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S. Hrg. 108–545

# PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING

## HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

MARCH 24, 2004

Printed for the use of the Committee on Governmental Affairs

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# CONTENTS


| | Page |
|---|---|
| Opening statements: | |
| Senator Coleman | 1 |
| Senator Levin | 7 |
| Senator Akaka | 9 |
| Senator Dayton | 11 |
| Senator Pryor | 29 |
| Prepared statements: | |
| Senator Durbin | 85 |
| Senator Lautenberg | 87 |


## WITNESSES

### WEDNESDAY, MARCH 24, 2004


| | |
|---|---|
| Raymond Schuck, Victim, Cambridge Credit Counseling Corp., Lima, Ohio | 12 |
| John Pohlman, Former Employee, Cambridge Credit Counseling Corp., East Granby, Connecticut | 14 |
| Jolanta Troy, Victim, AmeriDebt, Inc., Carlisle, Pennsylvania | 16 |
| Johnpaul Allen, Former Employee, AmeriDebt, Inc., New Market, Maryland | 17 |
| Chris Viale, General Manager, Cambridge Credit Counseling Corp., Agawam, Massachusetts | 32 |
| Matthew Case, Chief Operating Officer, AmeriDebt, Inc., Germantown, Maryland | 34 |
| Cuba M. Craig, Chief Executive Officer, American Financial Solutions, Seattle, Washington | 35 |
| James Kroening, Director, FamilyMeans Consumer Credit Counseling Service, Stillwater, Minnesota | 37 |
| Andris Pukke, President, DebtWorks, Inc., Germantown, Maryland, accompanied by John Williams | 62 |
| Michael Malesardi, Chief Financial Officer, The Ballenger Group, LLC, Frederick, Maryland | 63 |
| Bernaldo Dancel, Chief Executive Officer, Amerix Corporation, Columbia, Maryland | 65 |
| Mark W. Everson, Commissioner, Internal Revenue Service | 78 |
| Thomas B. Leary, Commissioner, Federal Trade Commission | 80 |


### ALPHABETICAL LIST OF WITNESSES


| | |
|---|---|
| Allen, Johnpaul: | |
| Testimony | 17 |
| Prepared statement | 95 |
| Case, Matthew: | |
| Testimony | 34 |
| Prepared statement | 127 |
| Craig, Cuba M.: | |
| Testimony | 35 |
| Prepared statement | 142 |
| Dancel, Bernaldo: | |
| Testimony | 65 |
| Prepared statement | 175 |
| Everson, Mark W.: | |
| Testimony | 78 |
| Prepared statement with attachments | 181 |
| Kroening, James: | |
| Testimony | 37 |
| Prepared statement | 150 |

Page

Leary, Thomas B.:
Testimony ..... 80
Prepared statement ..... 193
Malesardi, Michael
Testimony ..... 63
Prepared statement with attachments ..... 153
Pohlman, John:
Testimony ..... 14
Prepared statement ..... 91
Pukke, Andris:
Testimony ..... 62
Schuck, Raymond:
Testimony ..... 12
Prepared statement ..... 89
Troy, Jolanta:
Testimony ..... 16
Prepared statement ..... 93
Viale, Chris:
Testimony ..... 32
Prepared statement ..... 97
Supplemental written submission with attachments ..... 102

APPENDIX

Staff Report entitled "Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling" ..... 203

EXHIBITS

1. Corporate Chart of Cambridge-Brighton ..... 240
2. Corporate Chart of DebtWorks-Ballenger Group ..... 241
3. Corporate Chart of Ascend One-Amerix ..... 242
4. *Service Agreement* between Raymond Schuck and Cambridge Credit Counseling Corp., dated June 29, 2001 ..... 243
5. $1,946 check sent by Raymond Schuck to Cambridge Credit Counseling Corp. for enrollment in his debt management plan, dated July 13, 2001 ... 248
6. *Client Financial Disclosure* of Raymond Schuck, dated October 12, 2001 .. 249
7. Correspondence between AmeriDebt and Better Business Bureau, dated December 26, 2002, regarding Jolanta Troy's enrollment in debt management plan ..... 250
8. AmeriDebt *Debt Management Plan Agreement,* page 5 ..... 251
9. *Flow Chart* prepared by AmerDebt for employee training ..... 252
10. Debt Relief Clearinghouse solicitation letter ..... 254
11. AmeriDebt document outlining procedure for forwarding leads for home equity loans to Fidelity & Trust Mortgage, Inc. and outlining compensation received by AmeriDebt counselors for such lead ..... 255
12. *Get Excited* employee training document prepared by AmeriDebt ..... 258
13. Tip Sheet on telephone sales skills for AmeriDebt employee training ..... 259
14. Portion of AmeriDebt script pertaining to "voluntary" contribution ..... 260
15. AmeriDebt *September 2001 Company Notes* ..... 261
16. *How Do You Respond When Explaining Questions Regarding The Contribution,* prepared by DebtWorks ..... 262
17. *Was The Client Forced To Sign The Agreement?,* prepared by DebtWorks . 263
18. Deposition of John Puccio conducted by the Permanent Subcommittee on Investigations, July 1, 2004 ..... 264
19. Statement for the Record of Preston O. Duppins, Jr., President and Chief Executive Officer, Genesis Financial Management, Inc ..... 322
20. Statement for the Record of David C. Jones, President, Association of Independent Consumer Credit Counseling Agencies ..... 327

Page

21. Responses to suplemental questions for the record submitted by Senator Frank Lautenberg to:
    a. The Honorable Mark W. Everson, Commissioner, Internal Revenue Service ..... 338
    b. The Honorable Thomas B. Leary, Commissioner, Federal Trade Commission ..... 339
    c. Chris Viale, General Manager, Cambridge Credit Counseling Corp ... 341
    d. James Kroening, Director, FamilyMeans Consumer Credit Counseling Service ..... 343
    e. John Pohlman, Former Employee, Cambridge Credit Counseling Corp ..... 344
    f. Raymond Schuck, Victim, Cambridge Credit Counseling Corp ..... 345

# PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING

**WEDNESDAY, MARCH 24, 2004**

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 9:04 a.m., in room 342, Dirksen Senate Office Building, Hon. Norm Coleman, Chairman of the Subcommittee, presiding.

Present: Senators Coleman, Levin, Akaka, Dayton, and Pryor.

Staff Present: Raymond V. Shepherd, III, Staff Director; Joseph V. Kennedy, General Counsel; Steven Groves, Counsel; Katherine English, Counsel; Leland Erickson, Counsel; Mark Greenblatt, Counsel; Jay Jennings, Investigator; Mary D. Robertson, Chief Clerk; Kristin Meyer, Staff Assistant; Katherine Russell, Detailee, FBI; Bill Winne, Professional Staff; Andrew Plehal, Intern; Elise J. Bean, Democratic Staff Director/Chief Counsel; Laura Stuber, Counsel to the Minority; Marianne Upton (Senator Durbin); Tate Heuer and Gita Uppal (Senator Pryor); Joyce Nicolas (Senator Akaka).

## OPENING STATEMENT OF SENATOR COLEMAN

Senator COLEMAN. This hearing of the Permanent Subcommittee on Investigations is called to order. Good morning and welcome to today's hearing. We are holding this hearing to address the continuing ongoing problems with the credit counseling industry.

Consumer debt has more than doubled in the past 10 years. The Nation's credit card debt current tops $735 billion, or an average of nearly $7,000 per household. Since 1996, more than one million consumers have filed for personal bankruptcy each year and a record 1.7 million new filings in 2003.

Since the 1960's, consumers with credit card debt regularly turned to their local non-profit credit counseling agency for advice and financial education. Consumers were given face-to-face counseling sessions with trained counselors. Credit counselors conducted a detailed budget analysis with a consumer, analyzed their spending habits, determined why the consumer was in debt, and educated the consumer in how to avoid falling back into debt.

One such agency, FamilyMeans Consumer Credit Counseling Service, will testify about how the industry has run successfully for all these years. Even today, FamilyMeans provides an in-depth analysis of each consumer who comes to them for help, gives them proper counseling and education, and only when the consumer

needs intercession with their creditors enrolls them in a debt management plan. They provide these services free of charge or at minimal expense to the consumer.

FamilyMeans is by no means the only credit counseling agency that takes a comprehensive and holistic approach to each consumer they provide services to. The agencies organized under the National Foundation for Credit Counseling and the Association of Independent Consumer Credit Counseling Agencies require their members to adhere to strict standards of practice and restrict the cost that customers may be required to cover. Those associations prove that self-regulation can be an effective means of keeping this industry consumer-friendly.

Under traditional social service models, consumers who could not afford to make all their monthly credit card payments often enrolled in a debt management plan, or DMP for short, which allowed them to consolidate their debts from several credit cards, reduce their monthly payments, and lower their interest rates. The traditional credit counseling agencies provided counseling, education, and debt management plans free of charge or for minimal contributions. To cover operational costs, creditor banks paid credit counseling agencies a percentage of the money that was collected from consumers through debt management plans. The credit counseling industry successfully operated in this manner for several decades.

Over the past several years, however, the credit counseling agency has undergone significant changes. New and aggressive credit counseling agencies have changed the manner in which consumers are treated. These changes have resulted in consumer complaints about excessive fees, pressure tactics, nonexistent counseling and education, promised results that never come about, ruined credit ratings, poor service, in many cases being left in worse debt than before they initiated their debt management plan.

We will hear testimony today from two insiders who worked for two of the Nation's largest non-profit credit counseling agencies. They describe the organizations at these non-profits as telemarketing sweatshops designed to take advantage of thousands of people in bad financial positions. One of the insiders describes this scene as "it was a boiler room mentality. There was a large board at the front of the room that reminded me of the leader board at a golf tournament. It had the names of counselors who had the top sales for the month in red and yellow lights." Make no mistake, these credit counseling agencies were designed to sell a product, the debt management plan, not primarily to deliver a service of education and counseling.

The Federal Trade Commission and the Attorney Generals of Illinois, Maryland, Minnesota, Missouri, and Texas have taken action against AmeriDebt, DebtWorks, and their related partners. The Internal Revenue Service has initiated audits of over 50 credit counseling agencies. Several class action lawsuits are currently pending against several of the new entrants.

Clearly, something is wrong with the credit counseling industry. So what has gone wrong and what has happened? It would seem that money is the root cause of these problems. Many of these new entrants in the credit counseling industry have developed a busi-

ness model which is based on generating revenue rather than providing counseling to indebted consumers.

This new for-profit model is designed so that credit counseling agencies generate massive revenues to fund advertising, marketing, executive salaries, and any number of other activities beyond actual credit counseling. The new model looks to the consumer to provide these revenues.

When profit motive is injected into a non-profit industry, it should come as no surprise that harm to the consumers will follow. Indeed, the primary effect of the for-profit model has been to corrupt the original purpose of the credit counseling industry, which was to provide advice, counseling, and education to indebted consumers free of charge or at minimal charge and place consumers on debt management plans only if they are otherwise unable to pay their debts.

Some of the new entrants now reverse the practice. They provide no bona fide education and counseling and place every possible consumer into a debt management plan charging unreasonable or even exorbitant fees.

For the past several months, Subcommittee staff has conducted interviews of individuals, agencies, and for-profit corporations to play a role in the credit counseling industry, including credit counseling agencies, major creditor banks, State and Federal officials, and consumer advocates. Thousands of documents were reviewed. Over 500 consumer complaints were examined and we spoke with over 50 consumers about their experiences with several different credit counseling agencies. We have also spoken to over 40 current and former employees of credit counseling agencies in order to see how these agencies operate from the inside.

Today's hearing presents the results of our investigation. As I stated earlier, it would seem that money is at the root of the problems currently facing the credit counseling industry. The affiliation between non-profit credit counseling agencies and for-profit businesses is at the core of that problem. A review of the tax returns for both the non-profit and for-profit entities reveals that the vast majority of the fees and contributions made to the credit counseling agency are siphoned off by the for-profit partners.

Our hearing today focuses on three particular credit counseling conglomerates, and I say conglomerates because these new entrants often consist of a complex network of interrelated companies who are organized and operated for a common purpose, to generate revenue by charging fees to consumers for enrolling in debt management plans. The business practice of these new entrants constitute a potential abuse of the 501(c)(3) tax-exempt status granted to the credit counseling agencies by the IRS. The misrepresentations made by these agencies to consumers regarding fees and what education will be provided may likely violate the Federal Trade Commission Act.

Our investigation has revealed the common patterns of improper conduct by the new entrants. Each new entrant has been established and organized for the specific purpose of generating profits for one or more insider beneficiaries. The insiders of the new entrants have engaged in questionable transactions for the purposes of turning the non-profit agency into a profit-generating business.

The new entrants, through their affiliated agencies, have generated massive revenue for themselves by charging excessive fees for initiating and managing a debt management plan and/or siphoning off such fees to related for-profit companies. Multiple nonprofit counseling agencies have been organized by the insiders to provide multiple streams of revenue for the for-profit back-office processing companies.

Regardless of what business model is used, debtors received little or no actual credit counseling or education as was contemplated by granting them tax-exempt status. Employees are routinely given bonuses based on their ability to enroll debtors in debt management plans, evidencing an intent to generate revenue rather than to provide relevant counseling and education.

The new entrants that we have investigated engage in most, if not all, of these practices. One of the conglomerates we have invited to testify today is the Cambridge-Brighton family of companies. Cambridge-Brighton consists of three credit counseling agencies and three for-profit affiliates. Cambridge-Brighton is owned and operated by two brothers, John and Richard Puccio, who control each of the five entities in the conglomerate. All revenues for this family of companies come directly from the consumers. The vast majority of revenue that comes into the three credit counseling agencies from consumers is channeled to the three for-profit affiliates.

At the top of the pyramid is the for-profit Brighton Credit Corporation of Massachusetts, now known as Brighton Debt Management Services, which does the account processing for the debt management plans generated by the three credit counseling agencies. Since 1998, this entity realized gross revenues in excess of $40 million.

Debt Relief Clearinghouse is the for-profit company that produces infomercials, promotional videos, and other marketing materials for the conglomerate. Between 2000 and 2002, Debt Relief Clearinghouse has been paid in excess of $25 million.

A third for-profit company, Cypress Advertising and Promotions, serves as an advertising broker and has been paid over $6.5 million since 1999.

In total, the Cambridge-Brighton for-profit companies boasts over $71 million during that time period, all as a result of consumers being enrolled in debt management plans.

From where did all this money originate? It comes from consumers who look to Cambridge for assistance with their debts. Where some credit counseling agencies charge $25 or no fee at all to set up a debt management plan, the Cambridge-Brighton agencies charge a full month's payment as an up-front fee. Raymond Schuck will testify as to how he was charged close to $2,000 just to enroll in a debt management program. That fee did not go to Mr. Schuck's creditors. It went into Cambridge's coffers. Mr. Schuck's counseling and education consisted of two phone calls lasting a total of 20 minutes. Unfortunately for Mr. Schuck, the Cambridge debt management plan left him in worse financial condition than when he started and he ultimately declared bankruptcy.

The second conglomerate that is testifying today consists of AmeriDebt and its for-profit affiliate, DebtWorks, now known as

The Ballenger Group. The credit counseling agency known as AmeriDebt was operated for several years by Pamela Pukke as a stand-alone entity enrolling consumers in DMPs and doing all the necessary processing for the accounts. Then in 1999, AmeriDebt decided to simply split itself into two companies, one non-profit to enroll customers onto DMPs and one for-profit company to perform the DMP processing function. The new for-profit was called DebtWorks and was wholly owned and controlled by Pamela Pukke's husband, Andris Pukke.

Employees who had been trained at AmeriDebt fanned out to form additional credit counseling agencies which provide additional streams of revenue for DebtWorks. DebtWorks and Mr. Pukke assisted in the formation and organization of new credit counseling agencies with start-up loans and legal assistance. In return, these new agencies also contracted with DebtWorks for DMP processing and referred consumers to Mr. Pukke's other for-profit entities, Infinity Resources Group, Fidelity and Trust Mortgage, and F&M Mortgage.

The non-profit credit counseling industry was very profitable for DebtWorks. Between 1999 and 2002, DebtWorks grossed in excess of $108 million. Again, it was the consumer who paid all the money.

AmeriDebt's price for enrolling in a debt management plan is 3 percent of the consumer's total debt, so if the consumer is $25,000 in debt, the price of their plan with AmeriDebt would be $750. Jolanta Troy will testify today about how she thought her first payment to AmeriDebt of $783 was going to be sent to her creditors, only to find out that AmeriDebt actually kept the money. She had specifically told AmeriDebt she could not afford to make the large up-front contribution. Mrs. Troy wrote to AmeriDebt asking for the money to be returned, but AmeriDebt flatly refused. Mrs. Troy received no actual counseling and education. She was simply enrolled in a debt management plan and left to her own devices. Like Mr. Schuck, Mrs. Troy was left worse off by her debt management plan than she was before and had to declare bankruptcy.

The final conglomerate we have invited to testify today is the Ascend One conglomerate. The Ascend One conglomerate began like AmeriDebt, as a single credit counseling agency called Genus Credit Management. It was operated by Bernaldo Dancel. Like AmeriDebt, Mr. Dancel simply split his agency into two parts, naming his new for-profit company Amerix Corporation. Amerix then set out across the country in an effort to form additional credit counseling agencies. Amerix assisted in the formation of five credit counseling agencies, all of which currently contract with Amerix for DMP processing services.

As with the prior two conglomerates, the Ascend One-Amerix group of companies is funded by consumer fees and contributions. The credit counseling agencies in this conglomerate are contractually obligated to remit between 50 and 85 percent of all their revenue to Amerix. In all, between 1998 and 2002, Amerix received gross revenues in excess of $386 million, all generated by the debt management plans. Other revenues realized by Ascend One come from consumers who were referred by the affiliated credit counseling agencies to its wholly-owned for-profit subsidiaries, Free-

domPoint Corporation and FreedomPoint Financial. These companies market mortgage broker services and other projects to highly leverage consumers.

