FOR IMMEDIATE RELEASE:
December 1, 2003

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LACK OF UNDERSTANDING ABOUT CREDIT COUNSELING LEAVES CONSUMERS OPEN TO FRAUD AND ABUSE

Consumer and Industry Groups Join Forces on Reform Agenda

(WASHINGTON, DC) – A new survey commissioned by Consumer Federation of America (CFA) and InCharge Institute of America® has found that most Americans do not know much about credit counseling. As more Americans have sought assistance for serious debt problems in recent years, some of the nation's largest credit counseling agencies have come under scrutiny by federal and state officials for deceptive practices, improper advice, excessive fees and abuse of non-profit status. An important finding of the survey is that low- and moderate-income Americans – those who tend to pay the highest price for credit and are the most vulnerable to counseling abuses – are the least knowledgeable about credit counseling.

"Despite the fact that consumer demand for counseling and other forms of debt assistance appears to be growing, a strikingly high percentage of Americans say that they know very little or nothing about credit counseling agencies," said CFA Executive Director Stephen Brobeck. "Given the recent problems that we've seen with some players in the industry, this lack of awareness leaves many consumers vulnerable to abuse."

"This lack of consumer knowledge reinforces the continued need for educational outreach to all consumers, especially those who are unaware of an alternative to bankruptcy. Advertising the availability of these services is essential to inform consumers of choices in the market. We are pleased to be assisting CFA in their efforts to alert consumers of some deceptive practices that have become rampant in the industry," said Robert Barrett, president and chief executive of InCharge Institute.

The survey was conducted by the Opinion Research Corporation International from November 13 to November 17, 2003. ORCI interviewed a representative sample of 2,030 adult Americans to learn if they knew a great deal or something about credit counseling agencies. 473 respondents said that they did. 121 of those surveyed said that they or a family member had used the services of an agency.

The survey's margin of error is plus or minus two percentage points. The margin of error for the sample of 473 is plus or minus four percentage points. All of the differences cited are statistically significant at the .05 level.

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Consumer Knowledge of Credit Counseling Agencies is Poor

Most Americans do not know much about credit counseling agencies. Only one in twenty (5 percent) said that they know a "great deal" about these agencies, and less than one quarter (24 percent) said they know a great deal or "something" about these agencies. The proportion of the least affluent (under $25,000 annual income) who said they know a great deal or something about the agencies is even lower, at 18 percent.

"The potential vulnerability of these uninformed consumers to fraud and abuse is a serious concern because credit counseling is the major institutional alternative to bankruptcy," said CFA Legislative Director Travis Plunkett. "It is also a concern because pending legislation in Congress would mandate that consumers receive a credit counseling consultation before they are allowed to file for bankruptcy."

Knowledgeable Consumers Believe Credit Counseling Agencies to be Very Useful

Large majorities of respondents who said they know a great deal or something about the agencies believe that these agencies provide several useful services – helping individuals pay off large credit card debts (86 percent), providing them with useful information about credit and debt management (86 percent), and helping them to learn how to manage their money more effectively (84 percent). Moreover, nearly one-half of these respondents said that they find these services "very useful."

Most of those who had used consumer credit counseling services, or whose family had, found the services useful – 77 percent for paying down consumer debts, 65 percent for increasing knowledge about credit and debt management, and 58 percent for managing money and debts more effectively.

Consumers Also Want Agencies to Provide Counseling as Well as Fixed Payment Plans, to Charge Modest Fees and to Not Be Closely Associated with For Profit Firms

A majority (58%) said that they oppose credit counseling agencies "being closely associated with a for-profit company." And two-thirds said they oppose agencies "offering little or no education and counseling, only fixed payment plans."

Large majorities said that they favor limits on fees the agencies charge and clear disclosure of these fees. 84 percent said they favor requirements (61 percent "strongly") that would limit the fees that the agencies charge consumers. And 93 percent said that they favor (85 percent "strongly") requiring the agencies to clearly inform consumers about all fees.

When asked whether agencies should be "prohibited from keeping the first month's payment from clients as a fee for service" on a fixed payment plan (known as a debt management plan) one-half (50 percent) said they favor such a restriction.

Only 37 percent of those surveyed said they considered a $50 monthly fee to help pay off a large consumer debt over several years to be "reasonable." But three-fifths (60 percent) said

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that they consider a $25 fee to be "reasonable." InCharge Institute stated that the average voluntary contribution it receives is $24, with 18% of their customers paying nothing.

