

CONSUMER CONCERNS

Information for Advocates
Representing Older Adults

National Consumer Law Center®

Credit Card Debt and Credit Counseling

An increasing number of older Americans are now “aging into debt.” Older consumers generally get into debt to pay for groceries, prescription drugs, major home repairs, loans to children or grandchildren, and other necessities. Older consumers are experiencing problems not only with mortgage and other types of secured debt, but with credit card debt as well. In fact, credit card debt is the most cited reason for filing bankruptcy among consumers 65 and older.¹ This trend is rapidly growing. In 1991, 2.1% of bankruptcy filers were over 65.² In 2001, this figure more than doubled to 4.5%.³ By 2007, 7% of bankruptcy filers were over 65.⁴

Those with unmanageable credit card debt have a number of options. Many turn to credit counselors for help. When done well, credit counseling can be very helpful for consumers in financial distress. However, if a consumer falls prey to an unscrupulous agency, she is likely to end up even deeper in debt.

The ABCs of Credit Counseling

• Brief History

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.⁵ At first, most of the agencies were non-profit and called themselves the Consumer Credit Counseling Service (CCCS) of the regions they served. The CCCS agencies

1. John Pottow, *The Rise in Elder Bankruptcy Filings and the Failure of U.S. Bankruptcy Law*, 19 *ELDERLY LAW J.* 219, 220 (forthcoming, 2012). Two-thirds of consumers over 65 who file for bankruptcy specifically cite credit card interest and fees as reasons, whereas only half of younger debtors cite credit card debt as a reason for filing for bankruptcy. *Id.* at 226.
2. *Id.* at 221.
3. *Id.*
4. *Id.*
5. For a summary of the credit counseling industry and current problems with the industry, see National Consumer Law Center and Consumer Federation of America, “Credit Counseling in Crisis”, (April 2003), available at: http://www.nclc.org/initiatives/credit_counseling/content/creditcounselingreport.pdf.

were affiliated with the National Foundation for Consumer Credit (NFCC), now called the National Foundation for Credit Counseling. Presently, there are many other types of credit counseling agencies and other trade associations such as the Association of Independent Consumer Credit Counseling Agencies (AICCCA).

The vast majority of credit counseling agencies have been granted tax-exempt status by the Internal Revenue Service (IRS).⁶ Yet not all agencies behave like true non-profits. The IRS has been taking a closer look at this issue and investigating agencies that have non-profit status, but in reality operate like for-profit businesses. Since 2005, the IRS has revoked the non-profit status of hundreds of credit-counseling agencies.

The Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009 requires creditors to establish and maintain toll-free telephone numbers to provide borrowers with information about credit counseling and debt management services.⁷ The toll-free numbers must provide referrals to non-profit credit and budget counseling agencies that are approved by a U.S. bankruptcy trustee.⁸

Credit Counseling Agency Services

• Debt Management Plans

Through debt management plans (DMPs), a consumer sends the credit counseling agency a lump sum, which the agency then distributes to the consumer's creditors. In return, the consumer is supposed to get a break usually in the form of creditor agreements to waive fees and 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. DMPs have become less effective tools over time, particularly since many creditors have increased the interest rates they charge through those plans.⁹

In the past, agencies charged little or no fees to consumers enrolling in DMPs. This was mainly because of a creditor policy known as Fair Share through which creditors voluntarily returned to the agency a set percentage of the funds that were disbursed to them through DMPs. Creditors cut back on Fair Share payments, and in response many agen-

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. The terms "tax-exempt" and "non-profit" organizations or corporations are used interchangeably even though there are some differences between them. For more information, see Internal Revenue Service, "Charities and Non-Profits", and IRS Publication 557, *Tax-Exempt Status for Your Organization*, available at www.irs.ustreas.gov. 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. The terms "tax-exempt" and "non-profit" organizations or corporations are used interchangeably even though there are some differences between them. For more information, see Internal Revenue Service, "Charities and Non-Profits", and IRS Publication 557, *Tax-Exempt Status for Your Organization*, available at www.irs.ustreas.gov.
7. Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009, Pub. L. 111-24, § 201(b)(11)(B)(iv), 123 Stat. 1745 (amending 15 U.S.C. 1637(b)(11)).
8. CARD Act, Pub. L. 111-24, § 201(c), 123 Stat. 1745 (amending 15 U.S.C. 1637). The list of approved agencies is also available on the website of the Executive Office of the U.S. Trustee (EOUST) at http://www.justice.gov/ust/eo/bapcpa/ccde/cc_approved.htm.
9. See generally Consumer Protection and the Credit Crisis, Before U.S. Senate Committee on Commerce, Science, and Transportation (Feb. 26, 2009) (statement of Travis B. Plunkett).

