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YOU DON'T THINK THEY'D LIE, DO YOU? THE TRUTH ABOUT CREDIT COUNSELING & DEBT RE-NEGOTIATION SERVICES

"It is always the policy to speak the truth.
Unless of course, you are an exceptionally good liar."
Jerome K. Jerome

Well, at least they've got some competition ... *finally.*

Ah yes ... those "angels" whose mission statement is simple enough: To help financially troubled consumers get their act together. For years the folks from Consumer Credit Counseling Service (CCCS) not only had a virtual monopoly on the consumer debt marketplace, but a media spin campaign that still continues to sucker in naive or lazy journalists. Content to regurgitate CCCS's press releases that have consistently played on the "we're a nonprofit organization" theme, too many news organizations have fueled the pro-CCCS propaganda fires without asking some obvious questions.

But my, how things have changed since the mid-1990s.

The big banks and credit card companies created a huge debt counseling service industry while they were giving the American consumer all of the rope needed to financially hang themselves. What was once dominated by CCCS is now a crowded field of companies, each one crowing about their nonprofit status: Myvesta, AmeriDebt, Genus, Debt Counselors of America, Profina are a few of the notables. And by the time you read this, there could be dozens more.

For the life of me, I don't know why being a "for profit" company is such a dishonorable mission statement in the debt-counseling world. If you think the people running these "nonprofit" debt-counseling organizations are working for charity, helping you get your butt out of a jam as part of their therapy, or because they're trying to guarantee their spot in heaven, you're sadly mistaken. Perusing the IRS's website will only get you buried in technical jargon if you're trying to get an understanding of the motivation for choosing to work under the cover of a nonprofit.

However, I did stumble across the website of one company that specializes in the formation of all types of legal entities; their explanation of the benefits associated with a "nonprofit" or "not-for-profit" corporation was by far the easiest to understand. According to www.mycorporation.com, here are a few of the major advantages for operating a company as a "nonprofit," which may also be referred to by its IRS tax code section/reference number as a "501 (c) (3)":

Tax Exemptions: Under IRS Code Section 501 (c) (3), a nonprofit corporation is eligible for certain federal and state tax exemptions. (With income tax rates as high as 34% on income over $75,000, tax exemption status can be invaluable.)

Receiving Public Funds: Many organizations are required by law to donate a certain percentage of their funds to nonprofit organizations or possibly endanger their own tax-exempt status. In addition, many exemptions exist for property transferred at death to a nonprofit organization.

Limited Liability for Members and Directors: As with a general, for-profit corporation, directors, trustees, and officers of non-profit corporations are usually afforded the same limited liability status. Thus, creditors of the nonprofit corporation can only reach as far as the corporation's assets to satisfy corporate debts and not the personal assets of the people involved in the nonprofit corporation.

Separate and Perpetual Existence: A nonprofit corporation, like a for-profit corporation, is an entity with a perpetual existence that may outlive all of its founders. In addition, the corporation can act like an individual in that it can enter contracts, incur debt, and own property.

Employee Benefits: The principal of a nonprofit corporation can be employed by the corporation. As such, these employees can be eligible for fringe benefits not available to self-employed people. Examples of these benefits include sick pay, group life insurance, accident and health insurance, and corporate pension plans.

Other Advantages

- Nonprofit corporations under 501 (c) (3) receive lower postal rates on bulk mail
- Many organizations offer discounted advertising rates to nonprofit entities
- Many Internet service providers offer discounted rates to nonprofit corporations
- Many national chains (Costco, for example) offer lower membership rates
- Nonprofit corporate employees may qualify for job-training and other work-study programs subsidized by the federal government

Well hell yes! Why wouldn't you try to operate your debt (or credit) counseling business as a nonprofit? Not only do you get to mislead the majority of under-educated Americans that believe they're putting their personal affairs into the hands of a company that's not profit-driven, but you get to pick up a slew of assorted financial incentives and other perks along the way. And apparently it's not terribly difficult to qualify as a nonprofit ... good legal counsel always pays for itself, especially in this arena.

So why am I spending so much time and effort trying to educate you about the facts regarding "nonprofit" or "not-for-profit" debt/credit counseling companies? Because they use the term as one of their strongest selling points. You deserve to know how (and how much) they're getting paid. Which leads me to my next point. How do they get paid?

They're Glorified Debt Collectors

There are a few of us out there who have sniffed around long enough to know how the debt counseling game is played and how they're paid. I was happy to see Ray Martin, a frequent contributor to CBS's "Early Show," file a report on June 26, 2002, about this subject. From CBS's website, Ray's segment notes about credit counseling agencies (as posted on www.cbsnews.com) do a terrific job of giving you much-needed background on the topic.