A large majority of consumers (80 percent) believe that lenders should not charge additional interest on the debts of consumers who enter credit counseling; 65 percent felt strongly about this. (Most credit card issuers continue to charge interest rates of 10 to 20 percent in credit counseling. Some don't reduce consumers' existing interest rates at all.)

<u>Public Policy Recommendations</u>

CFA and InCharge Institute also offered a sweeping agenda for reform of the credit counseling industry. Consumer groups have offered more extensive proposals for reform. Industry associations have also made recommendations to improve oversight of the credit counseling industry. This is the first time, however, that a consumer organization and a credit counseling provider have offered joint recommendations. There are many legitimate credit counseling agencies, but abuses in the industry are widespread enough to necessitate significant new public policy measures immediately. New laws and tougher enforcement of existing laws are needed to address the three primary abuses that are occurring in the credit counseling industry:

- Abuse of non-profit status;
- Excessive costs, and
- Deceptive and misleading practices.

1. The ***Internal Revenue Service*** should continue and broaden its examination of non-profit credit counseling organizations and immediately sanction agencies that are abusing their non-profit status. State charity regulators should consider similar investigations of agencies based in their states.

2. ***States and/ or Congress*** should enact meaningful new laws to restrict credit counseling abuses. The laws should be as uniform as possible to enable effective compliance by agencies that operate across state borders. The key areas that these laws should cover are the following:

   - <u>Prohibit false or misleading advertising</u> and fees charged by agencies to financial services providers for referral of consumers.
   - <u>Require credit counseling agencies to better inform consumers</u> about fees, the sources of agency funding, the unsuitability of debt management plans for many consumers, and other options that consumers should consider, such as bankruptcy.
   - Give consumers <u>three days to cancel an initial agreement</u> with an agency without obligation. Allow mutual cancellation rights to either party thereafter, if notice is given.
   - <u>Cap set-up fees</u> charged by agencies to enroll consumers in debt management plans to prevent consumers from being charged a full month's consolidated payment for this purpose. Consumer groups have proposed a cap of $50.

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- Cap monthly fees charged by agencies to maintain consumers in debt management plans. Consumer organizations have supported a standard that requires "reasonable" monthly fees, about $25 in the current market and considerably less for consumers with relatively small amounts of debt.
- Require agencies to prominently disclose all financial arrangements with lenders or other financial services providers.
- Non-profit organizations should not be exempted from the requirements of the law, as some states currently allow.

3. ***Credit counseling trade associations*** should set strong, public "best practice" standards to eliminate abuses and to encourage the provision of better education and counseling. Just as importantly, these trade associations need to increase the enforcement of their standards. Enforcement should be ongoing, vigorous, and independent.

4. ***Creditors*** should increase financial support to legitimate credit counseling agencies, especially to improve credit counseling options for consumers who are unlikely to benefit from debt management plans. Creditors should also reverse the trend of reducing the concessions they offer to consumers who enter debt management plans. Most importantly, most creditors should significantly cut the interest rates they charge to consumers in credit counseling. Additionally, creditors should immediately stop funding and doing business with agencies that charge high fees, function as virtual for-profit organizations, and/or use deceptive or misleading practices, as well as those companies that function solely as debt management service providers, forgoing necessary counseling and education services.

"We agree with CFA that these proactive steps toward reform are crucial. Improved operating procedures by organizations is essential; and there is a need for industry groups to set a high bar for standards and insist on enforcement among their members," said Barrett. "There are differences in our approaches, but we look forward to continuing our discussions with CFA, industry trade groups and government officials to pursue a common ground."

"Too many consumers are being harmed by credit counseling agencies that promise too much, that swindle or that price gouge," said Plunkett. "Consumer organizations, legitimate credit counseling agencies and creditors are going to have work together to insure that consumers are helped, not hurt, by credit counseling."

Consumer Federation of America (CFA) is a non-profit association of 300 pro-consumer organizations, which was founded in 1968 to advance the consumer interest through advocacy and education. InCharge Institute of America is a national non-profit organization specializing in personal finance education and credit counseling. The InCharge Institute family includes InCharge® Institute Foundation for Personal Finance Education and Research, Inc. which publishes YOUNG MONEY ® magazine and *Military Money* magazine and Profina℠ Debt Solutions, which provides professional credit counseling and education services.

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