cies began charging consumers higher fees. Some agencies have moved away from the Fair Share model, although many agencies continue to receive significant creditor contributions. Some creditors have switched to a grant format, awarding funding to agencies based on criteria that are not tied to individual DMP accounts. A 2006 revision to the Internal Revenue Code limits the aggregate revenue a non-profit credit counseling agency may receive from creditor payments that are attributable to DMP services.¹⁰ Due to these changes, agencies as of 2010 typically receive less than 10% of their revenues from Fair Share payments.¹¹

Prior to filing for bankruptcy, consumers are required to obtain credit counseling from an approved credit counseling agency no more than six months before filing. The list of approved agencies is available at http://www.justice.gov/ust/eo/bapcpa/ccde/cc_approved.htm. The bankruptcy code states that if a fee is charged for counseling services, agencies must charge a reasonable fee and provide services without regard to ability to pay the fee.¹² Studies to date have found that most agencies typically charge \$50 or less.¹³

• Counseling, Education and Other Services

Because DMPs are the primary, or even sole, source of revenue for most agencies, there is a built-in bias toward enrolling consumers in these plans. However, particularly early on in the development of the industry, most agencies offered services other than DMPs as well. Agencies often used excess revenues from DMPs to fund these other services, including counseling for consumers who were not enrolled in DMPs and consumer education seminars and courses. Despite growing financial problems, many agencies still offer a wide range of services. In fact, agencies should only be granted non-profit status if they provide meaningful educational services and meet other IRS requirements.

The 2006 Pension Reform Bill revised the Internal Revenue Code's tax exemption standards for credit counseling agencies.¹⁴ Tax-exempt credit counseling agencies are now required by law to provide services tailored to the specific needs and circumstances of consumers.¹⁵ Agencies may not charge separately for services meant to improve a consumer's credit record, credit history, or credit rating, and they may only provide such services to the extent that the services are incidental to providing credit counseling services.¹⁶ Moreover, agencies may not extend loans to debtors or negotiate the making of loans on behalf of debtors.¹⁷

Industry Abuses

Common problems associated with many agencies include:

• Lack of face-to-face or individualized contact with consumers.

10. See National Consumer Law Center, Fair Debt Collection § 12.2.3.3 (7th ed. 2011).

11. See 75 Fed. Reg. 48458, 48460 (Aug. 10, 2010); Telemarketing Sales Rules, 16 C.F.R. § 310 (2011).

12. 11 U.S.C. § 111(c)(2)(B).

13. See, e.g., United States Government Accountability Office, Bankruptcy Reform: Value of Credit Counseling Requirement Is Not Clear 28 (Apr. 2007).

14. Pub. L. No. 109-280 (Aug. 17, 2006), *codified at* 26 U.S.C. § 501(q).

15. 26 U.S.C. § 501(q)(1)(A)(i).

16. 26 U.S.C. § 501(q)(1)(A)(iii), (iv).

17. 26 U.S.C. § 501(q)(1)(A)(ii).