Consumers who contact credit agencies affiliated with the Ascend One receive little counseling or education. In fact, consumers were permitted to enroll in a debt management plan entirely over the Internet without having spoken to a credit counselor. This practice apparently removes the expense associated with the counselor actually spending time to give advice and education to consumers.

We will also hear testimony today from the Federal agencies responsible for regulating and enforcing the laws in this area, the Internal Revenue Service and the Federal Trade Commission. Each of these agencies have taken modest steps to enforce the tax code and consumer protection laws within this industry. I am heartened to hear that Commissioner Everson has initiated over 50 audits of credit counseling agencies. However, where consumers are being victimized by supposed non-profit agencies they trust to help get them out of debt, it is incumbent upon the Federal Government to do more.

I look forward to hearing from our panelists this morning and I know we will all learn a great deal. I am committed to discovering the causes of the problem plaguing this once consumer-friendly industry. I am equally committed to finding solutions either by additional enforcement or legislation to remedy these problems.

That was a rather lengthy statement, but due to the complexity of what we are looking at today, I thought it was the right thing to do.

As we have this hearing, I don't want to paint every credit counseling agency with a broad brush here and say that all consumers are being abused. But we had a system that was set up to help people in debt and to provide them with counseling and education and afterwards, if necessary, enroll in debt management plans. It appears from our investigation that what has happened in debt management plans for some of the new entrants in this market have become a product, a product to simply be marketed and to be sold. The person who loses out on that is the person who needs help, who is reaching out for help, who believes that they are going to a non-profit and finds out in the end that, in fact, they are not getting the counseling and the education that they need.

In addition, who is hurt are the other agencies out there. I believe the best welfare program is a job. I want business to prosper. But if I am a consumer out there, I am not going to know who to call today. There are the NFCC and AICCCA, some of the organizations that work with these agencies, have done, in my opinion, a good job of working with their members, but it is going to become difficult to distinguish between who is doing the good job and who isn't and I think that is unfortunate. We all get hurt by the actions of a few, and in this area, there is a lot of money being made and it certainly caused this Subcommittee to have a lot of concern.

I look forward to the hearing today, and with that, I will turn it over to my distinguished colleague and Ranking Member, Senator Levin.

## OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you, Mr. Chairman, and thank you for calling these very important hearings. Your leadership here is critically useful and it is going to make a difference.

The United States is awash in consumer debt. U.S. credit card debt alone now exceeds $730 billion. That is even larger than the country's deficit at the moment, our annual deficit. Much of this consumer debt is owed by working families of modest means trying to make ends meet. Part is due to expenses associated with a health crisis, a death in the family, legal problems, a divorce, or a job loss. For many middle-income households, substantial debt is a fact of life and debt management is an urgent and a painful necessity.

The issue that the Subcommittee is examining today under the leadership of our Chairman is how to ensure that persons who are struggling with debt and who turn to a credit counselor for help are protected against abusive credit counseling agencies seeking to exploit their financial distress.

Traditionally, and hopefully in most cases today, credit counseling agencies are community-based, truly non-profit entities seeking to educate consumers about their finances and helping them to get back on their feet. For nominal fees, reputable agencies set up formal debt management plans for consumers to consolidate their debts, find ways to reduce the debts owed, establish a schedule for repaying them, and in many cases are able to reduce the interest rates owed.

Such agencies will contact creditors like a bank or a credit card company and arrange for a waiver of late fees and penalties, negotiate a reduction in debt in return for a debtor's promise to begin a regular repayment schedule. When done right, this work can save individuals and families from bankruptcy and financial ruin while helping creditors obtain some of the monies owed to them.

The problem is that in recent years, a less benign type of credit counseling agency has infiltrated the credit counseling industry. These newcomers generally claim to operate as non-profits but are, in fact, organized to squeeze as much cash as possible from debt-laden consumers and then funnel the bulk of it to insiders or for-profit affiliates.

The 6-month Subcommittee investigation of three of the largest credit counseling conglomerates in operation today has documented a host of disturbing and abusive practices. One key abuse involves debtors being charged excessive start-up and monthly fees by a non-profit credit counseling agency to set up and administer a debt management plan. For example, instead of start-up and monthly fees of $23 and $14, the average charged in 2002 by credit counseling agencies who are members of the reputable National Foundation for Credit Counseling, the investigation found some agencies charging hundreds or even thousands of dollars per debtor.

Consumers have also complained of being misled about their initial payment, believing it would go to their creditors when instead the money was kept by the credit counseling agency as a fee. The investigation also found that some agencies were providing little or no individualized counseling to their clients, instead, simply directing them to standardized debt management plans.

In addition to excessive fees and poor counseling, the Subcommittee investigation found a pattern of non-profits funneling substantial amounts of cash to affiliated for-profit entities under the guise of paying processing costs or other charges. While reputable credit counseling agencies typically pay monthly processing costs of a dollar to two dollars per debt management plan, the monthly processing costs in the three case studies investigated by the Subcommittee are dramatically larger, typically $25 to $30 or more per plan. In this way, significant sums are transferred from the non-profits to an affiliated profit-making entity.

The Subcommittee found, for example, in a one-year period between June 2001 and July 2002, one credit counseling agency sent over $80 million to its for-profit affiliate. Another for-profit entity over a 4-year period accumulated gross receipts from five different non-profit credit counseling agencies in excess of $386 million.

At the same time, the related owners of the for-profit and non-profit companies were paying themselves lucrative salaries. At one time, for example, in 2002, the owner and his brother each drew salaries of $624,000. This is not how non-profit community-based charities are supposed to operate.

The staff report being released today details three case studies of credit counseling conglomerates which manage billions of dollars in consumer debt and are suspected of engaging in these kinds of abusive practices. All three groups will testify today.

We will also hear from the two Federal agencies with key responsibilities for stopping credit counseling abuses. One is the Internal Revenue Service which has the power to determine whether a tax exempt CCA is acting as a front for a profit-making enterprise. The second agency is the Federal Trade Commission which has the authority to determine whether particular businesses are engaged in deceptive or unfair trade practices. Both agencies have begun to tackle the mounting problems in the credit counseling industry, but much more enforcement is needed.

There is one more group that isn't here today but also has an important role in stopping credit card abuses, and that is the creditors. This is a third group with a real interest in stopping these abuses. Major banks and credit card companies often support credit counseling agencies by providing them with a percentage of the payments made by the debtors they counsel. These so-called fair share payments are a key source of revenue for credit counseling agencies. Creditors can and should do a better job in screening the credit counseling agencies they support to stop abusive practices that hurt debtors and often leave them in worse shape after paying their bills. Creditors have powerful tools to help clean up the industry if they choose to use them. It is clearly in their own financial interest that the money owed to them actually reach them and not be skimmed by unscrupulous operators.

Again, I commend Chairman Coleman for taking on this issue and for shining a spotlight on credit counseling abuses. Too many predatory credit counseling agencies are profiting at the expense of debt-laden consumers who are very vulnerable, at times leaving these consumers worse off than when they found them. It is time to stop these practices before they ruin a vitally needed community service sector.

Again, I thank you, Mr. Chairman, for taking this issue on and for protecting America's consumers.

Senator COLEMAN. Thank you, Senator Levin. Senator Akaka.

**OPENING STATEMENT OF SENATOR AKAKA**

Senator AKAKA. Thank you very much, Mr. Chairman. I will make a brief statement and ask that my full statement be placed in the record.

Senator COLEMAN. Without objection.

Senator AKAKA. I appreciate your conducting this hearing today, Mr. Chairman, and all of the work that has gone into this thorough investigation of the credit counseling industry.

Americans are carrying enormous amounts of debt, and let me mention some data from the Federal Reserve and *Daily Bankruptcy News.* In 2003, consumer debt increased for the first time to more than $2 trillion, according to the Federal Reserve. This is a 28 percent increase since the year 2000. According to the *Daily Bankruptcy News,* consumer debt is now equal to 110 percent of disposable income. Ten years ago, it was 85 percent, and 20 years ago, it was 65 percent. These are daunting facts.

I have placed tremendous importance on the issue of economic and financial literacy so that individuals are able to make informed financial decisions in today's complex modern economy. We must do more to increase financial literacy in our country to help people better manage their credit.

I have sponsored a number of initiatives intended to increase the financial knowledge of students, adults, and investors, and I will continue to pursue these efforts to empower individuals to better manage their finances.

In addition to education efforts, we must ensure that people seeking help in dealing with complex issues, such as debt management, are able to locate the assistance they need and ascertain the quality of such assistance. More and more working families are trying to survive financially and meet their financial obligations. They seek out help from credit counselors to better manage their debt burdens. It is extremely troubling that unscrupulous credit counselors exploit for their own personal profit, individuals who are to locate the assistance that they need. As debt burdens increase, people will need to seek more credit counseling.

I am concerned that certain credit counseling agencies have abused their non-profit tax-exempt status. People believe sometimes, mistakenly that they can place blind trust in all non-profit organizations and that their fees will be lower than those of other credit counseling organizations. Too many individuals may not realize that the credit counseling industry does not deserve the trust that the consumers often place in it.

Many credit counseling organizations simply lead their consumers to debt management plans. This may not be the best option for many consumers. Certain credit counseling agencies fail to provide consumers with their full range of options and recommendations. For some individuals, bankruptcy is appropriate for their set of circumstances and they may be better off in the long run declaring bankruptcy instead of having an ill-suited debt management plan imposed on them.

This flagrant abuse of individuals seeking assistance to help manage their debts by certain credit counseling organizations is appalling. I intend to introduce legislation that will increase fee disclosures and prohibit certain unfair practices so that consumers are adequately protected. We must act to ensure that vulnerable individuals have access to financial education and counseling that they need. Consumers must be better informed about credit counseling fees and the possibility that debt management plans may not be appropriate for them.

In addition, relevant financial arrangements with lenders or other financial service providers need to be disclosed to consumers. In the past, the majority of credit counseling organizations provided a reliable and valuable service to people in need. We must restore consumer confidence in this troubled industry.

Mr. Chairman, I look forward to working with my colleagues and with you to restore trust in the credit counseling industry. Thank you very much.

Senator COLEMAN. Thank you, Senator Akaka.

[The prepared statement of Senator Akaka follows:]

PREPARED OPENING STATEMENT OF SENATOR AKAKA

Thank you, Mr. Chairman. I appreciate your conducting this hearing today and all of the work that has gone into this thorough investigation of the credit counseling industry. Americans are carrying enormous amounts of debt. In 2003, consumer debt increased for the first time to more than 2 trillion dollars, according to the Federal Reserve. This is a 28 percent increase since 2000. The Congressional Research Service reports that the percentage of income used for household debt payments, including mortgages, credit cards, and student loans, rose to the highest level in more than a decade in 2001 and remained above 13 percent in 2003. According to the *Daily Bankruptcy News,* consumer debt is now equal to 110 percent of disposable income. Ten years ago, it was 85 percent, and 20 years ago, it was 65 percent. It is also important to note that when interest rates do eventually rise, consumers will be faced with increasing debt obligations. These are daunting facts.

I have placed tremendous importance on the issue of economic and financial literacy so that individuals are able to make informed financial decisions in today's complex modern economy. We must do more to increase financial literacy in our country to help people better manage their credit. I have sponsored a number of initiatives intended to increase the financial knowledge of students, adults, and investors, and I will continue to pursue these efforts to empower individuals to better manage their finances. In addition to education efforts, we must ensure that people seeking help in dealing with complex issues, such as debt management, are able to locate the assistance they need, and ascertain the quality of such assistance.

More and more working families are trying to survive financially and meet their financial obligations. They seek out help from credit counselors to better manage their debt burdens. It is extremely troubling that unscrupulous credit counselors exploit, for their own personal profit, individuals who are trying to locate the assistance that they need. As debt burdens increase, people will need to seek out more credit counseling.

I am concerned that certain credit counseling agencies have abused their nonprofit, tax-exempt status. People believe, sometimes mistakenly, that they can place blind trust in all nonprofit organizations and that their fees will be lower than those of other credit counseling organizations. Too many individuals may not realize that the credit counseling industry does not deserve the trust that consumers often place in it. The Consumer Federation of America (CFA) found that 46 percent of agencies it surveyed encouraged debt management plan (DMP) participants to view their voluntary contributions as charitable donations. The representation that these fees are voluntary is often misleading and inaccurate.

In addition, many of the fees imposed by credit counseling agencies appear to be excessive. The National Federation of Credit Consumers (NFCC) indicates that the average credit counseling organization in 2001 charged $14 for budget counseling sessions while most banks offered this information for free. Furthermore, the average agency charged $19 to enroll in DMPs, and $12 monthly to service them. To-

gether, these fees equaled $179 in expenses for participants during the first year of enrollment. NFCC has sited that some organizations are charging sliding and fixed monthly account fees as high as $50 and $95, respectively.

Many credit counseling organizations simply lead their customers to debt management plans. This may not be the best option for many consumers.

However, certain credit counseling agencies fail to provide consumers with their full range of options and recommendations. For some individuals, bankruptcy is appropriate for their set of circumstances and they may be better off in the long run declaring bankruptcy instead of having an ill-suited debt management plan imposed on them.

This flagrant abuse of individuals seeking assistance to help manage their debts by certain credit counseling organizations is appalling. I intend to introduce legislation that will increase fee disclosures and prohibit certain unfair practices so that consumers are adequately protected. We must act to ensure that vulnerable individuals have access to financial education and counseling that they need. Consumers must be better informed about credit counseling fees, and the possibility that debt management plans may not be appropriate for them. In addition, relevant financial arrangements with lenders or other financial service providers need to be disclosed to consumers. In the past, the majority of credit counseling organizations provided a reliable and valuable service to people in need. We must restore consumer confidence in this troubled industry. I look forward to working with my colleagues to restore trust in the credit counseling industry. Again, thank you Mr. Chairman for conducting this hearing.

Senator COLEMAN. Senator Dayton.

## OPENING STATEMENT OF SENATOR DAYTON

Senator DAYTON. Thank you, Mr. Chairman. I received a note that you are limiting your opening statements to 5 minutes. I haven't been here long enough to be allowed to make opening statements. [Laughter.]

This is a novelty for me, so that won't be a problem. But I do want to commend you, Mr. Chairman, and this excellent staff for this excellent investigation report. It is very troubling, what you have uncovered, but it is very important as it affects, I am sure, many Minnesotans, whose concerns we share as well as others.

I am mainly looking forward to hearing from the witnesses and getting a perspective of that and I want to compliment the Ranking Member also for involvement of himself and his staff. He has put me to shame, once again. While I was enjoying the balmy climes of Minnesota in March, he was in Iraq for the second time last week savoring that 115-degree or whatever the approximation is this time of year temperature.

Anyway, thank you again, Mr. Chairman. Congratulations on excellent work and I look forward to hearing the witnesses today.

Senator COLEMAN. Thank you very much, Senator Dayton.

I would now like to welcome today's first panel. Raymond Schuck, a consumer who used Cambridge Credit Counseling Corporation's debt management services; John Pohlman, former employee of Cambridge Credit Counseling Corporation; Jolanta Troy, a consumer who used AmeriDebt's debt management services; and Johnpaul Allen, a former employee of AmeriDebt.

I really do appreciate all of you coming today to tell your stories. I want to thank you in advance for your courage in testifying. I know it is probably a pretty daunting thing to be sitting on that side of the hall here.

As I mentioned in my opening statement, we are here to address problems that are facing the credit counseling industry. Mr. Schuck and Ms. Troy, you have had bad experiences with credit counseling

agencies, and since you have been most directly and unfortunately affected by the changes in the industry, I appreciate your willingness to share your stories with us today. And as former employees of credit counseling agencies, Mr. Pohlman and Mr. Allen will enlighten us to the inside operations of some of these new entrants.

Before we begin, pursuant to Rule 6, all witnesses who testify before the Subcommittee are required to be sworn in. I would ask the witnesses to please stand at this time and raise your right hand.

Mr. SCHUCK. May I take it by affirmation, please?

Senator COLEMAN. Yes. Do you swear that the testimony you will give before the Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. SCHUCK. I so affirm.

Mr. POHLMAN. I do.

Ms. TROY. I do.

Mr. ALLEN. I do.

Senator COLEMAN. We will be using a timing system today. You will see the lights change from green to yellow to red. Yellow means time to wrap up. Your full statements will be entered into the record in their entirety.

Mr. Schuck, we will begin with you first, followed by Mr. Pohlman, Ms. Troy, and Mr. Allen, and then after we have heard all the testimony, we will turn to questions.

With that, Mr. Schuck, you may proceed.

## TESTIMONY OF RAYMOND SCHUCK,[1] VICTIM, CAMBRIDGE CREDIT COUNSELING CORPORATION, LIMA, OHIO

Mr. SCHUCK. Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for the opportunity to share my story with you. I am Raymond Schuck and I am here today briefly to share my experience with you in dealing with Cambridge Credit Counseling.

In the summer of 2001, after retiring from 20 years of serving as the director of a museum in Ohio, I found myself in a strained financial situation. I was having difficulty managing my debt, which had risen to the amount of approximately $90,000 distributed among nine credit cards and various banking institutions.

I heard about Cambridge on the radio and I decided to look into what this non-profit credit counseling agency could do for me to help me manage my debt. I called Cambridge and spoke with a credit counselor. The counselor suggested a debt management plan. I was promised a considerable reduction in interest rates and that Cambridge could handle all my accounts.

After answering a list of questions about my various credit cards, the counselor told me my monthly payment would be $1,946. He said that Cambridge could charge me, or would charge me 10 percent of my monthly payment for their services, which amounted to $194 a month. I thought this was high, but I knew very little about the industry and what was appropriate as far as a fee goes. Also, I made the apparently naive assumption that because it was a nonprofit agency, I could trust them.

[1] The prepared statement of Mr. Schuck appears in the Appendix on page 89.