First of all, they are not regulated by the federal government, and only 17 states have any laws that do regulate such businesses. This means that anyone can start up a credit-counseling or debt-consolidation company. The largest and best-known company is actually a national network of offices; member agencies typically use the trademarked name Consumer Credit Counseling Services.

Services offered by debt counselors: Some companies offer budget and financial-management education. Customers may sit down with a counselor and draw up an "action plan" to get out of debt. More often than not, however, the counselor will suggest a **Debt Management Plan,** or **DMP**. Instead of an individual trying to pay off several credit accounts each month, he sends one check to the counseling company, which then disperses the money among the creditors. The company also contacts creditors to request lower interest rates and/or lower monthly payments on behalf of the individual.

How do these debt counselors make money? Customers agree to pay a start-up fee, often called a "voluntary contribution," and monthly maintenance fees. Martin says the average start-up fee is around $20 and the monthly fees about $12. Here's where things start to get a little sticky. Some companies charge as much as 100 percent of your first monthly payment as a start-up fee. In several newspaper articles, disgruntled customers said this fee was not made clear until they had sent in their first monthly payment and learned none had gone to creditors.

A June 17, 2002, *U.S. News and World Report* article described another common complaint: *"But after three months in AmeriDebt's program, the man was $900 deeper in the red. AmeriDebt, he says, failed to pay his creditors on time, generating late fees and other penalties."*

The biggest source of income for debt-counseling companies comes from credit card companies themselves. Creditors kick back a percentage of each monthly payment to the debt counselor. The creditors write this off as a debt-collection fee, assuming that they are getting more money back than if the cardowner went bankrupt.

This is the most important thing to remember when signing on with a debt counseling company: **The company is not there to help you!** The company wants to place you in a DMP so it can earn money from creditors. Credit-counseling agencies are all registered as nonprofits. Don't be fooled–this doesn't mean you're getting an advocate.

"What this amounts to is that credit-counseling companies are paid by creditors to be their debt collectors," Martin says.

Your Credit Report: It's important to keep in mind that the words "Managed by Credit Counseling Company"will appear under each account on your credit report that is involved in the DMP, Martin says: "This is industry code-speak for 'Credit Loser.' Also, if you fail to make monthly payments as agreed, that will show up as uncollected debt on your credit report for seven years–a red mark almost as bad as bankruptcy." Nice work, Ray.

More Insight ... From the Attorney General's Office

Perhaps you've noticed on the bottom of your credit reports, overdue bills or even "dun letters" that many times there's a promotional or "informational" plug, touting the potentially positive aspects of the services provided by CCCS.

When I was doing research for the first edition of *Back Off!* in 1994, I asked Stephen Gardner–a former assistant Attorney General for the State of Texas and the man who initiated a lawsuit on behalf of the State of Texas against TRW (now Experian) in 1991–for his thoughts about CCCS. His response:

"I think that Consumer Credit Counseling Service is intrinsically deceptive. They're funded or incorporated by the very people they're truly representing ... not the consumer/debtor but the creditors trying to collect the money.

"I think they're a con; they pitch themselves as serving the consumer's best interest but they don't. Their promotion practices are deceptive and the consumers are being grossly misled. If they were lawyers, they'd get disbarred! Representing one party and acting for the other? Come on! Think about it–if lawyers won't get involved in an enterprise like Consumer Credit Counseling, you know it must be bad."

An article written by Mr. Gardner that appeared in the Fall 2001/Winter 2002 edition of *Advancing the Consumer Interest,* a publication of the American Council on Consumer Interests, further illustrates this point: "CCCS organizations often fail to disclose to consumers that they make money based on how much they persuade consumers to pay their debts. CCCS organizations call this a 'fair share' contribution. A more honest description is 'kickback.' The standard kickback obtained by CCCS organizations is 15% of the amount collected. In 1998, the CCCS organizations affiliated with the National Foundation for Consumer Credit (about two-thirds of the total number of CCCS organizations in the country) returned approximately $1.9 billion to creditors."

Yeowch! Mr. Gardner's assessment of CCCS fits the picture that became clear while researching this book. Something that the good folks at CCCS and many other credit counseling services don't make clear to consumers is that they're paid by the creditors. That's right, the very people you owe money to are paying CCCS and other companies like them for the privilege of "helping" you through your debt-related challenges. Isn't that like the fox guarding the henhouse?