- **Nothing but DMPs.** The trend is away from providing a range of services such as consumer education and counseling for non-DMP clients and towards offering DMP-related services only.
- **Aggressive and sometimes deceptive marketing tactics.**
- **Higher costs for services.**
- **Close connections to for-profit businesses.**

Warning Signs: Six Reasons to Reject a Credit Counseling Agency (Tips for Consumers)

1. **High Fees.** Beware high fees! If the agency is vague or reluctant to talk about specific fees, go elsewhere.
2. **“Voluntary” Fees that Aren’t So Voluntary.** Some agencies publicly claim that their fees are voluntary, but don’t pass this information on to consumers. Others will tell you that their fees are voluntary, but will put a lot of pressure on you to pay the full fee, even if you can’t afford it. When you ask about what the agency charges, be sure and ask if they consider the fees to be voluntary.
3. **The Hard Sell.** If the person at the other end of the line is reading from a script and aggressively pushing debt “savings” or the possibility of a future “consolidation” loan, hang up. Also, beware if they try to sell you a debt management plan right away.
4. **Employees Paid by Commission.** Most credit counseling agencies are non-profit organizations that are supposed to consider your best interests when offering you counseling options. Employees that receive commissions for placing consumers in debt management plans are more likely to be focusing on their own wallets than yours.
5. **One Size Fits All.** The agency should talk to you about whether a debt management plan is appropriate for you rather than assume that it is. If the agency doesn’t offer any educational options, such as classes or budget counseling, consider one that does.
6. **Aggressive Ads.** Many agencies that advertise treat consumers fairly. However, some are being investigated or sued for deceptive practices. Many others charge unreasonable fees or offer no real counseling. Avoid choosing an agency based on advertising alone. Get referrals from friends or family, find out which agencies have been subject to complaints and talk to a number of agencies before making a decision.

Possible Legal Claims

There are a number of possible remedies available to challenge problems with credit counseling. The closest statutory scheme at the federal level is the Credit Repair Organizations Act (CROA).¹⁸ The CROA applies only to agencies that offer credit repair services. The definition is broad, encompassing any person who performs or offer to perform any service, for a fee or other valuable consideration, for the express or implied purpose of i) improving any consumer’s credit record, credit history, or credit rating; or ii) providing advice and assistance to any consumer with regard to any activity or service described above.¹⁹ Many credit counseling agencies should fit this definition. However, a critical

18. 15 U.S.C. §§ 1679-1679j. See National Consumer Law Center, Fair Credit Reporting Ch. 15 (7th ed. 2010 & Supp.).

19. 15 U.S.C. § 1679a(3)(A).

problem with the CROA and its state analogues is that it does not apply to 501(c)(3) non-profit organizations.²⁰ Although the vast majority of agencies now charge at least some fees for service, nearly every organization in the industry operates as a non-profit. It may be possible to overcome this hurdle by arguing that a non-profit is a for-profit business in disguise either because it focuses entirely on selling DMPs or because of close connections to for-profit affiliates.²¹ CROA is important in the credit counseling context because it offers powerful remedies that consumers can invoke, including consumer class action lawsuits.²² Any person who fails to comply with CROA is liable to the consumer for either actual damages or the amount the consumer paid to the credit repair organization, whichever is greater, plus punitive damages and attorney fees.²³

In recent years, many states have passed credit counseling licensing or registration laws for agencies providing debt management services. Some of these laws exempt non-profit agencies or other providers that do not charge for services.²⁴ Among the states that do require licensing or registration for debt management service providers, a few states restrict licenses to non-profits, but the trend is to allow both non-profits and for-profits to obtain state licenses.²⁵

The stronger state laws provide regulation beyond licensing and/or regulation. The most common substantive regulations include fee limits, requirements that consumers be given written contracts and that agencies maintain consumer payments in separate trust accounts. In addition, most of the states that require licenses also require agencies to post bonds. With only a few exceptions, most of the states that have licensing requirements also limit the fees that licensed agencies are allowed to charge.

A number of states do not require credit counseling agencies to obtain licenses or registrations. Most of these states generally prohibit debt adjusting (also known as debt management plans, debt consolidation, budget planning or debt prorating), but allow a long list of exceptions. Most important, nearly all of these states exempt non-profit organizations from the general prohibition. Other states that do not require licensing may limit the fees agencies can charge and/or other practices.²⁶ With notable exceptions, these state laws are generally ineffective and/or under-enforced. Some are contained in the state criminal codes. The majority do not specifically provide for private enforcement. Nonetheless, where no specific private remedy is provided, violations should be Unfair and Deceptive Acts and Practices (UDAP) violations.²⁷

20. See 15 U.S.C. §1679a (3)(B)(i); National Consumer Law Center, Fair Credit Reporting Ch. 15 (7th ed. 2010 & Supp.) (discussing state credit repair organization laws).