The counselor told me to hurry and send my first payment to Cambridge to get the program started. I sent in a cashier's check and felt optimistic that I was on the right path. I put every credit card I could on the program except for one that I retained for emergencies. And then I started getting calls from some of my creditors. I received calls from three of my creditors asking me why I had not made payments. I told them I was with Cambridge on a debt management plan. Each of these creditors was unaware of this fact and told me that no payments had been received on my behalf.

I called Cambridge to find out what was going on, and getting in touch with someone who knew about my debt management plan and the status of my payments was an exercise in frustration. When I was finally able to speak with someone in customer service who could tell me about my account, I was informed that the first payment I sent to Cambridge, almost $2,000, was a fee for constructing my debt management plan. I was absolutely shocked by this information. Had I known this policy in advance, I would have reached a different—certainly researched and looked into a different credit counseling agency. I would not have agreed to give Cambridge $2,000 when my money could have gone to my creditors.

I made numerous attempts to get matters straightened out with my creditors on the late status of my accounts. Meanwhile, I was receiving no help from Cambridge. In fact, I found out that two of my cards actually never received payment from Cambridge, even though I had been on their plan for several months.

Taking all this into consideration, I felt obligated to file a complaint against Cambridge with the Better Business Bureau of Massachusetts. Not only was I disappointed by Cambridge's failure to provide any financial counseling or assistance to me, but also, I was actually financially worse off after dealing with this company.

My credit rating was completely ruined because of the late payments, and in addition, I was even penalized for these late payments on my own credit card that I had left off the debt management plan. The card raised my interest rate from 9.9 percent to 24 percent because they saw the late payments on the other accounts.

After the mess of dealing with Cambridge, I went to a local credit counseling service. This agency accepted a monthly donation. There was no set-up fee like Cambridge. I was on a debt management plan with this agency for about 2 months when it became clear to me that the only reasonable option was to file for bankruptcy, which, in retrospect, I probably should have done in the first place.

It seems to me that if Cambridge had done a reasonable analysis of my financial circumstances, the proper recommendation would have been to advise me that a debt management plan was not a feasible option. Putting me on a debt management plan that cost $2,000 plus a high monthly maintenance fee seems irresponsible and far from what one considers a normal practice for a non-profit agency.

Having directed a non-profit organization myself for 20 years, I know that if I had operated my organization the way Cambridge operates their organization, my non-profit status would have been revoked. I can only conclude that credit counseling agencies such

as Cambridge are more interested in making profits than they are in providing financial advice and education.

Thank you for allowing me to tell my story and I look forward to answering any questions that you may have.

Senator COLEMAN. Thank you, Mr. Schuck. Mr. Pohlman.

**TESTIMONY OF JOHN POHLMAN,[1] FORMER EMPLOYEE, CAMBRIDGE CREDIT COUNSELING CORPORATION, EAST GRANBY, CONNECTICUT**

Mr. POHLMAN. Mr. Chairman, Senator Levin, and Members of the Subcommittee, it is an honor to be here today to testify about working in the credit counseling industry and specifically working at Cambridge Credit Counseling.

I began working in the credit industry in 1991. I worked for two different National Foundation of Consumer Credit agencies until I was laid off by Consumer Credit Counseling Services of Southern New England, who was downsizing due to the state of the market. Large national credit counseling agencies were acquiring significant portions of the market, causing National Foundation of Consumer Credit agencies to merge amongst themselves or to close their offices altogether.

With this in mind, I decided to look for a job with one of those larger organizations, so I applied and was hired as a counselor with Cambridge in September 2003. It did not take me long to realize that Cambridge's approach to the credit counseling industry was fundamentally different from mine. I disagreed with most of Cambridge's practices, particularly those that related to how they treated, managed, and served their customers.

On the first day at Cambridge, I had to pick a false name. I chose my son's name, Daniel. I thought this practice was very strange, although most every Cambridge employee uses a fake name when they are on the telephone talking to their customers. I did not understand why I was unable to use my own name when I was dealing with customers. I would always use my own name in the past. Even management personnel used different names.

This, sir, was my first clue that I was about to take a trip down a disheartening path. I was immediately uncomfortable with the environment at Cambridge. I would describe it as a boiler room mentality. All the counselors were in a large room with video cameras on us all day long. You had to clock in and out to go to the bathroom, to eat lunch, even to make a personal call.

There was an electronic board at the front of the room that reminded me of the leader board in a golf tournament. It had the names of the counselors who had top sales for the month in red and yellow flashing lights. This exhibited an obvious emphasis on the sale of debt management plans.

In addition, I was surprised to learn that Cambridge paid commissions to its counselors based on the size of the up-front fees that are charged to their customers. A counselor could earn 25 percent of this amount. Some counselors were rewarded with 2-week sales trips to Florida for high sales volume. This was unusual to me, as

[1] The prepared statement of Mr. Pohlman appears in the Appendix on page 91.

it was clear it would give the counselor motive to enroll consumers on a debt management plan regardless of their financial situation.

Along with positive incentives for sales, Cambridge also used negative incentives when a counselor had low sales. On the refrigerator in the Cambridge lunchroom, a sign hung on the refrigerator saying, "The two lowest producing counselors will be cleaning the refrigerator on Saturdays."

Cambridge's overall approach to the consumer was the most troubling matter for me. I was entirely dissatisfied with the level of scrutiny this company gave to a consumer's financial circumstances when making such important decisions as whether to go on a debt management plan. There are many options out there in addition to the debt management plan—education, self-budgeting, financial restructuring, and yes, in the worst case, bankruptcy. I never heard any of these options discussed by anyone at Cambridge. It was focused solely on the debt management plan.

In my experience working at the National Foundation of Consumer Credit agencies, I would spend an hour and a half working with a consumer and their finances. When I was at Cambridge, this process was expected to take roughly 10 to 15 minutes, all the time that was needed because the only information that we got from the consumer was the account information. There was no true budget analysis done for the consumer. It was just an analysis to determine whether their creditors would allow the consumer to enroll in the debt management plan.

I was uneasy with the fact that I did not know anything about the person's mortgage payments, health care costs, car insurance, etc. How could I recommend this person to go on a debt management plan? I knew nothing about them except that they were in debt.

With the time they spent with the consumer so limited, I had little confidence that they understood that the first payment was kept by Cambridge. In fact, I was trained to tell the customer, "I will be faxing you the paperwork. It is very simple and easy to fill out, shouldn't take you more than 10 minutes." But this was a pressure tactic that we were supposed to use. It was a goal to authoritatively take them through the process of signing up the plan as quickly as possible. I was even instructed by one member of management to "Treat them like alcoholics." In other words, they need to know they need help. Make them get it. Be authoritative and be forceful.

I truly believe that Cambridge preyed on a consumer's desperation. In fact, I was regularly reprimanded for being too nice to consumers. I was told to stick to the scripts. There was no need for conversation or pleasantries. Words cost money and defeat the purpose.

I only worked for Cambridge for 2 weeks, long enough to realize that the practices of companies like Cambridge can give the entire industry a bad name. Agencies like Cambridge abuse the trust and vulnerable position of financially stressed consumers and fail to provide any meaningful counseling or education.

I came here today to help this Subcommittee understand that something must be done about the credit counseling agencies like

Cambridge. The industry must be reformed for the good of the American consumer. Thank you.

Senator COLEMAN. Thank you very much, Mr. Pohlman. Ms. Troy.

**TESTIMONY OF JOLANTA TROY,[1] VICTIM, AMERIDEBT, INC., CARLISLE, PENNSYLVANIA**

Ms. TROY. Good morning, Mr. Chairman and Members of the Subcommittee. My name is Jolanta Troy and it is an honor to sit before you this morning to tell you about my experience with the company called AmeriDebt.

In 1999, shortly after my divorce, I found myself in a terrible financial situation. I am a behavior specialist consultant. I work with mentally ill children and children with behavior problems. I love working with the kids, but I don't necessarily make a lot of money. I have two young children who I have been raising by myself since my husband and I split up. I had to use my credit cards to help support my children and myself. The expenses started adding up and my credit card debt reached a level I could not manage. I was $30,000 in debt.

I was very upset and depressed at this time of my life. I was in terrible financial trouble. I was worried about my bills and losing my house. I had no family here and nobody to turn to to borrow money from or for support.

I saw a commercial for AmeriDebt on television. They said they were a non-profit company, so I called AmeriDebt and I spoke with a counselor who told me to go on a debt management plan. I wasn't sure what to do and I wanted to think about it for a while. After this call, the counselor called me back four times, four different times. Every time the counselor called, she would tell me how bad my situation was and that I needed to do something about it. This counselor also said that AmeriDebt was a non-profit organization, like a charity, and that I needed their help. She was very pushy and almost degrading. She made me feel embarrassed and ashamed, but I eventually decided to go on the program.

The AmeriDebt counselor told me there would be a small monthly charge, but since they were a non-profit, I was not worried about the fees. The counselor told me to send a money order to AmeriDebt right away for $783 so they could start my payment program as soon as possible. So I sent AmeriDebt $783 and believed my debt management program would be set up immediately and money would be going to my creditors.

Then I started receiving calls from the credit card companies asking why I had not paid them. I tried to get in touch with my counselor at AmeriDebt. I called customer service and they told me that AmeriDebt kept the money as a voluntary contribution. I knew that I agreed to a monthly charge, but I knew nothing about them keeping my first payment as a voluntary contribution. This was the first I heard of this.

I told AmeriDebt that I wanted a refund. They said it was too late and they would not give me a refund. I was devastated. I wrote to Better Business Bureau, but AmeriDebt still would not re-

[1] The prepared statement of Ms. Troy appears in the Appendix on page 93.

fund my money. AmeriDebt wrote a letter saying that I had agreed to make a contribution. That was not true. They never refunded my money to me. I could not afford to give AmeriDebt $800. I thought that money would go to my credit cards to pay down my balances.

I did not have any money left over to pay my credit card bills that month. I was still getting calls from my creditors. They were now charging me late fees because they had not received my payments. I was in a worse position than before I went to AmeriDebt. I felt that I had no choice but to go to a lawyer to help me file for bankruptcy. I wanted to be able to pay my bills, but my income only stretched so far.

I am here today so that no other person has to go through what I did. AmeriDebt took advantage of me. They present themselves as some kind of charity there to help people. Instead, they took almost $800 from me when they knew how bad my finances were. This company preyed on me when I was at a most vulnerable time, when I was frightened and unsure how to manage my finances. I feel like my fears were manipulated by AmeriDebt for their own benefit. Something must be done to stop companies like AmeriDebt who are making money off good people who are just trying to do the right thing.

Thank you very much.

Senator COLEMAN. Thank you, Ms. Troy. Mr. Allen.

**TESTIMONY OF JOHNPAUL ALLEN,[1] FORMER EMPLOYEE, AMERIDEBT, INC., NEW MARKET, MARYLAND**

Mr. ALLEN. Mr. Chairman, Senator Levin, and Members of the Subcommittee, good morning. My name is Johnpaul Allen. I am speaking to you this morning because of my experience as an employee with AmeriDebt. I worked at AmeriDebt as a credit counselor during the summer of 2003. My experience at AmeriDebt was frustrating and disappointing.

I was interested in being a credit counselor because I enjoy working with people and helping them. I thought that working for a non-profit organization would be a great way to interact with people and to actually make a difference in somebody's life. What I found at AmeriDebt was nothing short of a sweatshop, a telemarketing outfit taking advantage of thousands of people in bad financial situations.

I should have seen a red flag during my interview with AmeriDebt when I was asked by my interviewers to sell them a stapler to prove that I can make a sales pitch. That is really what AmeriDebt is all about, sales. The goal for AmeriDebt's counselors was to sell consumers a debt management plan regardless of whether they needed it or not. When I was training for my position as a counselor, I asked about the education provided to consumers on financial matters. I was told by management to "concentrate on getting them on a debt management plan."

Throughout my time working at AmeriDebt, I was reprimanded for spending too much time with consumers on the phone. When I was trained, I was told that each call should take no more than 20 to 25 minutes and I would generally spend at least that long

[1] The prepared statement of Mr. Allen appears in the Appendix on page 95.

with each caller explaining our program. Several times, I was instructed to spend less time on each call and that my calls should be no more than 15 minutes. This bothered me because I didn't want to have to rush through such important things with consumers who really needed my help.

Another thing I was repeatedly reprimanded for was the information I was giving to customers. AmeriDebt charges a set-up fee and a monthly fee, or as they call it, a "voluntary contribution." The consumer was supposed to have a choice whether they wanted to pay the contributions. I would always tell the customer that they did not have to pay the voluntary contribution, or if they wanted, they could make the initial contribution or the monthly contribution and not necessarily both. At least two or three times a week, I would get pulled aside by my managers and instructed to make sure that consumers paid the voluntary contribution. The managers would say such things to me like, "Do you know that you are letting them choose to pay or not to pay your salary?" Or, "Think of all the money you could make if you collected those voluntary contributions."

What they were referring to were the bonuses that could be made for enrolling people on debt management plans. AmeriDebt would pay you a commission every 2 weeks for the number of debt management plans you signed up or if you hit a certain amount of voluntary contributions.

The pressure to get people signed up on the debt management plan was significant. In fact, the only time we were allowed to go off the script on a call was when a customer was not going to give the voluntary contribution. We were instructed to say things like, "Don't you want us to be around for the next person?" We would tell them that we were a non-profit corporation and thus subject to be audited by the IRS in an effort to gain their trust in our fees and their reasonableness. These were practices that seemed strange for a non-profit organization.

In addition to feeling like a used car salesman pushing these debt management plans, I also had concerns about the service that these customers were getting after they set up on a plan. I would get calls from people 2 or 3 months after I set them up on a plan complaining that their creditors had still not received a payment. The only thing I could do was to refer them to The Ballenger Group. I did not have access to the consumer's payment information.

One time, I took a special interest in a particular client's predicament. This man was named Derek and he kept calling me because his creditors were not getting paid. I tried several times myself to get in touch with someone over at The Ballenger Group so I could help this man, but to no avail. I felt helpless and responsible, since it was me personally who had enrolled Derek on the debt management plan.

I made the decision to leave AmeriDebt shortly after that. I wanted to help these people, but in the end, I felt I had done them a disservice. I can relate to these people. I have been through tough financial times myself and have had to file bankruptcy several years ago. I know how these people feel. No one wants to declare bankruptcy. The average person wants to take responsibility and

pay their bills. They want to do the right thing and AmeriDebt just pulls the rug right out from underneath them.

I am thankful for the opportunity to be heard on the real need for change in the practices of the companies like AmeriDebt and I thank you for your time.

Senator COLEMAN. Thank you very much, Mr. Allen.

Each of the witnesses talked about non-profit. Ms. Troy, you mentioned it twice in your testimony, that it was a non-profit. Mr. Allen, I think I would describe you as talking in altruistic terms, working for a non-profit, wanting to help people. For the sales people, was there any doubt in your mind that the use of the non-profit was as a vehicle to get the trust of the customer?

Mr. ALLEN. Without a doubt.

Senator COLEMAN. Was there any question about that?

Mr. POHLMAN. No.

Mr. ALLEN. If I were to tell you that we were a 501(c)(3) corporation subject to be audited by the government every 3 months, I believe people do put a little trust in that.

Senator COLEMAN. Mr. Schuck, you have worked with non-profits. Did you come in with a preset notion of it being a non-profit? What did that mean in the back of your mind? What were your expectations of dealing with a non-profit?

Mr. SCHUCK. My expectations were that I could trust them. I felt they had the fiduciary responsibility as a non-profit to take that trust and hold it sacred and, therefore, I felt quite comfortable working with them initially until actually I started to and then it changed and went the other way.

Senator COLEMAN. Both Mr. Pohlman and Mr. Allen—excuse me. Ms. Troy, you mentioned that twice. You used the phrase non-profit. Can you tell me what, in the back of your mind, what you were thinking?

Ms. TROY. Yes. For me, I understood non-profit organization as an organization which is getting donations or grants from some sources, the State possibly, and I was sure that those were trusted sources. I never thought that they might be actually making profits. I thought they were designated to help people.

Senator COLEMAN. Mr. Allen, you made a comment and we have a chart there, for the DebtWorks-Ballenger Group.[1] I think DebtWorks is a predecessor to The Ballenger Group, but The Ballenger Group then would be where DebtWorks is today. You made the comment that you were concerned about one of your customers——

Mr. ALLEN. Yes, sir.

Senator COLEMAN [continuing]. And when you wanted to track down what happened, you said you had to check with The Ballenger Group? In other words, there wasn't anybody within AmeriDebt who could answer those questions?

Mr. ALLEN. There was no one at AmeriDebt that could answer the questions. I would try to go in to my supervisor, to go to my supervisor's supervisor, tried going up the chain as best I could to no avail. They didn't have the questions.

[1] See Exhibit No. 2 which appears in the Appendix on page 241.

Senator COLEMAN. Did you understand what the relationship was between AmeriDebt and The Ballenger Group?

Mr. ALLEN. I did. From the time that we get a consumer's information back, it is checked over and then it is sent over to The Ballenger Group. The Ballenger Group is the group of people that are responsible for setting up the program, contacting the creditors, or so we thought. So it seemed natural to get a hold of The Ballenger Group to find out what is going on with this particular person's case.

Senator COLEMAN. Were you aware that DebtWorks or The Ballenger Group you dealt with is a for-profit organization.

Mr. ALLEN. Yes.

Senator COLEMAN. Both of you, to Mr. Pohlman and Mr. Allen, talked about the environment. I just want to touch on what is probably obvious here, but when you talked about sales and bonuses, were there any bonuses for enrolling people in an education program? Mr. Pohlman.

Mr. POHLMAN. No, absolutely not.

Senator COLEMAN. Mr. Allen.

Mr. ALLEN. The only thing I educated people on was how to send their payment in.

Senator COLEMAN. And the big board, Mr. Pohlman, that you talked about, was there any doubt in your mind that board was about sales of debt management plans?

