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Presented Before

Assemblywoman Audrey I. Pheffer,
Chair, Committee of Consumer Affairs and Protection
Assemblywoman Helene E. Weinstein,
Chair, Committee on Judiciary
Assemblyman Darryl C. Towns,
Chair, Committee on Banks

Consumer Protection in the Debt Collection and Debt Management Industries Hearing,
250 Broadway, New York, NY
May 14, 2009

Dear Assemblywoman Pheffer,
Assemblywoman Weinstein
and Assemblyman Towns,

Thank you for holding this hearing. My name is Johnson Tyler. I am a consumer attorney at South Brooklyn Legal Services which provides free legal representation to low income New Yorkers. I wish outline why the Uniform Debt Management Services Act, as proposed in Assembly bill A.7268, is needed, and why its fee provisions must be tightened.

Debt Settlement Skirts Current Consumer Protection Laws In New York

In the early 20th Century, the first generation of debt scams arrived in the form of budget Planners.¹ These thieves (also known as debt adjusters, poolers, and pro-raters) purported to persuade creditors to accept partial payment in full satisfaction of the consumer's obligations. As the industry evolved, budget planners used deceptive advertising and charged hefty fees that prevented payment to creditors. In the 1950's, law makers in New York and elsewhere outlawed these businesses (except to licensed non-profits). *See* N.Y. Gen. Bus. Law 455-457, N.Y. Banking law § 579.

¹ National Conference of Commissioners On Uniform State Laws *Prefatory Note to the Uniform Debt Management Services Act*, pg 1-3 (March 6, 2008)

While New York still prohibits for-profit budget planners, its laws have been unable to stop debt settlers - the latest permutation of this original debt scam.²

The Debt Settlement: Business Model vs. Business Reality

The Debt Settler business model is simple and simplistic. The debtor, rather than paying a portion of his or her bill each month to the credit card company, pays that money into an escrow account at the debt settlement company. Once that escrow account equals about 40 - 50% of the balance owed on the credit card (typically in 24-36 months), the debt settlement company negotiates a settlement for 40 -50 % of the value of the existing debt.

The problem is this business model rarely works, largely because the debt settlement company takes its large fee (typically 15% -20% of the value of the original debt) from the debtor's initial deposits. Further preventing the accumulation of any savings in escrow are monthly maintenance fees that rival gym membership dues. (One client's monthly maintenance fees totaled \$65 a month.) Meanwhile, the debtor has defaulted on the credit cards, triggering debt collection calls, law suits and further destroying his or her credit score.

Three Debt Settlement Victims

Valerie Richardson is a typical debt settlement victim. Mrs. Richardson's credit card problems began when her income fell precipitously following her husband's death. Relying more on her credit cards yet unable to pay them, she soon found herself fielding aggressive debt collector calls. Unable to afford bankruptcy (about \$1500 - \$2000), she turned to "Debt Choice," a debt settlement company that runs ads on late night T.V. After a brief discussion with Debt Choice, she signed-up for a \$300 a month payment plan. Although Mr. Richardson's only income (Social Security) was already shielded from creditors by federal law³, no one at Debt Choice advised her of this. Nor did she realize that the first \$1333 she deposited would be taken for Debt Choice's set-up fee, or that \$65 would be taken each month as for "maintenance fees."

Five months into the program, Mrs. Richardson demanded a refund as she was still receiving harassing creditor calls, her credit card balances were increasing rather than decreasing, and she had been sued by a creditor. Although Debt Choice returned some money, Ms. Richardson is still owed \$1060 that was taken by Debt Choice's lawyers, the Palmer Firm.

Mr. Martinez, a 53 year Army Veteran and former triple AAA outfielder, fared no better. He fell into debt when he lost his job as a maintenance worker and needed a major dental procedure. Desperate, he turned to Morgan Drexen, a California debt settlement company.

² The penalty for non-compliance with New York's budget planner law (a criminal misdemeanor) is too weak to deter compliance. N.Y. GBL § 457. Moreover, only the Attorney General or the Banking Department have standing to bring a law suit or investigation under the budget planner laws.