21. See, e.g., *Zimmerman v. Cambridge Credit Counseling Corp.*, 529 F. Supp. 2d 254 (D. Mass. 2008) (rejecting argument that spurious non-profit credit counseling organization that funneled revenues into related for-profits fell within CROA's exemption), *aff'd* by *Zimmerman v. Puccio*, 613 F.3d 60 (1st Cir. 2010).

22. 15 U.S.C. §1679g(a)(2)(B).

23. 15 U.S.C. §1679g(a).

24. For a complete list of states that require credit counseling agencies to obtain licenses or registrations in order to provide services in those states, see National Consumer Law Center, Fair Debt Collection § 12.2.4.2.1 n. 66 (7th ed. 2011).

25. Examples include Texas and Maine, which eliminated the nonprofit requirement for debt management in 2007. Rhode Island and New Hampshire made similar changes in 2004, Virginia in 2005, and Mississippi in 2006. See *id.* at § 12.2.4.2.1 n. 69

26. *Id.* at § 12.2.4.2.1 n. 70.

27. As with the CROA and state credit repair laws, there may be issues in some states regarding whether the UDAP law applies to non-profit organizations. See National Consumer Law Center, Unfair and Deceptive Acts and Practices § 2.3.5.1 (7th ed. 2008 & Supp.).

In addition to these specific debt management laws, advocates should also consider state credit repair laws and UDAP laws.²⁸ Unauthorized practice of law statutes and regulations²⁹ and state loan broker laws³⁰ may also apply, as well as RICO claims and common law claims such as breach of contract or breach of fiduciary duty.³¹

States have stepped up enforcement against abusive credit counseling entities. The state actions generally raise UDAP claims and in some cases claims based on violations of federal and state telemarketing laws to state debt management laws. The Federal Trade Commission has also challenged credit counseling agencies abuses, often raising claims related to abuse of non-profit status.³² The Federal Trade Commission also has information on its web site about current lawsuits and information for consumers. (See www.ftc.gov).

Advocates should also keep up to date with IRS rulings and investigations with respect to agency non-profit status.³³ Information is generally available on the IRS web site at www.irs.ustreas.gov.³⁴

28. See National Consumer Law Center, Fair Debt Collection § 12.2.4.3 (7th ed. 2011).

29. See National Consumer Law Center, Unfair and Deceptive Acts and Practices § 10.4.2.4 (7th ed. 2008 & Supp.).

30. See *Id.* § 6.2.1.

31. See, e.g., *Baker v. Family Credit Counseling Corp.*, 440 F. Supp. 2d 392 (E.D. Pa. 2006) (plaintiffs successfully alleged RICO claim).

32. See National Consumer Law Center, Fair Debt Collection § 12.2.4.6 (7th ed. 2011).

33. See, e.g. Credit Counseling Compliance Project (May 16, 2006), http://www.irs.gov/pub/irs-tege/cc_report.pdf; Debra Cowen and Debra Kawecki, Credit Counseling Organizations, CPE 2004-1 (January 9, 2003), www.irs.ustreas.gov/pub/irs-tege/eotopica04.pdf.

34. The IRS maintains a list of resources for verifying the non-profit status of credit counseling agencies, including information about enforcement actions against credit counseling agencies for violations of consumer protection laws. See Credit Counseling – Joint Federal Agency Resources, IRS.gov (Nov. 5, 2010) <http://www.irs.gov/charities/article/0,,id=157776,00.html>.



Useful Information and Web Sites

National Consumer Law Center Publications and Articles:

National Consumer Law Center & Consumer Federation of America, "Credit Counseling in Crisis", April 2003, available at http://www.nclc.org/images/pdf/credit_counseling/report_creditcounseling_crisis.pdf.

National Consumer Law Center, Unfair & Deceptive Acts & Practices (7th ed. 2008 & Supp.).

National Consumer Law Center, Fair Debt Collection (7th ed. 2011).

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