Mr. POHLMAN. Oh, absolutely not. You wanted to be there. I wanted to see my name up there some day——

Senator COLEMAN. What kind of bonuses, were they?

Mr. POHLMAN. Training trips to Florida. There was a commission based on the amount of DMPs that we sold, in addition to an hourly wage, in addition to health care benefits. So it was clear there was an emphasis on putting people on the DMP.

Senator COLEMAN. Both to Mr. Schuck and Ms. Troy, I want to kind of focus again on this education issue. Non-profits are supposed to provide education. Mr. Schuck, can you tell us what kind of education or what kind of counseling you received from Cambridge?

Mr. SCHUCK. I received absolutely no counseling and absolutely no education.

Senator COLEMAN. You were asked to make your payment at what point in time in this transaction?

Mr. SCHUCK. My estimated payment?

Senator COLEMAN. When were you asked to make it?

Mr. SCHUCK. Oh, when was I asked to make the payment?

Senator COLEMAN. Yes.

Mr. SCHUCK. Oh, I am sorry. As soon as I had the initial contact with a fellow from Cambridge. He asked me to make a payment and that the payment should be in the form of a cashier's check or a money order, not a personal check, and that I should send it out immediately. In fact, before I even had signed the contract, he wanted payment.

Senator COLEMAN. So you, in fact, sent out a cashier's check.

Mr. SCHUCK. That is right.

Senator COLEMAN. This is before any education, of which there was none, any counseling, of which there was little or none?

Mr. SCHUCK. Oh, yes.

Senator COLEMAN. Ms. Troy, you made an attempt to get back your money. During the course of this time as you tried to get it back, can you talk about the education and the counseling that you received from AmeriDebt?

Ms. TROY. There was no education, absolutely none. It was just pushing me to set up a management plan, the bill management, debt management plan, and actually to make a payment on time because there was a due date, so I sent the money Western Union as soon as I got my paycheck. But there was absolutely no education, no support of any kind.

Senator COLEMAN. Mr. Pohlman and Mr. Allen: One of the goals of credit counseling, I presume if you are going to solve a problem, is to analyze somebody's financial situation. Can you give me a little more information on what kind of budget analysis that you were instructed to do for your clients? Mr. Pohlman.

Mr. POHLMAN. Yes, sir. I was not allowed to give any budget analysis to the client. What I was able to do was to give them a script. I was to get them to commit to me sending them the paperwork. It was seven pages of paperwork. I was told to tell them it was very easy to fill out. It would take 10 minutes. They would send it back to me via fax and I would have their new payment amount later in the day. So there was no budget analysis.

Senator COLEMAN. So you were attempting to enroll people in the DMPs before any budget analysis?

Mr. POHLMAN. Absolutely.

Senator COLEMAN. Is a debt management plan the right path for every person in debt?

Mr. POHLMAN. No, absolutely not. There are many other areas. There is self-administration. There is referral to other non-profit agencies. There is certainly the legal option.

Senator COLEMAN. And I presume there are times when you simply look at the facts and say that bankruptcy may be the option for that person.

Mr. POHLMAN. Of course, particularly in a very large deficit and depending on the creditors involved.

Senator COLEMAN. But the only bonuses and the only incentives that both you and Mr. Allen were given was for signing up debt management plans?

Mr. POHLMAN. Exactly.

Senator COLEMAN. Mr. Schuck paid a fee of close to $2,000 dollars. Eleven years in the business, can you assess, in terms of the amount of that fee, do you find that unusual?

Mr. POHLMAN. It is appalling. It makes me very upset.

Senator COLEMAN. Mr. Schuck, you did sign a contract,[1] and I think we have a copy of that.

Mr. SCHUCK. Yes, I had.

Senator COLEMAN. And that contract did provide a disclaimer in there about the payment, is that a fair statement?

Mr. SCHUCK. You have to find it, but it is in there.

Senator COLEMAN. How many pages is that contract?

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[1] See Exhibit No. 4 which appears in the Appendix on page 243.

Mr. SCHUCK. I don't recall the exact number, but I know it was a multi-page contract.

Senator COLEMAN. Is that exhibit a copy of the conract that we are looking at now? Is that a copy of the contract?

Mr. SCHUCK. Yes, it is. It looks exactly like the one that I signed.

Senator COLEMAN. Five pages?

Mr. SCHUCK. That is right.

Senator COLEMAN. But there is on the second page, I do note, there is a provision in there that says, summary of Cambridge's fee. Monthly payment design fee equals proposed monthly payment equals one time only.

Mr. SCHUCK. I see that. That is right, yes. And actually, it was only later that I realized that was the initial fee. I had no reason at all to believe that first payment wasn't going to my creditors.

Senator COLEMAN. Ms. Troy, did you have any reason to believe that you were paying, was it $783——

Ms. TROY. Seven-hundred-eighty-three dollars, yes.

Senator COLEMAN [continuing]. That money was going to the credit counseling agency rather than to your creditors?

Ms. TROY. No. I had no idea until I started to get calls from the creditors. I was sure that was going to my monthly payments. And then I confirmed with AmeriDebt that they received my payment and they said they did, and when I talked to the customer service, that is when I found out that the first payment is my voluntary contribution.

Senator COLEMAN. Mr. Allen, you talked about a script.

Mr. ALLEN. Yes, sir.

Senator COLEMAN. Mr. Pohlman, did you have a script?

Mr. POHLMAN. Absolutely.

Senator COLEMAN. In that script, were there—and I think we have a copy,[1] I am not sure whether it is for Cambridge or AmeriDebt—but were you given responses if someone said that, "I don't think I want to make a payment now," or "I don't want to make a voluntary contribution?" Would the script provide your answers? Mr. Allen.

Mr. ALLEN. There were no set answers given to us from a script as to how to deal with that. We were given guidelines, suggestions from supervisor, training staff. I believe I made mention of it in my statement. We were supposed to make them feel guilty, make them ashamed that they weren't going to keep us around for the next person.

Senator COLEMAN. When you were credit counseling, did you have a training manual? Did you ever take a look at that?

Mr. ALLEN. Yes, I did.

Senator COLEMAN. And in that manual—this purports to be a copy of a page from the Credit Counseling training manual.[1] Does that look familiar to you?

Mr. ALLEN. Yes, it does.

Senator COLEMAN. And at one point, it says for the statement, "I cannot afford a contribution now, but maybe I can afford to contribute later," and do you have a prepared response that you are supposed to give back?

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[1] See Exhibit No. 14 which appears in the Appendix on page 00.

Mr. ALLEN. Again, it was something that we were to make up on the spot. We were supposed to use our selling techniques.

Senator COLEMAN. The idea was to do what?

Mr. ALLEN. The idea was, if you can do this later, why can't you do this now? What is keeping you from doing it right now? It was all about the "right now."

Senator COLEMAN. Thank you, Mr. Allen. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

First, Mr. Schuck, you were told to send in a cashier's check, not a personal check?

Mr. SCHUCK. That is right.

Senator LEVIN. Why was that? Did they tell you why they wanted a cashier's check instead of——

Mr. SCHUCK. No, they did not. I only had to surmise that it perhaps was safer and that was it. But they did not explain why. They just simply said they would not take a personal check.

Senator LEVIN. And you were told originally on the phone that 10 percent of your check would go to them for a fee?

Mr. SCHUCK. That is right.

Senator LEVIN. Did they distinguish between a monthly fee and your original fee?

Mr. SCHUCK. Not that I intentionally recall. I know the initial payment had to be made because that is what they said, they needed to get started. And like I said, in my thoughts, thinking my creditors are being paid, and that there would be then a monthly fee of 10 percent of every payment that I made that would go toward a maintenance fee of the contract for the life of the contract period.

Senator LEVIN. Did they distinguish between the initial fee and the monthly fee?

Mr. SCHUCK. Yes, they did, actually.

Senator LEVIN. And then what——

Mr. SCHUCK. There were two separate——

Senator LEVIN. What did you believe the initial fee would be?

Mr. SCHUCK. Well, I thought the initial fee would go toward my creditors. I thought that initial monthly fee was actually like what I would consider my first payment, my first fee.

Senator LEVIN. So that after that conversation, you believed that all of the check you were sending would go to your creditors, and from that point on, 10 percent of each of your monthly checks——

Mr. SCHUCK. Each monthly fee would be the maintenance fee, that is right. Actually, I thought the first $196 or whatever it was, the 10 percent of that first payment, was actually the maintenance and start-up fee. That would be, to me, in my mind, that was what their fee would be to run the program, basically, and that the $2,000 that I sent or the other amount would be the amount that is paid to my creditors. Of that, 10 percent would come out for them.

Senator LEVIN. How many payments did you make?

Mr. SCHUCK. Several payments. I was in the program for, I believe, maybe half a year, 7 months, and finally after calls and trying to work out some sort of a compromise with them, I simply could not and I just simply stopped——

Senator LEVIN. There were several payments that were made?

Mr. SCHUCK. That is right.

Senator LEVIN. As many as three or four?

Mr. SCHUCK. Oh, absolutely.

Senator LEVIN. Out of the second, third, fourth payments, did they retain 10 percent and send the rest of those payments to your creditors?

Mr. SCHUCK. I can only assume that they had. I did not receive something that indicated to me that they might not have.

Senator LEVIN. So the difficulty you had with creditors was over that first payment which did not get to the creditors, not over the 10 percent that may have been withheld from your second through your fifth or sixth payment?

Mr. SCHUCK. I believe that is right, because apparently the creditors, when I called them—I remember one day specifically where I had called—a creditor called me. I talked with them. They said they hadn't received payment. I called Cambridge and said they said they hadn't received payment. What is going on? They said, "No, we have paid them." And then I called the creditor back and they said, no, indeed Cambridge had not paid them. And so there seemed to have been more than just that one payment.

Senator LEVIN. And Mr. Pohlman, what did you represent to folks about that first payment?

Mr. POHLMAN. We also had scripts at Cambridge that were very highly structured. We were not allowed to take the employee handbook, or bible, as I called it, home. The idea was to get them to commit to the plan. Yes, they were told verbally that the first month's fee would be retained by the organization, but again, I had to fax the paperwork to them. They had to fill it out. They had to send it back.

So yes, I told them there was a monthly fee up front, but I didn't even know what it would be until it came back from the Automated Underwriting Department and then I would tell them. But by then, they have already forgotten about it or they are too excited that someone is going to take all the pain away from them. So it was really kind of an illusion, if you will. In other words, they were verbally told in a 5 minute conversation, perhaps while they were driving, that, yes, there is a service fee that is retained by the Cambridge organization.

Senator LEVIN. From the first payment?

Mr. POHLMAN. Yes, sir.

Senator LEVIN. Were you told to create an impression of any kind relative to the first fee going totally to the——

Mr. POHLMAN. Oh, gosh, no. Again, these were highly structured scripts in which——

Senator LEVIN. Yes, but when you say highly structured, what was the impression that was created in the mind of the listener, that it was all going to the company?

Mr. POHLMAN. The impression—no——

Senator LEVIN. That a part of it was going to the company?

Mr. POHLMAN. The clients were told that 1 month, the first month's fee, was a service type of fee and it was to be retained by the organization. I don't recall their exact verbiage, but the verbiage was very confusing, very authoritarative. It was glossed over.

Senator LEVIN. Are you surprised that people like Mr. Schuck got the impression that the first month's payment would go to creditors?

Mr. POHLMAN. No, absolutely not.

Senator LEVIN. That doesn't come as a surprise to you no matter what it was that you were saying on your script?

Mr. POHLMAN. No, sir.

Senator LEVIN. Ms. Troy, what were you told in terms of that first payment?

Ms. TROY. As far as I recall, the first conversation with the counselor, I was told that I would be paying about $5 per account. That would be the monthly fee which will be going from month to month. And based on my number of my credit cards, I figure it will be probably about $30, $35 a month. She mentioned a voluntary contribution and I told her, I am not in a position right now to give any voluntary contributions to anybody. And she said, well, you don't have to. We can do that later. Just don't worry about it. It was just something like that.

Senator LEVIN. And what about that first month's payment? What were you told about it? Was that any different from the other payments that would follow?

Ms. TROY. No. I was not informed about any difference. To my full knowledge, the first payment I sent, it was going to cover my debts to my creditors.

Senator LEVIN. And that is the impression you got from the phone call?

Ms. TROY. Definitely, yes.

Senator LEVIN. And you signed a contract, as well?

Ms. TROY. I believe I signed the contract.

Senator LEVIN. Did you read the contract, or could you have read it given the size of the print?

Ms. TROY. I have difficulties with reading without glasses——

Senator LEVIN. You should try a magnifying glass on some of those contracts.

Ms. TROY. From now on, I will.

Senator LEVIN. Mr. Allen, were you surprised to hear that Ms. Troy believed that her fee that was sent in, or the check that was sent in with her first payment, she thought would go to her creditors? Does that surprise you?

Mr. ALLEN. Yes and no. As a counselor, I gave my consumers a choice. Because we were a non-profit organization, I took it at face value. If we are not here to make a profit, why should I push the contributions? I gave people a choice. They could either do a monthly contribution, and by the time I came on in 2003, the costs had risen slightly. It was now $7 for every creditor you put on the program, with a $20 minimum and a $70 maximum that AmeriDebt would accept as a monthly payment.

Senator LEVIN. As the alternative to what?

Mr. ALLEN. As an alternative to not make a contribution——

Senator LEVIN. At all?

Mr. ALLEN. At all.

Senator LEVIN. And could you be given that service if you made no contribution?

Mr. ALLEN. Supposedly.

Senator LEVIN. Did you have people who were serviced by your company who made no contribution whatsoever?

Mr. ALLEN. I serviced many consumers that decided not to give a contribution one way or another.

Senator LEVIN. And were they serviced, do you know?

Mr. ALLEN. As far as I know and as far as I hope. I hope that——

Senator LEVIN. You hope they were?

Mr. ALLEN [continuing]. What they signed for is what they got.

Senator LEVIN. And so they may or may not have been serviced if they made no contribution whatsoever, either up front or month-by-month, is that correct?

Mr. ALLEN. Very true.

Senator LEVIN. So you just don't know that part of it?

Mr. ALLEN. I just don't know. I never saw them, the maintenance of these——

Senator LEVIN. And were they told that the first payment that they would send, like the $700-and-some that Ms. Troy sent, would go entirely to the company? Is that the impression which was left with them? Her impression was only a small part of it, as I remember her testimony, would go to the company, the rest to her creditors. Are you surprised that she had that impression?

Mr. ALLEN. I am surprised that it actually happened based on what her counselor had told her. If her counselor had said, we will not worry about it at this point in time, to me, that seems then my first payment is going to my creditors. Now, like I said, I can only speak for myself and the type of counselor that I was.

Senator LEVIN. I understand. And then were you told that you could send a personal check?

Ms. TROY. No. They didn't accept personal checks. I had to obtain cashier's checks from my bank because it was the only option, cashier's checks or money order.

Senator LEVIN. Did they explain to you why they would not accept a personal check?

Ms. TROY. No, they didn't, but I figured that maybe, if people realized what went wrong, they can always stop the check. You cannot stop the money order or cashier's checks.

Senator LEVIN. Thank you. Thank you, Mr. Chairman.

Senator COLEMAN. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman. I want to thank all of you for coming forward today and sharing your experiences with the Subcommittee.

Mr. Schuck, when did you contact Cambridge Credit?

Mr. SCHUCK. I contacted them when I realized that I simply wanted to control the debt that I had.

Senator DAYTON. What date? At what point in time?

Mr. SCHUCK. It was—point in time—it must have been about in June or something in 2001.

Senator DAYTON. Two-thousand-one, OK.

Mr. SCHUCK. I believe it was——

Senator DAYTON. Were you sent then at some point in the process this service plan, service agreement?

Mr. SCHUCK. I am sorry?

Senator DAYTON. Were you sent at some point in the process a service agreement?

Mr. SCHUCK. Yes, sir, I was.

Senator DAYTON. And when was that in the process?

Mr. SCHUCK. It would have been after I talked with them, they indicated they would be able to fax me a copy of the service agreement.

Senator DAYTON. And did you read the agreement, then?

Mr. SCHUCK. Well, I read it as fast and as close as I could thinking——

Senator DAYTON. And you were——

Mr. SCHUCK [continuing]. The sooner I get it back, the better off I will be.

Senator DAYTON. But you were not aware, based on your review of that document, of this monthly payment—the first monthly payment was, in fact, going to be a set-up management fee to them?

Mr. SCHUCK. No, I was not. No. And certainly in retrospect, now looking back, I should have read the document a lot closer. It was only several months later that I realized that.

Senator DAYTON. Mr. Pohlman, you joined the company in September of last year?

Mr. POHLMAN. Yes, sir.

Senator DAYTON. I don't know what changed in terms of the format of the document that was sent. This one is five-pages, single-spaced. We have a document that has been provided by the company. You haven't had a chance to see that, but at what point in the process was that document sent to your people you were recruiting?

Mr. POHLMAN. Just about right on the first contact, sir. I was going to explain myself, the organization, and how we can help them. I was to push and push and push until I could fax the service agreement and the creditor information to them. I was to tell them that it was very simple to fill out, takes about 10 minutes. They were instructed to fax it back to me immediately and I would be calling them back later that day with their new payment amount.

Senator DAYTON. So they are getting the service plan. Are they then at that point aware of what their actual monthly payment is going to be?

Mr. POHLMAN. No. When I am faxing the service agreement to them, they are to review it and review it closely, fill out their creditor information, send it back to us. We would process that and then I would contact them later today with their new payment amount.

Senator DAYTON. OK. So they are signing this document——

Mr. POHLMAN. The agreement——

Senator DAYTON [continuing]. They are agreeing to terms without knowing what those terms are, if they haven't received word about what their monthly payment is going to be, and the 10 percent on top of that.

Mr. POHLMAN. But I am faxing them out the five-page service agreement——

Senator DAYTON. Right.

Mr. POHLMAN [continuing]. A one-page cover sheet and the creditor sheet.