³ 42 U.S.C. Sect. 407(a).

After one creditor sued him and another froze his bank account despite \$1511 in payments to Morgan Drexen, Mr. Martinez realized that he had been scammed. To date, Morgan Drexen and its attorney Eric A. Rosen has not responded to Mr. Martinez' requests that it return the \$1511 he'd paid to settle his debts.

Ms. Bernadita Duran fared the worst. Although her only income (welfare and SSI) was exempt from debt collection, the Freedom Debt Network and the Law firm of Jason D. Hass took \$3,025 from her over eight months while "settling" four debts for impossible payment terms that exceeded Ms. Duran's income and assets.

Being Fleeced by a Debt Settlement Company Is the Norm, Not the Exception

The internet is replete with press releases from state attorney generals concerning litigation to curb debt settlement fraud and return taken money to duped consumers.⁴ Reporters uniformly warn consumers to stay away from debt settlement.⁵ The Better Business Bureau has given the industry as whole its lowest possible rating - an "F."⁶ Most telling was an auditor's finding in a Federal Trade Commission law suit against a giant net work of debt settlement companies. It found that less than two percent of the consumers who enrolled in the defendants' debt settlement programs – 638 out of 44,844 consumers – actually completed them. The others abandoned the programs having lost thousands of dollars in set-up fees to the defendants.⁷

Lessons Learned In Other States: If You Want To Ban Debt Settlers,

⁴ See E.g. Idaho Department of Finance *Department of Finance Reaches Agreements with Out-of-State Debt Settlement Companies*, September 19, 2008; New York Office of Attorney General *Nationwide Investigation into Debt Settlement Industry*, May 7, 2009; South Carolina Department of Consumer Affairs, *Over \$700,000 Recovered for South Carolina Consumers from Debt Settlement Company*, May 15, 2007; Illinois Attorney General, *Illinois Sues Two Debt Settlement Firms, SDS West, Debt Relief USA Accused of Deceptive Practices*, May 6, 2009; and Georgia Department of Consumer Affairs, *Debt Relief Settles Case, must Pay Customers*, March 19, 2009.

⁵ Streitfeld, *An Inquiry Into Firms That Offer to Cut Debt*, New York Times, May 8, 2009; Streitfeld, *Debt Settlers Offer Promises but Little Help*, New York Times, April 20, 2009; Birnbaum, *Debt Relief Can Cause Headaches of Its Own*, New York Times, February 9, 2008; Phillips, *Debt Settlement Company Fails* (May 13, 2008) available at http://abclocal.go.com/wabc/story?section=news/7_on_your_side&id=6137542;

⁶ See. E.g. <http://www.la.bbb.org/BusinessReport.aspx?CompanyID=100054427>; and <http://www.tascsite.org/article.php?id=29>.

⁷ National Consumer Law Center, *An Investigation of Debt Settlement Companies : An Unsettling Business for Consumers*, (March 2005); Federal Trade Commission , *Debt Services Operations Settle FTC Charges*, (March 30, 2005), available at <http://www.ftc.gov/opa/2005/03/creditcouncil.shtm>.

Set Fees Below the UDMSA Recommendations

States have taken two approaches in combating debt settlement companies. First, some state depart from the Uniform Debt Management Services Act (UDMSA), and permit only small set-up and maintenance fees. For example, Kansas limits initial set-up fees to \$50, and a monthly maintenance fee of \$20. K.S.A 50-1126(b). This appears quite effective. Only one of the 32 debt counseling firms registered in Kansas is a debt settler.⁸ South Carolina limits initial start-up fees to \$80, and a monthly maintenance fee of \$40. S.C. Code Ann. § 34-39-110. Like Kansas, this measure has stopped any debt settlement companies, with the exception of one, from registering.⁹ Georgia also limits debt settlement companies by limiting fee collection to 7.5% of the monthly payment. O.C.G.A. § 18-5-2. In other words, a person paying \$300 a month would have all but \$22.50 of each month's payment applied to the escrow account for debt settlement. (Compare with Mrs. Richardson who had \$65 taken each month in maintenance fees from her \$300 payment, plus the her first four payments being taken completely to recover the set-up fee.)¹⁰ Finally, Minnesota recently passed a debt settlement law which limits the set-up fee to \$200 or 2% of the debt owed whichever is lower, when the consumer's debt is less than \$20,000.¹¹