Competition Is Squeezing Profit Margins

While Mr. Gardner states that CCCS gets a 15% kickback on the accounts they're collecting, I contend that the explosion of competition in the debt/credit counseling world has led to fee-slashing and squeezed profit margins for everyone in the business.

One industry insider told me that the crowded field once dominated by CCCS is now having to deal with kickback fees as low as 5-7%. Combine lower revenues with the usual advertising and overhead costs, and some CCCS offices around the country have had to lay employees off in order to make their own ends meet. But business continues to be brisk thanks to the incredibly stupid and irresponsible lending policies of Internet-only credit card companies like Phoenix-based NextCard or San Francisco-based Providian, so I'm not too concerned about CCCS or any of their ilk going out of business anytime soon. But it's probably worth running you through the drill of "who gets what" so you'll have a better understanding of why the credit card companies would much rather see you sign up with their operatives in the debt/credit counseling world than the alternative–turning your overdue account over to a traditional, third-party debt-collection agency. Here's a CCCS-like example:

Suppose you owe Kramer's Department Store (among others) $1,000; CCCS "assists" you by creating a repayment schedule with your creditors. You successfully repay the entire $1,000 owed through CCCS, but in fact, only $900 is returned to Kramer's Department Store.

An average commission equal to 10% (remember, these kickback margins have been squeezed downward from the 15% range over the last few years)–in this case $100–is kept by CCCS for "helping" you through this period. So once again, I ask the age-old question: Whose interest is CCCS really representing? Yours, as the consumer/debtor, or the creditor's? Who's paying whom? And who do you think your creditors would rather do business with? A traditional, third-party debt-collection agency that will charge them as much as 50% of the total monies collected, or a CCCS-like company, whose kickbacks (commissions) they've been able to successfully squeeze these down to margins as low as 5-7½%? You do the math.

A Deer in the Headlights

One of the funniest–and most telling–moments in the "how are you paid" world of disclosure from CCCS came when I was a guest on *The Oprah Winfrey Show* in the mid-1990s. As I was doing (verbal) battle with multiple debt collectors in the audience, all of a sudden, this one young lady stands up (she was a setup, of course) to tell America about an alternative to dealing with a debt collector. You guessed it! She began touting those angels known as CCCS.

But when I put her on the spot and asked her point blank: "How are you paid? How is CCCS paid for their services?", she truly looked like the proverbial deer in the headlights. "We receive a voluntary commission!" she responded. "Then if it's voluntary," I asked her, "why don't you clearly disclose this to consumers?" (Insert frozen, deer-in-the-headlights response here.) ***Next!***

The moral of the story? I'm not just picking on CCCS because they're an easy target. I'm focusing on them because they're the most recognized and oldest of all of the debt-counseling organizations. As far as I'm concerned, the newer players in the debt-counseling world need to be watched and questioned just as closely.

If It Sounds Too Good To Be True ...
The Truth About Debt Re-Negotiation Companies

These guys are the worst. Companies that don't place themselves in the "debt counseling" category, but instead promise to "make deals" with your creditors to settle for a fraction of the outstanding balance. One notorious company in Southern California is in hot water for taking fees equal to 36% of the total balance owed by a consumer and keeping 69% (25% out of 36% collected, or 69% of the total fees received) for themselves–the rest (11% or 31% of the total amount paid) is used to settle with creditors. And of course we're reminded once again: "If it sounds too good to be true, it probably is." In this case, *it definitely* is.

Consumers paid millions of dollars to these thieves and received practically nothing. Many borrowed money from family members or 401Ks and, in good faith, expected to be able to settle their debt problems by hiring these rogues. They rarely ever succeeded; a former top lieutenant of the company I'm discussing (based in a Los Angeles suburb) admitted that the company collected millions of dollars and settled less than 2-3% during his two-and-a-half-year association with them. The company is now being investigated by several state and federal agencies, and hundreds–perhaps thousands–of consumers are in worse financial shape than ever.

I don't care if they're licensed by the state and bonded by the most stable insurance company on the planet–if it sounds too good to be true, it almost always is. If you want to play a little hardball and renegotiate your credit card balances, the best track record of consistency I've seen over the last several years are attorneys that handle this side of the business as a sideline to their bankruptcy practice. But again, not all attorneys are created equal, and there are a few non-attorneys out there who I think do a pretty good job in this arena, too. You might want to check out the special section I've created on my website for any up-to-date developments in this area, as well as referrals to those experts I think do good work in the hardball world of renegotiations: www.bendover.com/hardball.asp.