Senator DAYTON. Right, and they are filling that out and they are signing a document here that I believe is—I haven't read the whole document, but is an agreement they are making for payment of an amount that has not yet been specified to them, is that——

Mr. POHLMAN. The first month's payment.

Senator DAYTON. The first month's payment, all right. What is the value to the client of this arrangement? You are consolidating all or some portion of their existing credit card debt——

Mr. POHLMAN. Right.

Senator DAYTON [continuing]. And then that determines the monthly payment, and then on top of that is a 10 percent fee collected by or retained by Cambridge Credit. What does that monthly payment amount to?

Mr. POHLMAN. Typically a repayment of a debt management plan is 3 to 5 years, depending on the amount of the debt.

Senator DAYTON. So you are paying off the credit card companies based on a monthly payment of X amount——

Mr. POHLMAN. Yes.

Senator DAYTON [continuing]. And then in addition to that X amount, there is another 10 percent surcharge on that?

Mr. POHLMAN. No. It would have been included in the total——

Senator DAYTON. Included in that, OK.

Mr. POHLMAN [continuing]. Payment amount.

Senator DAYTON. So that 10 percent is in there. So the 90 percent, then, is sufficient to pay off these existing debts plus interest within 3 to 5 years.

Mr. POHLMAN. That is the theory.

Senator DAYTON. Do you make that computation?

Mr. POHLMAN. No, sir. I believe it was an automated process in the computer system.

Senator DAYTON. So you plug in the information and then the computer spits out the terms?

Mr. POHLMAN. No. They were highly sophisticated. The client was instructed to fax the information back to us and it was faxed into their system and it was electronic from there on.

Senator DAYTON. Electronic being that some computation then is made of the amount necessary to pay off all the debts within three to 5 years plus the 10 percent surcharge for the company.

Mr. POHLMAN. Yes, sir. Creditors have minimums and there are some——

Senator DAYTON. Right, and that is all included in the 90 percent.

Mr. POHLMAN. Yes. It is all included in the monthly payment amount.

Senator DAYTON. So what is the benefit to the client?

Mr. POHLMAN. I don't see any.

Senator DAYTON. But what are you representing as the benefit when you sign up the client?

Mr. POHLMAN. That they are going to be debt free within a specified period of time.

Senator DAYTON. Is there any value in that? You are basically in sales. If he calls back to try to get any clarification of the informa-

tion about why money wasn't sent to creditors, you don't take those calls?

Mr. POHLMAN. No, sir. We were highly departmentalized and customer service was a separate department and we were not encouraged to speak with other departments.

Senator DAYTON. You are representing yourself as a credit counselor?

Mr. POHLMAN. Yes, sir.

Senator DAYTON. You are a credit counselor, but you don't deal with customer service?

Mr. POHLMAN. Once they are on the plan, it was out of my domain.

Senator DAYTON. So, what kind of counseling is actually——

Mr. POHLMAN. Performed?

Senator DAYTON. Yes.

Mr. POHLMAN. Little to none, sir.

Senator DAYTON. At all. If somebody actually wants either some questions asked or some actual hands-on direct counseling after you have enrolled them, then that goes on to someone else. What do they call themselves, do you know? They are not credit counselors, are they?

Mr. POHLMAN. Customer service reps.

Senator DAYTON. OK. So you have a fake name and you have a fake title, in effect. You are a credit counselor, and you are working for somebody that is also representing itself to a non-profit, so it is really basically faked all the way through until that person has been put on the line and started to pay money.

I guess my time has expired, Mr. Chairman. Thank you.

Senator COLEMAN. Thank you, Senator Dayton. Senator Pryor.

**OPENING STATEMENT OF SENATOR PRYOR**

Senator PRYOR. Mr. Chairman, thank you, and I am so glad that you are taking the lead on this issue. I think it is a very important issue for consumers all across America.

Mr. Pohlman, if I can follow up with some of the questions that Senator Dayton was asking, he asked about the credit counselor moniker that you had. Did you receive any training or any accreditation as a credit counselor?

Mr. POHLMAN. No, sir. My training was about one day of reading their material. I was on the phone the next day. They are very structured scripts. You were not to deviate a single word or syllable from the scripts and I just jumped right in.

Senator PRYOR. Is it fair to say that the training you received from your company was more sales training than it was counseling training?

Mr. POHLMAN. Yes, sir. I mean, you must understand, I had 11 years' experience in the industry.

Senator PRYOR. Yes, I want to ask you about that in just one second, but first, I want to ask about something you said in your opening statement about your fake name.

Mr. POHLMAN. Yes, sir.

Senator PRYOR. I have been sitting here trying to think of why anyone in the credit counseling business would want a fake name to be used, even managers having fake names, with the customers

and I am having trouble coming up with a rationale for that. Do you know what the rationale is for having a fake name?

Mr. POHLMAN. No. When my wife also had a lot of trouble with that rationale, I can tell you that we went by a first name. It was more of an acronym. I mean, if your name was David Wood, they may call you Woody or what have you. But anyway, I chose the name of Daniel. I was not allowed to be John. I was told that the reason why I could not use my name of John was because of computer and customer service reasons. Years ago, we had a John, and we don't want our customers confusing the previous John with the current John.

Senator PRYOR. Yes, but——

Mr. POHLMAN. So I was told that I had to——

Senator PRYOR. I guess the reason that doesn't hold water with me is that the company probably had employed people in the past named Daniel, too. That doesn't make sense. But is that all you were told about it at the company?

Mr. POHLMAN. That was what I was led to believe, sir.

Senator PRYOR. Now, you had mentioned that you had had, what, 11 years' experience——

Mr. POHLMAN. Yes, sir.

Senator PRYOR [continuing]. In this type of work before, and you had worked for non-profits, as I understand it.

Mr. POHLMAN. Yes, sir.

Senator PRYOR. Tell me, in your view, how this is supposed to work. How should non-profits service consumers who are having financial and debt problems? How should this work?

Mr. POHLMAN. Yes, Mr. Pryor. We were spending an hour and a half with our clients, and again, this was an NFCC affiliate and we were licensed within the State of where we were doing business. We had——

Senator PRYOR. I am sorry, licensed in what way?

Mr. POHLMAN. Licensed, I am sorry, by the State of—in my case, the State of Connecticut——

Senator PRYOR. Right.

Mr. POHLMAN [continuing]. Banking Department. We were licensed debt adjustors.

Senator PRYOR. OK. And were you licensed at this new company where you were working?

Mr. POHLMAN. I believe they were licensed in the State of Massachusetts, but we did business all across the country.

Senator PRYOR. OK. Now keep going. I am sorry.

Mr. POHLMAN. OK. In my 11 years with an NFCC affiliate, we provided up to an hour and a half counseling with the client. The client was mailed a budget worksheet in which they were to put their income, their expenses, who their creditors were. We told them—they were then booked for an appointment for an hour and a half. They were told to bring a source of income, such as pay stubs, such as child support, any legitimate form that income comes in. We were looking at budgeting, money management. Perhaps they were having too much money withdrawn from their paycheck.

There was an intensive hour and a half of budgeting, money management. In some cases, the clients were so well educated in

that hour and a half that they could handle things on their own. They found out that they were having too much money taken out of their paycheck, so the counselor told them to reduce that. Perhaps there are ways of eliminating debt that they weren't aware of. We made referrals to other non-profits, other social service agencies like legal aid or aid for the elderly. We considered those successful counseling sessions.

We let them go home and let them talk to their spouse, their significant other, about a debt management plan. We did not push the plan during the session. If they chose the plan, fine. They had the options. They could go home and think about it.

Senator PRYOR. When you were working for other non-profits, did you feel like you were helping consumers?

Mr. POHLMAN. Absolutely.

Senator PRYOR. And when you were working for Cambridge, did you feel like you were helping consumers?

Mr. POHLMAN. No, sir.

Senator PRYOR. That is all I have, Mr. Chairman. Thank you.

Senator COLEMAN. Thank you very much, Senator Pryor.

Just one last thing, if I can do a follow-up, Mr. Allen, just to follow up on a question that you responded to from Senator Levin. He was trying to understand what you would have told your customers, again, to understand whether Ms. Troy would have been told about that first payment going to the company, and you did testify that you told customers that was a voluntary payment, is that correct?

Mr. ALLEN. Yes, sir.

Senator COLEMAN. Did you also recall in your testimony saying that you were reprimanded for doing that by your superiors?

Mr. ALLEN. Many times.

Senator LEVIN. Could I just ask one question about these checks? Were the monthly checks after your first payment also supposed to be cashier's checks and not personal checks?

Mr. SCHUCK. Absolutely, they were.

Senator LEVIN. Is that true with you, too, Ms. Troy?

Ms. TROY. The first one, I said it was. And then when I picked up that the money didn't go to the creditors, I asked for a refund. I wanted to——

Senator LEVIN. Did you send a second check?

Ms. TROY. I don't think so.

Senator LEVIN. Thank you.

Senator COLEMAN. I want to thank the panel very much. I appreciate your testimony, appreciate you coming forward today.

Senator COLEMAN. With that, I would then call our second panel for today's hearing.

I would now like to welcome our second panel to today's hearing. This panel is comprised of representatives of four credit counseling agencies. I welcome Chris Viale, General Manager of Cambridge Credit Counseling Corporation; Matthew Case, the Chief Operating Officer of AmeriDebt; Ms. Cuba Craig, the Chief Executive Officer of American Financial Solutions; and finally, James Kroening, the Director of FamilyMeans Credit Counseling Service in Stillwater, Minnesota.

I believe, Mr. Kroening, you are an NFCC member?

Mr. KROENING. That is correct.

Senator COLEMAN. I appreciate all of you being with us this morning and I look forward to hearing your testimony regarding the credit counseling industry.

Before we begin, pursuant to Rule 6, all witnesses who testify before this Subcommittee are required to be sworn in. I would ask you now to please rise and raise your right hand.

Do you swear that the testimony you are about to give before the Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. VIALE. I do.

Mr. CASE. I do.

Ms. CRAIG. Yes.

Mr. KROENING. I do.

Senator COLEMAN. As I indicated to the first panel, we do have a timing system. When you see the yellow light come on, it means you should conclude your testimony. Your entire written statement will be entered into the record.

With that, we will start with Mr. Viale, followed by Mr. Case, Ms. Craig, and finish up with Mr. Kroening. After your further testimony, we will then turn to questions.

Mr. Viale, you may proceed.

**TESTIMONY OF CHRIS VIALE,[1] GENERAL MANAGER, CAMBRIDGE CREDIT COUNSELING CORPORATION, AGAWAM, MASSACHUSETTS**

Mr. VIALE. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Chris Viale. I am the Chief Operating Officer of Cambridge Credit Counseling. I want to use my 5 minutes to respond to the Subcommittee's staff report and the first panel because I think the public so far has heard a very slanted and biased view of Cambridge Credit Counseling.

I am proud that we are not a debt mill, that our main focus is providing education and financal solutions for the approximately two million consumers who have contacted us during our 7 years of operation. These are productive, tax-paying, middle-class people who are struggling under mountains of consumer debt and our education and debt management plans help them.

You found one unhappy client, but I wish the Subcommittee had spoken to Sister Veronica or the other clients that are here with us today. They would love to share their experience and how we have helped them at Cambridge.

So let me first respond to Mr. Schuck and let me show you how Cambridge provides full and adequate disclosure at two critical points in the decisionmaking process. The first example is our service agreement. As you can see, Section 1 covers services, fees, and sign-up instructions. The first payment is our design fee, which is equal to 1 month's payment. Our payment program service fee is charged monthly and is equal to 10 percent of the client's payment or $25, whichever is greater. The example box on the board was added in July 2002 as a way to disclose this even clearer and it

[1] The prepared statement and supplemental written submission with attachments of Mr. Viale appear in the Appendix on pages 97 and 102 respectively.

is very easily summarized at the bottom of the section, right above where each consumer has to sign.

As for Mr. Schuck, although he made seven payments and interest fee concessions were arranged on his accounts, we still refunded half his initial fee after he complained. But for the record, I have a copy of a service agreement where Mr. Schuck signed. Right above the signature is a clear disclosure of the fees we charge. Our records also show that Mr. Schuck took 2 weeks, not 1 day or 15 minutes, after he signed the service agreement to think about joining our program and sending the initial fee in. But again, I am sorry his experience is not that of the vast majority of the clients that we help.

The second example of disclosure is our debt management summary. Now, while we have started this about 8 months ago, the information provided is very clear. It illustrates for a consumer exactly how much is going to each creditor, how much the monthly service fee is, the fact that the first payments are a fee, what the program costs will be, and how much the consumer will save. And we have recently added even clearer disclosure that the first payment fee does not go to your creditors.

Now, I hope for the Q&A that I will get the opportunity to address many of the false statements that Mr. Pohlman has made today.

Now let me respond to the Subcommittee's staff report, which unfortunately is slanted against Cambridge because it conveniently leaves out several important facts. The first, the staff report does not mention that our fees are regulated and approved by State authorities in four different States and that we undergo annual reviews in Michigan, Connecticut, and Maine. In New York, the Banking Department has licensed Cambridge's sister company to conduct its programs and has approved its fee structure under the statute that says fees charged to consumers cannot be unreasonable. If the Subcommittee staff believes our fees are "clearly excessive," then perhaps the staff should investigate the New York State Banking Department, which has also approved the similar up-front fee structures of other credit counseling companies.

Second, the staff report does not mention at all the Cambridge "Good Payer" program. Cambridge is the only company in this industry that actually rebates half of the fair share money that we get from creditors to our qualified clients. We have given to over 75,000 clients a total of more than $14 million back in rebates, and here is the data that we submitted to the staff, but for some reason it is not mentioned in the report. It is important, because if a client successfully completes our program, in almost all cases, they will receive more back in rebates than they were charged in the initial fee.

And the third thing, the report makes an unfair and distorted accusations that Cambridge is essentially a money-making machine for the Puccios. I can tell you this is not what Cambridge is about. We provide real benefits for real people with real value to them. Moreover, the vast majority of the 40,000 consumers that contact us each month take advantage of access to financial education. Only about 12 percent of the consumers that contact us ever join

our debt management program. We are not telemarketers in any way.

Doesn't the fact that tens of thousands of consumers are succeeding under our program mean anything to this Subcommittee? I wish the Subcommittee staff had told a balanced story about the value that our clients get for the fees they pay. They might have done this if they had accepted our invitation to visit the Cambridge site and to see firsthand how much we care and how much we help consumers.

Now, I am sorry that my CEO, Mr. Puccio, will not be here today to appear on the second panel. He is in the George Washington Hospital with symptoms of a stroke, and the Subcommittee has received a letter from the Chairman of the George Washington Neurology Department.

In conclusion, the Cambridge revolution is all about education, empowerment, service, choice, and ultimately financial freedom. Congress can share in this mission or kill it, but if you kill it, you will be denying consumers the innovative solutions they need in today's environment.

At Cambridge, we are committed to the consumer. You can ask Sister Veronica or the other Cambridge clients that are here with us today if you really want to know how consumers feel about Cambridge and their experience. Thank you.

Senator COLEMAN. Thank you, Mr. Viale. Mr. Case.

**TESTIMONY OF MATTHEW CASE,[1] CHIEF OPERATING OFFICER, AMERIDEBT, INC., GERMANTOWN, MARYLAND**

Mr. CASE. Thank you, Mr. Chairman and Members of the Subcommittee. I am Matthew Case, Chief Operating Officer of AmeriDebt. On behalf of everyone at AmeriDebt, I would like to express our thanks for the opportunity to participate in this hearing today.

AmeriDebt has helped hundreds of thousands of Americans work their way out of debt and gain control over their finances. We are proud of our record as a pioneer in the modern credit counseling industry. At the outset, let me stress the fact that AmeriDebt is actively engaged in attempting to resolve the concerns of consumers and government officials. Even though the vast majority of AmeriDebt clients have no complaints with the organization, we are working diligently to correct any remaining concern.

What is more, AmeriDebt took an extraordinary step last November when we decided to stop advertising and stop accepting new clients onto our program. Today, we continue to fulfill our non-profit mission by serving approximately 72,000 clients whose accounts were active at the time. For these clients, AmeriDebt represents a lifeline of fiscal health. It would be tragic if their financial recovery plans were jeopardized by hasty or ill-conceived regulatory action.

AmeriDebt has worked hard to resolve all alleged consumer protection issues. There is no question that we continue to pursue our non-profit counseling and consumer education missions. The time has come to put these issues behind us and work together with pol-

[1] The prepared statement of Mr. Case appears in the Appendix on page 127.

icy makers and the public to deal with the much larger crisis of consumer debt.

Revolving consumer debt has now surpassed three-quarters of a trillion dollars. As this crisis depend over the past few years, AmeriDebt helped consumers save millions by providing credit counseling services and debt management plans to reduce monthly payments, lower interest rates, and reduce or eliminate late payment and over-the-limit penalties.

Correcting financial problems years in the making is no easy task. It requires commitment and discipline by consumers and is time and labor intensive for credit counselors. As a result, many credit counseling agencies follow the advice of an influential report published by Visa in 1999. The Visa report suggested that the credit counseling agencies could be more efficient and serve clients better by contracting with private sector companies to perform back-office administrative tasks. AmeriDebt's decision to do so accomplished these objectives.

Some say this approach clashes with the non-profit status of credit counseling agencies. Although AmeriDebt was formed before I joined the organization, it is critical to realize that our non-profit status, like that of nearly every credit counseling agency in the country, is in large measure an outgrowth of State laws and creditor mandates. Many States require credit counseling agencies to be non-profit and creditors reject debt management plans unless the plans come from non-profit organizations. The practical effect is to force any credit counseling agency to organize as a non-profit entity if it wishes to help consumers in more than one State.

Historically, credit counseling was provided only by small, local counseling agencies. Unfortunately, their services were either unknown or unavailable as a practical matter to a majority of the people in need. Even if this credit counseling model made sense 30 or 40 years ago, there should be no question that the magnitude of America's consumer debt problem far exceeds the capacity of traditional credit counselors to fix.