Two states, Utah and Rhode Island have passed laws that largely mirror the UDMSA except that they allow for-profit debt settlement firms to operate.¹² Utah and Rhode Island limit set-up fees to \$400, and cap monthly fees at \$50 a month. In Utah, (no data available on Rhode Island) only two debt settlement firms make up the 26 firms that have registered, suggesting the modest fees may be a deterrent.

⁸ The debt settlement firm registered in Kansas is iPayDebt Financial Services, Inc. The Kansas Approved Registered Credit Services Organizations list is available at <http://www.osbckansas.org/DOCML/DOCMLBrokerLenderSearch/csoapproved5-8-09.pdf>

⁹ As in Kansas, the only registered debt settlement firm in South Carolina is iPayDebt Financial Services, Inc. The South Carolina Licensed Credit Counselors list contains 37 licensees and is available at: http://www.sconsumer.gov/licensing/credit_counseling/licensed_organizations.pdf.

¹⁰ I have been unable to locate a debt counselor licensee list in Georgia that might measure the law's effectiveness. However, I would imagine that it would go far in deterring such conduct provided Georgia is enforcing its laws.

¹¹ The bill, which passed as part of an omnibus bill, is available at: <https://www.revisor.leg.state.mn.us/laws/?id=37&doctype=Chapter&year=2009&type=0>

¹² U.C.A. 1953 § 13-42-123, R.I. Gen.Laws 1956, § 19-14.8-23; CO. R.S. § 1214.5223.

On the other hand, Colorado limits set-up fees to 4% of the total debt. Thus a \$20,000 debt (national average) in Colorado has a set-up value of \$800 as opposed to \$400 in Utah. Colorado also sets few limits on monthly maintenance fees. Consequently, the debt settlement law in Colorado is weak. Indeed, seven (7) of the 41 firms that are licensed under Colorado's UDMSA are debt settlement companies, including one masquerading as a non-profit and two others under investigation by various attorney generals, including Andrew Cuomo.¹³

Assembly Bill A.7268 Needs More Stringent Fee Limitations.

These States' experiences tell us is that the fee schedule in proposed Assembly bill A.7268 is too lenient to deter debt settlers. New York has a huge number of persons in financial distress. Limiting the collection of \$400 as a set-up fee, followed by \$50 a month maintenance fees, is not going to discourage debt settlers from seeking easy money from desperate and unwitting consumers. And while the non-profit status may seem like a considerable road block, already a debt settlement company with non-profit status has registered in Colorado. Indeed, the massive Federal Trade Commission law suit that uncovered the 2% completion rate was against a non-profit debt settler.¹⁴

Conclusion

Assembly bill A.7268 is a step in the right direction. However, it is not the final step. More stringent fees caps, like those in Kansas, South Carolina, Georgia and Minnesota are needed to put an end to this 21st Century version of the Budget Planner scam.

Thank you.

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¹³ The debt settlement firms registered in Colorado are: Century Negotiations, Inc. iPayDebt Financial Services, Inc., New Life Debt Relief Corp (non-profit), Prestige Financial Solutions, Inc., Superior Debt Services, Inc., Debt Settlement America and Freedom Debt Relief, LLC (the later two are under investigation by the New York Attorney General and have been sued by other Attorney Generals.) The Colorado Debt-management Services Act Registered Providers list is available at:
<http://www.ago.state.co.us/UCCC/PDF/debt%20management%20list.pdf>

¹⁴ See discussion, *Supra* note 7.