by some unscrupulous and predatory credit counseling organizations. Consumer complaints about deceptive debt counseling practices are on the rise, prompting the Federal Trade Commission and Internal Revenue Service to issue an alert in October 2003, to caution consumers about abusive credit counseling services. Some state attorney generals have also filed actions against several new credit counseling providers.

The National Foundation for Credit Counseling, Inc. ® (NFCC) the nations largest and longest-serving nonprofit credit counseling organizations also advises consumers to use caution when seeking credit counseling services.

<u>Industry Issues & Consumer Impacts</u>

Over the past decade, new organizations have entered the credit counseling field. The estimated number of new credit counseling organizations has increased from approximately 200 in 1990 to over 1,000 last year. Many of the new entrants operate as telemarketing phone centers with centralized, single-focused, debt prorating services, often disguised 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: "we'll fix your debt problems in just minutes," with a 15-minute, one size fits all, quick-fix counseling session touted as a cure for the consumer's ailing fiscal health. Through sometimes misleading and aggressive advertising and marketing tactics, many consumers are lured 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 of these agencies 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.

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. The unscrupulous industry 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 protected trademarks. This behavior is causing unconscionable harm to uninformed consumers who ultimately become the victims of these new players' deceptive and irresponsible practices. After receiving poor service from some of the new entrants, many unsuspecting consumers find themselves digging out from under even worse financial conditions and others are faced with filing for bankruptcy.

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, and reputable credit counseling agencies that provide excellent services and that are true to their nonprofit 501 (c) (3) designations.

It appears that some of these groups have exceeded the original mission and intent of nonprofit credit counseling organizations. Growing consumer complaints have also triggered government lawsuits against several organizations, legislation in 17 states, agency reviews and investigations by the IRS and FTC and hearings by US House Ways & Means Subcommittee on Oversight and the US Senate Permanent Subcommittee on Investigations. The IRS is investigating 50 agencies to review their compliance with IRS requirements for tax exempt credit counseling agencies. The IRS spells out specific guidelines for services and makes clear that <u>no</u> part of a credit counseling agency's net earnings may inure to the benefit of any individual or insider, such as an officer or director. Credit counseling agencies also cannot operate for private purposes.

The FTC is also examining industry practices to ensure agencies are in compliance with the FTC Act that prohibits unfair and deceptive acts or practices, specifically involving allegations of misrepresentations about fees or voluntary contributions; promising results that cannot be delivered; abuse of non-profit status; false advertising regarding credit counseling services; failure to pay creditors in a timely manner or at all; failure to abide by telemarketing laws and failure to provide Gramm-Leach-Bliley ("GLB") Privacy and Safeguards.

During the November 20, 2003, House Ways and Means Subcommittee on Oversight hearing on credit counseling abuses, Indiana Congresswoman Julie Carson stated, "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."

The passage of *H.R 975, Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, could place more consumers in harm's way.* This bill includes a provision that requires individuals to seek credit counseling services before filing for bankruptcy and thereby creates a pool of thousands and potentially millions of new candidates for credit counseling and debt services agencies. Without appropriate guidelines and standards for credit counseling, *H.R. 975* could place consumers in harm's way by steering them to services that increase their debt and push them further into financial crisis, instead of helping them consider all of their financial options for overcoming debt.

The lack of uniform credit counseling standards and lack of federal and state industry regulations make federal and state legislative and regulatory actions vitally important in helping to bring agency operating controls and stronger consumer protections to the credit counseling service sector.

Fast Facts

- Consumer debt climbed to $2,001,830,670,000 by the end of 2003. This is a 5.21% increase from the previous year. This figure includes all consumer debt with the exception of mortgages.
- The amount of consumer debt per household averaged $18,707 in the United States.
- Of the total US consumer debt, approximately $735,000,000,000 is from the use of credit cards. In Montana, this equates to a staggering $2,463,574,748.
- As only 40% of Americans pay their credit card debt in full each month, the 60% who make payments carry an average balance of $12,000. With the current national average rate for interest on credit cards at 13%, this would equate to approximately $335,712,312 sent outside of the state each year by Montanans in interest payments alone.
- Interest rates for high-risk accounts rose to 29.9% in 2001 further strapping those who can least afford to pay. Furthermore, based on minimum payments, it would take as long as 42 years to pay off!

- The Federal Reserve Board estimates that the average household debt service ratio (an estimate of the ratio of all debt payments to disposable income) was 13.14% in the 3rd quarter of 2003. The total financial obligations ratio (a broader measure that includes automobile lease payments, rental payments, home owners insurance, and property tax payments) was an average of 18.32% during the same time in 2003. For homeowners this ratio was 13.91% and for renters this was **31.43%.**
- In 2001, 7 percent of families reported at least one debt payment was overdue. This percentage was higher with low to moderate income families and those under 35 years old.
- According to the Federal Reserve Board, charge off rates by American banks in the fourth quarter of 2003 was 5.89%.
- Delinquency rates for American banks in the fourth quarter of 2003 was 4.49%
- Credit card companies mailed over 5 billion offers to US households in 2001.
- According to Nellie Mae, the average college student owes $3,262 in credit card debt and $17,140 in student loans after they graduate totaling $20,402.
- 84% of college students have at least one credit card an increase of 24% since 1998.

According to a report Retiring in the Red by Demos, a nonprofit organization dedicated to furthering issues regarding democracy reform, economic development, and America's long-range challenges:

- Americas Seniors over the age of 65 increased their credit card debt 89% between 1992 and 2001.
- Seniors between 65 and 69 years old, presumably the most recently retired, increased credit card debt 217% to an average of $5,844.
- Among seniors with incomes under $50,000 (70% of all seniors), about *one in five* families with credit card debt is in hardship – spending over 40% of their income on debt payments, including mortgage debt.
- Transitioners (people ages 55 to 64) experienced a 47% increase in credit card debt between 1992 and 2001, to an average of $4,041.
- Credit card debt of low to moderate transitioner families without health insurance increased 169% as opposed to 37% for similar families with health insurance.

Solution

Enact comprehensive legislation to address credit counseling abuses that have occurred at the state level.

Summary of Proposed Legislation

"An act creating a Montana Consumer Debt Management Services Act; requiring licensure of credit counseling services; establishing requirements for debt management plans entered into between consumers and credit counseling services; designating prohibited practices for credit counseling services; and providing remedies and penalties"