AmeriDebt helped pave the way for effective credit counseling on a national scale. We hope our knowledge and experience prove helpful to the Subcommittee as it considers the future of credit counseling.

Once again, on behalf of AmeriDebt and our 72,000 clients, I would like to thank the Subcommittee for this opportunity to testify.

Senator COLEMAN. Thank you, Mr. Case. Ms. Craig.

**TESTIMONY OF CUBA M. CRAIG,[1] CHIEF EXECUTIVE OFFICER, AMERICAN FINANCIAL SOLUTIONS, SEATTLE, WASHINGTON**

Ms. CRAIG. Thank you, Mr. Chairman. Members of the Subcommittee, good morning. I am Cuba Craig, President and CEO of American Financial Solutions, AFS, a non-profit consumer credit counseling agency and a division of North Seattle Community College Foundation in Seattle. We have offices in Seattle and Bremerton, Washington, which is across from the Puget Sound Naval Shipyard.

[1] The prepared statement of Mr. Craig appears in the Appendix on page 142.

AFS first opened its doors with two full-time employees, including me, in 1999. Since then, we have grown substantially. This morning, I would like to tell you what we do and how we support ourselves. Then I would like to explain recent changes we have made and other changes we have initiated as a result of your investigation.

AFS provides financial counseling and education to consumers and, where appropriate, enrolls them in debt management plans. Under such plans, clients agree to make regular payments and creditors typically agree to reduce their interest rates. This helps creditors to the extent it is an alternative to bankruptcy.

AFS does not charge up-front or other fees to our clients. Because of the steep decline in fair share payments from creditors, we have recently begun to request voluntary contributions from our clients. The client is informed that any contribution is voluntary, and the client can stop his or her contribution at any time. A client who cannot afford to contribute is not asked to do so. The maximum amount we allow a client to contribute is $50 per month.

Although we always intended to handle all of our original calls in-house, in the past, both AFS and counselors at Amerix, a for-profit back-office service provider, handled some of those calls. Origination calls are the initial calls from clients seeking credit counseling. The Amerix employees who handled the origination calls were trained and certified to our AFS standards. The arrangement was to assist us while we built up our workforce. AFS counselors now take all of our origination calls in-house.

AFS opened its Bremerton facility in 2001 with 12 counselors. When we reached 60 counselors, I began exploring options for further expansion, including plans to refurbish a former school and double our counseling capacity. Last fall, the foundation board decided not to purchase the new facility and asked for financial plans to support the project and cost-effective alternatives. Since then, I have been considering other ways to move all of our origination in-house.

At midnight on March 14 of this year, we stopped having Amerix handle our origination calls. Although handling all origination calls in-house has always been our plan, your investigation helped to bring this about more quickly than otherwise might have happened.

Last fall, the North Seattle College Foundation Board, which is composed of volunteers, installed a new president and oversight committee. Since then, they have been studying our operations to ensure that our activities are appropriate and that our management systems are effective and efficient.

Since the Subcommittee began its investigation, we have stepped up our efforts to ensure that AFS meets all applicable requirements. To that end, a review was conducted for AFS and the board and recommendations were prepared and considered. Earlier this month, the oversight committee made several recommendations to me for action.

First, AFS has stopped outsourcing origination. Any future expansion will be accomplished only by employing AFS counselors in-house.

Second, AFS counselors are trained to make all appropriate disclosures. We will review all of our written materials and scripts to ensure they reflect that practice.

Third, AFS will review and attempt to negotiate its contracts with Amerix, with particular attention to changing certain provisions, including the method by which payments to Amerix are calculated in favor of a transaction-based or similar payment system, and the assist rate provision in the current contract, which is counter to AFS philosophy and practice. We also will seek to terminate the FreedomPoint and the FreedomPoint Financial contracts.

Fourth, we will again seek competitive bids for back-office services.

Fifth, we will review and revise our debt management plan form agreements as appropriate.

Sixth, we will review all applicable laws and regulations.

AFS is proud of our well-trained counselors and the service we offer to the public. AFS, the foundation board, and the board's oversight committee are dedicated to ensuring that AFS carries out its mission appropriately and effectively and completely within the bounds of the law. I am happy to answer any questions you may have.

Senator COLEMAN. Thank you very much, Ms. Craig.

Ms. CRAIG. You are welcome.

Senator COLEMAN. Mr. Kroening.

**TESTIMONY OF JAMES KROENING,[1] DIRECTOR, FAMILYMEANS CONSUMER CREDIT COUNSELING SERVICE, STILLWATER, MINNESOTA**

Mr. KROENING. Good morning, Chairman Coleman and distinguished Members of Congress. I am James Kroening, Director of Consumer Credit Counseling Service at FamilyMeans, a multiservice agency located in Stillwater, Minnesota, serving not only the Twin City metropolitan area but Western Wisconsin and also Southeastern Minnesota. I am here today to describe how FamilyMeans CCCS, with a department budget of approximately $1 million and a program staff of 12, is able to provide affordable, effective, and client-centered budget counseling, education, and debt management plans to 10,000 people a year while adhering to the highest stringent standards of quality.

To understand our approach, one must first look at our organizational history. FamilyMeans is a mission-based non-profit started over 40 years ago by community leaders. Because financial stability is a key to a family's well-being, FamilyMeans has always provided financial counseling, mental health counseling, and supportive services to give people the tools they need to lead healthy, productive lives. Our multiple services give our clients assistance with underlying issues that may be affecting their lives.

Our 18-member board of directors provides fiscal oversight, establishes policy, and raises financial support for the agency. They serve a maximum of six consecutive years, sign disclosure statements about potential conflicts of interest, and are not related to staff members.

[1] The prepared statement of Mr. Kroening appears in the Appendix on page 150.

FamilyMeans has a long history of being accredited and licensed, meeting the rigorous standards set by the National Council on Accreditation of Services for Families and Children and the National Foundation for Credit Counseling. Our organization is licensed by the States of Minnesota and Wisconsin. Each of these licensing and accrediting bodies conducts thorough reviews and audits of business practices and our professional services. The agency also has an ongoing quality assurance program to help monitor and improve our programs.

Our community roots, the capable board of directors, and our adherence to the highest standards in the non-profit sector ensure that we provide well-run mission-based programs that effectively meet community needs.

FamilyMeans CCCS provides budget counseling, financial education, and debt management programs, which I will refer to as DMPs. Budget counseling is the heart of our CCCS program. We conduct one-and-a-half-hour comprehensive financial counseling sessions because they are effective. A certified financial counselor and a client work together to examine their income, their monthly expenses, and their debts. Each client leaves with a workable budget and a tailored action plan.

Many families learn how to manage their money from these sessions and, therefore, do not need a DMP. In fact, the DMP is only recommended to clients who need intervention with creditors. We put all unsecured debt on the DMP, not just major creditors or those who make creditor contributions.

Equally important, FamilyMeans CCCS offers consumer education each year to approximately 5,000 people. We conduct free classes about money management, home buying, credit use at schools, colleges, shelters, treatment and recovery programs, community centers, correctional facilities, and other non-profit organizations. This work helps to prevent future financial problems.

Over the last decade, organizations have entered into the credit counseling field who focus on the DMP and its potential revenue generation rather than offering comprehensive counseling and education services. The practices of these companies have adversely affected the credit counseling field and tainted the non-profit sector.

I am appalled to know that consumers receive only a 15-minute survey instead of comprehensive counseling and education that can lead to lasting change. I am disappointed to hear that some organizations put selected debt on a DMP, charge high set-up fees, guaranteeing income to the company and almost certain failure to the consumer. I am saddened that many individuals who could manage their own debt are lured into debt management plans with promises of lowered interest rates. I am frustrated that current laws tie our hands when people come to us after they have been badly served by another organization. I am angry that these same businesses enrich their executives and have for-profit affiliations that taint the word non-profit, betraying the spirit and the standards we honor.

Not surprisingly, creditors have responded to these practices by reducing their contributions, limiting customer concessions, such as lowered interest rates, actions that both hurt consumers and legitimate non-profit agencies like FamilyMeans. For us, creditor con-

tributions have decreased 30 percent in the last 4 years. Our inability to replace this revenue has forced us to close four locations and significantly reduce staff over the last 4 years.

Fortunately, others see the value in the work that we provide. We successfully have raised charitable dollars from the United Way, foundations, and many individuals to support our counseling and our education. With the help of these charitable funders and by voluntarily adhering to the standards of not only COA, the NFCC and its consumer protection standards, FamilyMeans will strive to maintain and restore the public's trust and continue to bring financial stability to families.

I am hopeful that Congress and the Executive Branch take action to uphold the integrity of the credit counseling field in the face of these questionable business practices by recent market entrants so that FamilyMeans and other non-profits like ours can continue to serve consumers experiencing financial difficulties in the communities throughout the country.

Senator COLEMAN. Thank you very much, Mr. Kroening.

Mr. Viale, is it correct that the employees at Cambridge are asked to pick out false names?

Mr. VIALE. If when they start there are other counselors with the same first name that are presently working within the group itself, we do ask them to pick out a different name for the purpose of making it simpler for a client to call in and get to that counselor from customer service.

Senator COLEMAN. Can't they just call themselves, Mr. Viale?

Mr. VIALE. They could, but people like to be more formal and call it by—more personal and go by their first name. This has recently changed—that policy. It has changed several months ago, but that was a policy we had in place and it was just to simplify the process for the client calling in.

Senator COLEMAN. There was testimony that there is what one would describe as a leader board for top sales for employees who are supposedly providing credit counseling services. Is there, in fact, what one would describe as a leader board in the Cambridge operation?

Mr. VIALE. There are two separate boards. One board is daily productivity, which is monitored by the people around them just so we can help motivate the counselors within the floor, and then there is the board that illustrates what the counselors achieved as far as their goals and what they have done as far as helping consumers.

Enrollment in debt management plan and also through education.

Senator COLEMAN. There is a board for education?

Mr. VIALE. Yes.

Senator COLEMAN. Could you describe that board?

Mr. VIALE. The board—well, it is actually—it is not the big monitor board but it is a board that goes up that shows how many consumers the counselors are getting to our education website, goodpayer.com, and having them opt in for financial newsletters.

Senator COLEMAN. So your education is not personal counseling. If someone doesn't enroll in a DMP, do you refer them to a website?

Mr. VIALE. Correct, and if they enroll, we refer them to our own website, correct.

Senator COLEMAN. If they enroll, aren't they sent educational videotapes and workbooks?

Mr. VIALE. That is correct.

Senator COLEMAN. If they don't enroll, are they sent educational videotapes and workbooks?

Mr. VIALE. No, they are not. The counselors work with each consumer to try and deliver whatever education, the wants and needs the best to our ability, and then we work with them to get them to our education wellness site, which is goodpayer.com.

Senator COLEMAN. Are there bonuses that are paid to employees for enrolling consumers in debt management plans?

Mr. VIALE. There are three separate incentives that we have for our counselors. Our counselors are hourly employees and they have incentives based on the number of qualified consumers they enroll in the program, the retention rates of the qualified consumers they enroll in the program, and the amount of people that they deliver some value of education to.

Senator COLEMAN. Do you disagree with Mr. Kroening's assessment that there are many people for whom DMPs aren't the appropriate path?

Mr. VIALE. One hundred percent correct. That is why only 12 percent of the people that enroll in our program, people that call in actually enroll in our program. We have——

Senator COLEMAN. But the bonuses you give are for DMPs?

Mr. VIALE. For qualified clients that do, indeed, need a DMP. Our systems, the technology that we have in place and the compliance measures we have in place only allow our counselors to enroll consumers that need a DMP plan.

Senator COLEMAN. Do we have Exhibit 6?[1] It is actually Mr. Schuck's client financial disclosure. On Exhibit 6, it appears that his expenses exceed his gross income. Is that the kind of client that needs a DMP?

Mr. VIALE. This person exceeds by $24?

Senator COLEMAN. Right, gross income, not take-home. Gross income, expenses exceed gross income.

Mr. VIALE. This document is not familiar to me. I know it has Cambridge Credit Counseling Corporation on it——

Senator COLEMAN. Assume just for the purposes of this discussion, assume that this is a document——

Mr. VIALE. No, this would be someone that does not belong in our DMP plan.

Senator COLEMAN. Mr. Kroening, would you disagree with that?

Mr. KROENING. I would agree, with it. A deficit, we would not put a client onto a debt management plan.

Senator COLEMAN. That is Mr. Schuck's counseling——

Mr. VIALE. From—correct.

Senator COLEMAN. The individual who is paying a fee of close to $2,000 to enroll in a DMP.

Mr. VIALE. Right, and that is from our systems of 2001.

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[1] See Exhibit No. 6 which appears in the Appendix on page 249.

Senator COLEMAN. Exhibit 10 [1]—Mr. Viale, does this exhibit look familiar to you?

Mr. VIALE. Yes, it does.

Senator COLEMAN. Is this a letter that you sent to consumers?

Mr. VIALE. Yes, we do.

Senator COLEMAN. And this is sent to consumers who have not enrolled in a DMP?

Mr. VIALE. That is correct.

Senator COLEMAN. And I note it says, "Second letter. We have no record of receiving a response from you. Please review this offer before it expires."

Mr. VIALE. Correct.

Senator COLEMAN. Does it appear you are selling something here? Is this an offer?

Mr. VIALE. Often to try and help people. We want them to call in to be able to try and provide them with whether or not they need a DMP or whatever type of education we can deliver to them.

Senator COLEMAN. And again when it comes to education, Mr. Kroening talked about an hour-and-a-half session with his clients. How long are your sessions?

Mr. VIALE. For in-house counseling, which his organization does, it lasts anywhere from an hour to an hour and a half. Phone counseling, which is a lot different than in-house, can last anywhere from 15 minutes to an hour, depending upon the perplex situation of the consumer.

Senator COLEMAN. But the decision to make a DMP often relates to that initial phone counseling?

Mr. VIALE. Not even close, no. It is not until we have done a full budget disclosure with the consumer, information has been put into our systems, and the systems allow for that consumer to come on our program. This is relatively new programming that we have, but that is the system that is in place. It has been in place that way for 2 years now.

Senator COLEMAN. Mr. Case, who founded AmeriDebt?

Mr. CASE. Who founded AmeriDebt?

Senator COLEMAN. Yes.

Mr. CASE. To my understanding, it was founded by three directors, Pamela Shuster, Ilze Vipulis, and Jane Conigliaro, I believe.

Senator COLEMAN. Is it Pukke, or how did you pronounce it?

Mr. CASE. Pamela Pukke.

Senator COLEMAN. Pukke. Is she related to Pamela Shuster?

Mr. CASE. It is the same person.

Senator COLEMAN. The same person?

Mr. CASE. Yes.

Senator COLEMAN. And Pamela Shuster is related to Andris Pukke?

Mr. CASE. Correct.

Senator COLEMAN. So Andris Pukke, DebtWorks, does the backroom services for AmeriDebt?

Mr. CASE. They have in the past. It is now The Ballenger Group who does the——

[1] See Exhibit No. 10 which appears in the Appendix on page 254.

Senator COLEMAN. The Ballenger Group. But in the past, under AmeriDebt. AmeriDebt would sign the folks up, but everything would be processed by——

Mr. CASE. AmeriDebt had processed clients in-house for approximately 2 years before the outsourcing arrangement was done with DebtWorks, sir.

Senator COLEMAN. Was Pamela Pukke "Pamela Pukke" when she started AmeriDebt, do you know?

Mr. CASE. I am sorry?

Senator COLEMAN. Was Pamela Pukke—you said Pamela Shuster. That is why I was a little confused early on. When AmeriDebt was formed and DebtWorks was in the position of processing AmeriDebt's work, was there a relationship between Ms. Pukke and Mr. Pukke?

Mr. CASE. Pamela Shuster had stepped down from the board somewhere around August 1999 and the contract was signed with DebtWorks in October 1999.

Senator COLEMAN. How long have you known Mr. Pukke? What is your relationship with him?

Mr. CASE. Long-time family friend.

Senator COLEMAN. If I may turn to a copy of Exhibit 15, can you identify Exhibit 15? [1] Does that look familiar to you?

Mr. CASE. Yes.

Senator COLEMAN. And can you tell me what it is?

Mr. CASE. From my understanding, this is a company meeting that the Executive Director Jeff Formulak had, and his notes.

Senator COLEMAN. And the notes talk about "We met our goal. We achieved $2,837,033 in contributions. Our goal last month was 7,500 clients and $2,600,000 in contributions." Does this look like a sales meeting?

Mr. CASE. It is kind of a—to get the morale up around the office, to my understanding.

Senator COLEMAN. But what are you selling?

Mr. CASE. Well, it also states there, sir, that we did help 9,100 clients, approximately.

Senator COLEMAN. Helped enroll them in DMPs.

Mr. CASE. These are the individuals that were enrolled in DMPs, that is correct, sir.

Senator COLEMAN. It talks about bonus structure. Is there a bonus for education?

Mr. CASE. A bonus is for several things. Again, I did not deal directly with the clients. The managers really handle all the bonuses.

Senator COLEMAN. Mr. Viale, who do you report to at Cambridge?

Mr. VIALE. I report to John Puccio.

Senator COLEMAN. John Puccio, he is the CEO?

Mr. VIALE. Correct.

Senator COLEMAN. Is there anyone else between you and Mr. Puccio?

Mr. VIALE. No, there is not.

Senator COLEMAN. Do you know how much Mr. Puccio earns each year from Cambridge Credit?

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[1] See Exhibit No. 15 which appears in the Appendix on page 261.

Mr. VIALE. Yes, I do.

Senator COLEMAN. Can you tell us what that is, what is his salary?

Mr. VIALE. Six-hundred-and-twenty-four thousand, I think, was his salary last year.

Senator COLEMAN. And your salary in this non-profit is how much?

Mr. VIALE. It is right around $400,000.

Senator COLEMAN. Ms. Craig, by the way, I do want to thank you for the initiatives that American Financial has made.

My time is going to be up, but I did want to follow up. Mr. Kroening and Ms. Craig, I want to thank you for the changes, and I am running out of time here. Mr. Kroening, I appreciate what the NFCC is doing and I think one of the great difficulties in this hearing is that we are grouping folks together.

Clearly, there is a difference in non-profits, and that may be one of the issues here. People buying something, it is a non-profit. It may be that you need for-profit agencies and folks should get out there and have that and they can make choices. But what you have got here is non-profits that do certain things with the idea of not making bonuses and not making money and not making $600,000 and $400,000 a year, and you have for-profits that are acting as non-profits. I think that is problematic.

Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Viale, you are presumably telling people that you are selling these management plans to how much their initial fee is. That is the theory of it, is that correct, on the telephone?

Mr. VIALE. I didn't understand the question. I am sorry.

Senator LEVIN. What is the initial fee?

Mr. VIALE. The first payment they make to our company is the——

Senator LEVIN. Regardless of that amount?

Mr. VIALE. Regardless of that amount, correct. About 20 percent of the consumers that join our program get a reduced initial fee due to hardship.

Senator LEVIN. So regardless of the amount of their debt, whether it is a small amount or a large amount, their initial fee is 10 percent of that debt?

Mr. VIALE. No, it is not 10 percent. It is the monthly payment that we develop, or our computer systems develop based on creditor guidelines to handle the debt for them.

Senator LEVIN. What is the amount of the initial fee, set-up fee?

Mr. VIALE. Whatever their monthly payment is going to be to satisfy the creditors and the program.

Senator LEVIN. I am sorry?

Mr. VIALE. Whatever their monthly payment needs to be to satisfy the program. So, for instance——

Senator LEVIN. So the first monthly payment is the fee.

Mr. VIALE. That is correct.

Senator LEVIN. It all goes to you.

Mr. VIALE. That is correct.

Senator LEVIN. And no matter what the size of that fee is, you keep it?

Mr. VIALE. Correct.

Senator LEVIN. Shouldn't there be a relationship between the fee you get to set up a management plan and the services that you render?

Mr. VIALE. There should be a relationship to the savings and the rebates available for the consumer. It is all relative to the size of the debt the consumer has, an example being if somebody owes——

Senator LEVIN. Shouldn't it relate to the services that you render?

Mr. VIALE. No, it should relate to the savings the consumer can receive, the rebates they are able to receive through the program, and also, it should also relate to the fact that we have our fees reviewed and licensed in separate States, so they are deemed reasonable.

Senator LEVIN. All right. Does that fee directly relate to what they are going to get in the future?

Mr. VIALE. It directly relates to their savings in interest rate reductions. It directly relates to the amount of rebates they can get back.

Senator LEVIN. Not can get back, but do get back.

Mr. VIALE. That they can get back, qualified——

Senator LEVIN. What if they don't get back any rebate?

Mr. VIALE. They haven't made their payments on time. Some of that is not in our control. Our system is not immune to the consumer following through with it.

Senator LEVIN. But you keep that first monthly fee regardless of what comes subsequently in terms of benefits to that consumer, is that correct?

Mr. VIALE. That is correct. The consumer understands that when they come into the plan. It is disclosed very clearly to them.

Senator LEVIN. Apparently, some consumers don't understand that.

Mr. VIALE. We disclose it at two very critical points. I can't see any other way to disclose it. Plus, our counselors reinforce it.

Senator LEVIN. You have that in fairly small print, do you not?

Mr. VIALE. No. It is boxed out. It is right above where they have to sign.

Senator LEVIN. Because apparently there were quite a few consumers that don't understand that their first fee was—just read that to us again.

Mr. VIALE. It says, "Payment design fee, proposed monthly payment, one time only." Below that, it is "Payment program service fee, 10 percent of each payment made to Cambridge or $25, whichever is greater," and then there is an example box. "This is not a finance charge or an interest rate. This is not your proposed monthly payment. This is only an example. Proposed monthly payment, $300, 10 percent, $30, dispersed to creditors, $270. This is only an example."

Senator LEVIN. I see. And where does it say that you are keeping the entire fee?

Mr. VIALE. It says it right there, "Payment design fee, proposed monthly payment, one time only." Plus, it says it all throughout——

Senator LEVIN. You are talking very fast. Payment—this is a program design fee?

Mr. VIALE. That is correct.

Senator LEVIN. Where does that say that you are keeping all the money?

Mr. VIALE. It says it throughout the text and it says it here.

Senator LEVIN. No, I know the text, which no one can read. I am talking about in the box you pointed to. Where does it say you are keeping all the fee? Program design fee are not words which jump out to the average reader as being, none of this goes to your creditors.

Mr. VIALE. Well, we have it here. It is—I mean, we feel that is clear enough. We feel this is way above what any other company does as far as disclosure, plus the consumer receives this before they join the program. I think we have to understand that once they sign the service agreement, they are not obligated to our program. They are not signing up. They receive this. It is very clear exactly what we are charging them. The counselors go through this line by line.

Senator LEVIN. Your counselors on the telephone go through your customers line by line with that debt management plan summary after it is received?

Mr. VIALE. Correct.

Senator LEVIN. So after that is received by your customers, they call back and then they go through with Mr. Daniel, or whoever it is, if they can find them, the——

Mr. VIALE. It is not——

Senator LEVIN. It is not hard to find your folks?

Mr. VIALE. No, it is not hard to find us.

Senator LEVIN. All right. They go through it line by line, OK. And your first payment fee there——

Mr. VIALE. Line by line. Each——

Senator LEVIN. No, just point out the first payment fee, if you would.

Mr. VIALE. "Payment design fee. This payment is not paid to your creditors," $374.

Senator LEVIN. All right.

Mr. VIALE. Total estimated monthly fees——

Senator LEVIN. So on that right there, not where they sign but something which is sent to them which looks like this is where the words, "This payment is not paid to your creditors—"

Mr. VIALE. That is relatively new, but yes, that is where it is.

Senator LEVIN. Relatively new? How new?

Mr. VIALE. Several weeks as far as just that—in parentheses.

Senator LEVIN. In parentheses? You didn't even have the parentheses year after year where people signed their name. It obviously wasn't very clear because now, 3 weeks ago, you add that.

Mr. VIALE. The payment design fee has been there all along.

Senator LEVIN. I know it has been——

Mr. VIALE. It is very clear.

Senator LEVIN [continuing]. But that is not intelligible to people, and so you finally, a few weeks before this hearing, add these words, not where they sign, not where they sign yet. That is still not added, is it? Where is it?

Mr. VIALE. Is what?

Senator LEVIN. Go back to where they sign their name, where you say everything is so clear, where there are no parentheses. See those words, "Payment design fee"——

Mr. VIALE. Yes.

Senator LEVIN [continuing]. Right where they sign?

Mr. VIALE. Yes.

Senator LEVIN. That is not intelligible. That doesn't tell people none of that goes to their creditors. So a few weeks ago, you put on this other exhibit, "None of this goes to your creditors." Why don't you put that in that box where they are signing their name, "None of this goes to your creditors"?

Mr. VIALE. These service agreements have been approved by several different banking departments and the States we are licensed in.

Senator LEVIN. That is fine.

Mr. VIALE. We are trying to do our best with full disclosure. The counselors go through this——

Senator LEVIN. Why don't you put the parentheses in that box where people sign their names?

Mr. VIALE. We can do that.

Senator LEVIN. Well, it is obviously clearer, isn't it, to say none of this goes to your creditors?

Mr. VIALE. Yes. That is why we have put it here.

Senator LEVIN. A few weeks ago.

Mr. VIALE. Correct, but the payment design fee and the counselors through their presentations, if you want to pull this up—can I pull up the presentations?

Senator LEVIN. No, I think——

Mr. VIALE [continuing]. Where we say——

Senator LEVIN. I think I would rather focus on my questions.

Mr. VIALE. OK, sir.

Senator LEVIN. Let me tell you, that is not disclosure. I am just going to make a statement here. You have got your statement that it is, but it is obviously not disclosure, payment design fee, unless you tell people where they sign their name and over the telephone that none of that is going to go to your creditors. You have now done this on a form which goes out afterwards, and that may or may not help. It is a little better than what you have been doing all these years.

Let me just ask one more question before my time runs out. You have got a relationship—let me be clear. The non-profit has a relationship with the for-profit, is that correct? The for-profit does the processing services, the so-called back-room services for the not-for-profit?

Mr. VIALE. Part of the family of companies is a for-profit company, correct, that does back-end support.

Senator LEVIN. And the people who control the non-profit also control the for-profit, is that fair to say?

Mr. VIALE. That is fair to say.

Senator LEVIN. And those folks, then, are negotiating with themselves in terms of what those processing fees are, is that correct?

Mr. VIALE. No. Those contracts—I am not 100 percent familiar with this, but those contracts are evaluated at fair market value.

Senator LEVIN. But they seem to be very different from all of the contracts which are worked out by the associations, for instance, the National Foundation for Credit Counseling and the AICCCA. They have very different fees than you do. So when you say fair market value, there is no place you look in a manual to find fair market value, is there?

Mr. VIALE. The back-end support systems we have are not within the industry anywhere. We have looked closely with other companies to gauge what fair market value would be.

Senator LEVIN. But in terms of setting that fee, it is set by the people who control the non-profit with the people who own the for-profit, is that correct?

Mr. VIALE. I didn't understand the question, sir.

Senator LEVIN. Who negotiates that fee? Isn't it the non-profit with the profit-making company?

Mr. VIALE. Oh, I don't know.

Senator LEVIN. How is the fee set? Who sets it?

Mr. VIALE. I don't know. That is not my line of expertise. My responsibilities are day-to-day operations of our family of companies.

Senator LEVIN. Does anyone outside of the two families of the companies set it up or is it set up within the family of companies as to what that fee is?

Mr. VIALE. Well, this is reviewed by two separate accounting firms——

Senator LEVIN. No, I know about that, but who sets the fee? Is it set up within the family of companies?

Mr. VIALE. I am not sure. I think it is reviewed and it is proposed, but I am not sure how it gets approved.

Senator LEVIN. Would it surprise you to know that it is $25 or $30 that compares to $1 to $2 for each of these plans per month by other non-profit companies, that it is 20 times higher than other non-profits?

Mr. VIALE. It is surprising, because there are other bids I have seen for $13, $15, and $18.

Senator LEVIN. Do you put this out for bids?

Mr. VIALE. That, I don't know.

Senator LEVIN. If it were—I thought you said a minute ago——

Mr. VIALE. I said I have seen bids from other organizations.

Senator LEVIN. No, I know that, but before that, didn't you say that this fee was negotiated between the profit——

Mr. VIALE. No.

Senator LEVIN [continuing]. And the non-profit?

Mr. VIALE. No, I did not say—I don't have the answer to that.

Senator LEVIN. You just don't know where these fees are set, or how these fees are set?

Mr. VIALE. No.

Senator LEVIN. The larger the fee, the more money would go to the profit-making corporation, is that fair to say?

Mr. VIALE. It seems fair to say.

Senator LEVIN. Yes. And so the larger the fee, the more money would get into a company which then is not regulated in terms of profit by the IRS, is that correct?

Mr. VIALE. I don't know. I am not an accountant. I don't know those answers.

Senator COLEMAN. Thank you, Senator Levin. Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman.

First, let me say to Mr. Case that I feel like your answer a few moments ago when you talked about Pamela Shuster was not forthcoming. I feel like you were deliberately misleading the Subcommittee by not giving her married name, and I want to thank the Chairman for drawing that out because I wouldn't have picked up on that.

Mr. CASE. I am sorry. I didn't mean to do that. I did not mean to do that. We refer to her, because back in the time when she was affiliated with the company, she was Pamela Shuster.

Senator PRYOR. Well, I just want to thank the Chairman for connecting the dots on that because I think that is a significant——

Mr. CASE. I apologize.

Senator PRYOR [continuing]. Fact that you left out.

If I may, is your name pronounced "Vile"? "Vi-al"?

Mr. VIALE. "Vi-al-ee."

Senator PRYOR. "Vi-al-ee."

Mr. VIALE. Yes.

Senator PRYOR. Mr. Viale, let me focus with you just for a few moments. You mentioned in your opening statement that you felt like some of the early witnesses had unfairly painted your company as a money-making machine for the two founders. And again, I am sorry, I am not sure of the pronunciation, but "Pu-chee"?

Mr. VIALE. "Pu-chee-oh."

Senator PRYOR. "Pu-chee-oh." As I understand your testimony, he made $624,000 in one year. His wife made $624,000 in one year.

Mr. VIALE. His brother.

Senator PRYOR. His brother. And in addition, he made an additional $600,000 from related organizations. Is that——

Mr. VIALE. That, I don't know.

Senator PRYOR. In 2002, did he sell the company?

Mr. VIALE. No. There was no sale of the company in 2002. There was a sale of a company in 1996 or 1997 to the non-profit when we moved to Massachusetts.

Senator PRYOR. OK. And then, as I understand it, your salary is $400,000 or more?

Mr. VIALE. Right around there, correct.

Senator PRYOR. And do you have any incentives or any bonuses on top of that $400,000?

Mr. VIALE. No.

Senator PRYOR. Now, if I can, I would like to ask Mr. Kroening down here on this end of the table, what is your salary at your non-profit?

Mr. KROENING. My annual salary is $60,000.

Senator PRYOR. Thank you. Mr. Viale, I believe you said that you have about 40,000 customers or clients that call in every month, is that the figure you said?

Mr. VIALE. New callers that call in each month, correct.

Senator PRYOR. But you only sign up, what, about 12 percent of those?

Mr. VIALE. That is correct.

Senator PRYOR. As I understood your testimony, that is what you said. So that is about 4,800 a month. Is my math right?

Mr. VIALE. Something right there, yes.

Senator PRYOR. What is your average fee that you charge your clients?

Mr. VIALE. Three-hundred-and-eighty dollars is right around the average initial fee of a consumer that joins a program.

Senator PRYOR. OK. Now, you said $385?

Mr. VIALE. It is right around $380. It fluctuates, but around $380

Senator PRYOR. And you said something there that I think is important, and that is your $385 for the initial fee.

Mr. VIALE. Yes.

Senator PRYOR. What is the total fees that they are charged during their relationship with you?

Mr. VIALE. It would be $38 per month from the second month thereafter, and the plan can range anywhere from 4 to 5 years, or 4 to 5½ years.

Senator PRYOR. OK. Now, how are these fees calculated?

Mr. VIALE. It is based on the service agreement. It is 10 percent of their monthly payment, and whatever their payment needs to be on the program is the initial fee. That is the first payment that is our fee.

Senator PRYOR. OK. And these are averages. They are not the same for everybody. They all fluctuate depending on what the customer's needs are.

Mr. VIALE. The payment size—well, it fluctuates for each consumer, yes, correct.

Senator PRYOR. OK. What percentage of your clients stay with the program through the duration?

Mr. VIALE. We have a little over a 30 percent completion rate.

Senator PRYOR. OK. And is there any penalty for dropping out?

Mr. VIALE. No penalty.

Senator PRYOR. Now, of the clients that you have, how many—what percentage, I think that is the best way to handle this, what percentage actually enroll in a debt management plan of the clients you have that have signed up with you? Do all of them enroll in debt management?

Mr. VIALE. No. Twelve percent of the people that call us enroll in the debt management plan.

Senator PRYOR. I understand that. We have already covered that.

Mr. VIALE. Right.

Senator PRYOR. But I am asking, of those 12 percent, how many sign up in the debt management, all of them?

Mr. VIALE. That is correct. The other 88 percent is counseled to our best ability with whatever education they need.

Senator PRYOR. OK. So you are going to try to tell the Subcommittee today that those 88 percent do receive some services from you?

Mr. VIALE. We try as hard as we can to deliver services to those consumers.

Senator PRYOR. But everybody that "signs up," they are moved into a debt management plan?

Mr. VIALE. That is correct.

Senator PRYOR. Now, Mr. Kroening, let me ask you, based on your experience, you have heard a lot about debt management

plans today. Do they work for everybody or how is this consistent—is this consistent with your experience and what you do?

Mr. KROENING. With our experience, again, we will only put folks on plans when it is necessary and needed by the family. Again, in our case, we don't talk about how many people contact us. We talk about the folks that we actually counsel. In this case, approximately 30 percent of the folks that we counsel will go onto a debt management plan.

Senator PRYOR. And your counseling is an hour and a half, whereas I believe the testimony is their's may be about 15 minutes on that initial phone call?

Mr. KROENING. Yes. Our counseling will be an hour and a half, sometimes as much as 2 hours.

Senator PRYOR. Mr. Chairman, I have one last question. I know I am almost out of time, but again, it is for Mr. Viale, and that is you are operating under the label non-profit. Why did you choose to operate under a non-profit label?

Mr. VIALE. Well, I don't have a specific answer for that, but I know the industry forces us to be a non-profit.

Senator PRYOR. I don't think that is true. I think you can——

Mr. VIALE. Well, the creditors only endorse, for the most part, a non-profit status to grant benefits to the consumer.

Senator PRYOR. So it is to your benefit to work with creditors to be a non-profit, but also, wouldn't you agree with me that it is to your benefit to work with your clients to call yourself a non-profit because it gives them an assurance that there is a credibility with your company, would you agree with that?

Mr. VIALE. No, I wouldn't agree with that. If we were for-profit or non-profit, we would put the same energy into working with each consumer we are talking to.

Senator PRYOR. I am not talking about the energy you put in. I am talking about how consumers feel toward a for-profit company versus a non-profit organization. Would you agree with me that they feel better about going to a debt counselor or a debt agency that is a non-profit, or would you not agree with that?

Mr. VIALE. I don't know. I don't know that to be true either way.

Senator PRYOR. That is all I have, Mr. Chairman. Thank you.

Senator COLEMAN. Thank you, Senator Pryor. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman.

So the purpose of your enterprise is ostensibly to provide the client with a reduction in his or her payments based on your negotiation with the creditors? How is that reduction documented? How does the client know that he or she is getting value from what you are charging?

Mr. VIALE. We fax them our service agreement. They sign the service agreement, so they understand the terms of the service agreement. We provide them with a budget analysis. We go over their bills in detail. Then we provide them with a debt management plan summary, which is here, and it goes over exactly each creditor we are handling, how much has to go to each creditor, how long it will take, what it would cost them on their own based on 18 percent interest, and what it would cost through us and their savings, as well as the fees and the rebates they can receive.

Senator DAYTON. Is that 18 percent what is actually being charged at that time?

Mr. VIALE. It is an underestimate. Most consumers we are talking to are being charged more than 18 percent interest.

Senator DAYTON. But you are representing this as their savings. Is this based on actual interest rates or are you making assumptions here?

Mr. VIALE. Well, they are not assumptions. They are not based on the actual information the consumer has. We don't have that available to us.

Senator DAYTON. Well, you are asking the consumer to provide you with information. Why wouldn't you obtain that information?

Mr. VIALE. We are not able——

Senator DAYTON. How do you assess whether the client is going to receive a benefit if you don't know what the client is presently paying?

Mr. VIALE. We don't know exactly what their interest rates are with each account. That is impossible for us to know.

Senator DAYTON. You are setting up a management fee, which in the case of Mr. Schuck was $2,000. Wouldn't that be an appropriate part of the service, then, to make an actual determination rather than just plugging in some generic assumptions?

Mr. VIALE. There is no generic assumptions. We know what the——

Senator DAYTON. What are the interest rates based on?

Mr. VIALE. The interest rates are based on creditor guidelines. We know what they will do upon acceptance of the proposals prior to our client joining our program. So there is no guesswork involved in the plan that we are setting up for them.

Senator DAYTON. Why aren't you representing to them in the plan the actual cost of their present situation and then showing them what reductions you are able to gain for them?

Mr. VIALE. Because it is creditor-specific. There are sliding scales for each creditor. It is impossible for us to determine exact figures for the consumer.

Senator DAYTON. But don't you have the exact figures based on that client's present situation?

Mr. VIALE. It is impossible.

Senator DAYTON. What is impossible?

Mr. VIALE. Well, I will give you an example.

Senator DAYTON. If I come to you and I have six credit cards and I am overdue on whatever they are, I have six interest rates that are being charged on my six accounts—what is complicated about that?

Mr. VIALE. Well, we don't know what certain creditors like Discover, MBNA, or other creditors are going to do with the interest rate concessions.

Senator DAYTON. You are negotiating with each creditor a reduction part of this management fee that you are collecting up front?

Mr. VIALE. No. There is not a negotiation process. They are going to evaluate the proposal we send in based on criteria of the client, their client. Then they are going to, in turn, set an interest rate for that particular account.

Senator DAYTON. These savings, then, are just based on a set of fictitious assumptions? They are not based on actual negotiations?

Mr. VIALE. We don't negotiate with the creditors.

Senator DAYTON. They are not based on an actual fact of what is going to be accomplished on their behalf?

Mr. VIALE. We have general terms for each creditor. Some vary——

Senator DAYTON. I am not talking about general terms. You are charging $2,000 for a computer printout and representing that as actual savings. If I am taking the time, which I would hope I would, to be reading this and trying to make an assessment, I am relying on your assertions that this is what I am going to save so I can understand whether I am getting an appropriate benefit or not, and you are saying that they are not based on actual facts, they are based on your assumptions or some generic numbers that you plug into a computer program.

Mr. VIALE. It is not——

Senator DAYTON. Why is that worth $2,000 to me?

Mr. VIALE. Because that is what the amount of the—that particular client, that is what you owe them. That is what it is going to take to pay back the debt through us.

Senator DAYTON. No, that is what you are charging. You are charging me an up-front management fee, which in Mr. Schuck's case is $2,000. I am just using that as an approximation. I don't know if that is high or low for your average customer——

Mr. VIALE. It is very high.

Senator DAYTON. High, OK. So whatever it is, $1,500—what is the average management fee?

Mr. VIALE. Three-hundred-and-eighty dollars. Three percent of our clients have payments over $1,000.

Senator DAYTON. I am talking about the first month, the up-front.

Mr. VIALE. Three-hundred-and-eighty dollars is the average.

Senator DAYTON. Does that include the 10 percent?

Mr. VIALE. Correct.

Senator DAYTON. All right. So for that, what am I getting? I am getting this computer printout?

Mr. VIALE. You are getting our systems of generating to our best ability what the estimated savings will be for each client that comes in to us.

Senator DAYTON. What is that document being represented as? What is the title of that, not the one in front of you now but the one that you send out there?

Mr. VIALE. It is called the Debt Management Plan Summary, A Pro Forma Statement.

Senator DAYTON. OK. Would I have any reason not to believe that is reflective of my situation and that you made that determination? I mean, what other kind of service are you providing except for an effort to reduce my overall payments?

Mr. VIALE. This is only part of what we do. I mean, this is only——

Senator DAYTON. What else do you do?

Mr. VIALE [continuing]. Ten to 20 percent of what we do. The rest is all education.

Senator DAYTON. On a website?

Mr. VIALE. No, not on the website. The counselors interact with the consumers and do our best to deliver whatever education they want and they need. What the Subcommittee doesn't understand——

Senator DAYTON. How can your counselors provide information if they don't have the facts? How can they counsel without the facts?

Mr. VIALE. We do have——

Senator DAYTON. Let me just ask one other question, Mr. Chairman. I am sorry. This fair, what do you call it, the fair share plan for the rebate——

Mr. VIALE. Good payer program.

Senator DAYTON [continuing]. The bonus you are paying——

Mr. VIALE. Yes.

Senator DAYTON. Based on the figures you have provided to your almost 76,000 clients, the $14 million, that averages out to $185 per client.

Mr. VIALE. A hundred-and-eighty-two dollars, correct.

Senator DAYTON. So that is less than—and you say the average up-front payment is $385?

Mr. VIALE. That is correct.

Senator DAYTON. You are giving them back a fraction of what they are paying you, but more importantly, I guess my question is, if twice that is the total value of the savings that you are getting from the creditors, again, what value are you providing to this client for all that you are charging?

Mr. VIALE. Some of those 10,000, and you have a payment of $300, we will use $300 as our example, they are going to save roughly between maybe $100 to $150 in interest charges every month by being on our program.

Senator DAYTON. How do you know that? You don't have that information.

Mr. VIALE. We have——

Senator DAYTON. You just said it is impossible to get that information.

Mr. VIALE. It is impossible to get accurate information. The information we are providing is very close to accurate.

Senator DAYTON. How is it impossible to get accurate information on what is actually occurring out there among your clients?

Mr. VIALE. You should talk to the banks about that.

Senator DAYTON. Well, no, I don't talk to the banks. It is what you——

Mr. VIALE. It is not——

Senator DAYTON. What do you——

Mr. VIALE. The creditor——

Senator DAYTON. I get a monthly statement. I get information on what the current interest rate is. But at the end of all my good behavior, I am getting $185 back as a bonus. The other $185 you are saving, that is the total value of the savings, $370, that on average you have achieved through interest reductions from the creditors.

Mr. VIALE. That is not true.

Senator DAYTON. I am just using the numbers you provided.

Mr. VIALE. That is not true. I mean——

Senator DAYTON. What is true, then? What are you getting for these costs?

Mr. VIALE. Extreme value we are delivering to people who need a debt management program.

Senator DAYTON. No. Quantify it. What are you getting for them?

Mr. VIALE. We are getting reduced interest rates so they can get out of debt in a reasonable time frame.

Senator DAYTON. So they are getting $370 worth of reduced interest rates?

Mr. VIALE. On a monthly basis, they are getting——

Senator DAYTON. No, not monthly, that is the total. The total rebate is $185.

Mr. VIALE. No, no——

Senator DAYTON. It is half of the interest that you have saved. So the total value of the interest you have saved—well, don't shake your head. Then tell me what the facts are.

Mr. VIALE. This is rebates. This is fair share money the creditor sends to an organization.

Senator DAYTON. And they get half of it and you get half.

Mr. VIALE. Right. That is not interest rate reductions. That is not savings on the plan. This is just fair share, that we give half back to our consumers. No one does that. Interest rate concessions, we all get. We all save the client the same type of money from a monthly basis from each creditor. It is all standard. There is no difference in what we do.

Senator DAYTON. But again, what are you saving them?

Mr. VIALE. Tens of thousands of dollars. Someone who owes $10,000——

Senator DAYTON. How do I know that if I am a customer? How do I know what you are saving me?

Mr. VIALE. It is our expertise, and everything we have in our system is all computerized based on creditor guidelines. There is no guesswork in what we do to a degree. We can't provide an exact detailed report, and nobody can.

Senator DAYTON. Thank you, Mr. Chairman——

Senator COLEMAN. Thank you, Senator Dayton.

Senator DAYTON [continuing]. For your indulgence.

Senator COLEMAN. I want to just follow up on a couple things. Fair share, you talked about fair share. The number one creditor for Cambridge is Citibank, is that correct?

Mr. VIALE. I am not exactly sure. It is one of the top ones.

Senator COLEMAN. The top ones. Do you know if Citibank does anything with fair share, provides any fair share rebate?

Mr. VIALE. Provides any fair share—I don't understand.

Senator COLEMAN. Isn't it true that many of your top creditors no longer participate in fair share or else only rebate a very small percentage?

Mr. VIALE. We are down——

Senator COLEMAN. Are you aware of that?

Mr. VIALE. I am aware of it. We are down to a little bit less than 5 percent fair share.

Senator COLEMAN. Your top creditor, Citibank, do you know if they provide any fair share?

Mr. VIALE. Yes, they do, to us.

Senator COLEMAN. And what percentage.

Mr. VIALE. Yes. Well, 9 percent is the fair share. I think it is nine. It is eight——

Senator COLEMAN. Citibank is giving you back 9 percent?

Mr. VIALE. It is 8 or 9 percent based on—they are still coming out with their new policy of their grants and that hasn't been released to the community yet.

Senator COLEMAN. Bank One, one of your top three, what is their fair share?

Mr. VIALE. That might be zero right now.

Senator COLEMAN. It might be zero. And MBNA, your number two credit group, what is their fair share?

Mr. VIALE. They are at zero right now.

Senator COLEMAN. OK. So your top creditors, and I want to turn to you, Mr. Kroening, because you are impacted by this, aren't you?

Mr. KROENING. Yes.

Senator COLEMAN. Is it fair to say that the top creditors today are not participating in fair share or have substantially cut their fair share because of the fact that so much of this revenue is being generated now through either for-profits that are making a lot of profits or for-profits that are benefitting from what the non-profits are doing?

Mr. KROENING. Yes, Mr. Chairman. My belief is that we have seen a major decrease in the creditor support for our type of counseling and debt management work that we do, related specifically to the number of new entrants and the number of folks that they are putting on plans. And specifically, I believe it is related to the fact that many people are being put into debt management plans that simply do not need it and creditors have seen their line item expense go out the roof with this. What they do is cut across the board. So this has drastically affected us. Our organization has a budget of just around $1 million. Over the last 4 years, these cuts have meant about $250,000 in less revenue for us.

Senator COLEMAN. The last area of inquiry, I want to clear up this thing about education so we are very clear. There is an initial call to a customer. Mr. Schuck is a customer. That call lasts approximately how long, Mr. Viale?

Mr. VIALE. It can last anywhere from 5 to 15, 20 minutes, the first call.

Senator COLEMAN. Let me back up. Is there any face-to-face education you have with any of your consumers?

Mr. VIALE. One hundred percent. If they live in the area, they come in for face-to-face counseling.

Senator COLEMAN. What percentage of your customers come in for face-to-face counseling?

Mr. VIALE. People that live in the area, almost 100 percent of them.

Senator COLEMAN. What percent of the total——

Mr. VIALE. We are national. We don't have a facility in every State and every county.

Senator COLEMAN. So what percent of your total customers get face-to-face counseling?

Mr. VIALE. Approximately 10 to 20 a day get face-to-face counseling, so I don't know what that would relate to. I have never done the numbers up.

Senator COLEMAN. The education—so I am making it very clear, if you don't enroll in a debt management plan, you get referred to a website, is that correct?

Mr. VIALE. That is correct.

Senator COLEMAN. And if you do enroll in a debt management plan, you get a workbook and a videotape, is that correct?

Mr. VIALE. You get a two-and-a-half-hour video series and a workbook plus the website plus newsletters and the education center along with the counselor.

Senator COLEMAN. If there is just a little follow-up, because we do have two more panels. Senator Levin?

Senator LEVIN. Mr. Viale, going back to the rebate issue, you said that your customers get the average of $185 rebate, so about half that average initial fee is rebated to all of those customers you have got that get the plan and sign up, is that what you are saying?

Mr. VIALE. A hundred-and-eighty-two dollars, correct.

Senator LEVIN. That is the average?

Mr. VIALE. That is the average amongst the whole group.

Senator LEVIN. All of the group?

Mr. VIALE. Correct.

Senator LEVIN. So that half of your total money that you got in initial fees last year, for instance, was rebated?

Mr. VIALE. That would be untrue because they have to be on the program for 6 months, so—but if you were to look at it over the time, yes, that would be true.

Senator LEVIN. Only people who were on the program for 6 months get rebates?

Mr. VIALE. Correct.

Senator LEVIN. What percentage of the 12 percent of the people that you sign up are on your program for 6 months?

Mr. VIALE. The average length of time for a consumer on our program is 23 months. That stat I have.

Senator LEVIN. So you don't have that figure, what percentage of people drop out before 6 months and therefore don't get a rebate at all?

Mr. VIALE. No. I do have that around 20 percent actually get more than their initial fee back in rebates.

Senator LEVIN. But you don't have the percentage that get nothing because they dropped out after——

Mr. VIALE. I don't have that percentage here, no.

Senator LEVIN. Mr. Case, very quickly, what percentage of your customers make no contribution up front at all?

Mr. CASE. I don't have a percentage, sir, but 5,000-plus are on our program right now with no contributions whatsoever.

Senator LEVIN. Up front?

Mr. CASE. Anything, in all——

Senator LEVIN. And how many are in your program?

Mr. CASE. We have approximately 72,000 people in the program right now.

Senator LEVIN. Are the people who sign up these customers discouraging folks from making voluntary contributions?

Mr. CASE. I am sorry?

Senator LEVIN. Are they—excuse me. I misspoke. Are the people who engage in these first phone calls trying to sign up people, do they discourage folks from saying that they can't make a contribution?

Mr. CASE. Mr. Levin, as far as if people can't make the contribution, we don't jam it down their throat. I mean, we understand certain people are in certain hardship situations and——

Senator LEVIN. Exhibit 14[1] has the following item. The script tells your employees what to say in response to the customer who says, "I can't afford a contribution right now, but maybe I can afford to contribute later," and here is what your script advises the employee to say. "If you can afford to make a monthly payment, you can afford to make a contribution. That contribution is not going into our pocket. It is going to cover the costs of setting you up on the program. Would you rather have that payment go to us to help people like you get out of debt or would you like it to go into the creditors' pocket as an extra interest? Would you rather support a non-profit company or help a bank get richer?" Is that your script?

Mr. CASE. I didn't personally write the script, sir.

Senator LEVIN. Is that your company's script?

Mr. CASE. That is in the company handbook, yes.

Senator LEVIN. Is that as disgusting as it sounds? Does that not disgust you? If you don't call that pressure on somebody to make a contribution, how would you label that?

Mr. CASE. I would call it pressure.

Senator LEVIN. You would call it pressure. That is how voluntary your contributions are.

One last question. Mr. Kroening, we have heard that the average initial fee that is charged by Cambridge is $380. What is your average initial fee?

Mr. KROENING. Twenty dollars.

Senator LEVIN. Thank you. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman.

I will be brief because we have a roll call vote starting, but Mr. Kroening, I want to thank you for being here and presenting a comparative perspective. You have given new meaning to the phrase, "swimming with the sharks." These are your compatriots. Ms. Craig, I am glad that this investigation has prompted a review of some of your practices. I hope they are conforming to Mr. Kroening's.

Ms. Craig, since I didn't have a chance to ask—I am sorry, Mr. Case—before, Ms. Troy stated that she was not able to talk with a counselor when she wanted some counseling information and was referred instead to "customer service," Who is customer service in your business?

Mr. CASE. Sir, the customer service would either be The Ballenger Group or DebtWorks, depending on when she was on the program. I believe she was in 1999, so it would be DebtWorks.

[1] See Exhibit No. 14 which appears in the Appendix on page 260.

Senator DAYTON. And DebtWorks is another subsidiary of The Ballenger Group?

Mr. CASE. DebtWorks was bought by The Ballenger Group, sir.

Senator DAYTON. OK. But she says she got a different person each time, that she didn't have anybody who was familiar with her case. So there is not a counselor? Mr. Allen is representing himself as a counselor, but he doesn't do any counseling.

Mr. CASE. He does do counseling, sir. My understanding of the customer service area is each client who comes onto the program, their customer number is their Social Security number. That enables them to be allowed to talk to any customer service representative simply by giving them their Social Security number to pull it up——

Senator DAYTON. Are those people trained as counselors, whatever that term means in your industry?

Mr. CASE. The customer service?

Senator DAYTON. Yes.

Mr. CASE. They are trained in customer service, sir.

Senator DAYTON. Who provides this "counseling"?

Mr. CASE. The counselors provide the up-front education.

Senator DAYTON. In the 15 minutes that you are allotting for that purpose?

Mr. CASE. My understanding is there are several calls. There is not one call and you are signing up. I mean, there is a lot of——

Senator DAYTON. What is the counseling? What is the content of the counseling?

Mr. CASE. Right up front, there is a budget analysis done right away, because different people are in different situations.

Senator DAYTON. Your budget analysis with people who are calling you, referring to your advertising, under the kind of circumstances they are in, does that budget analysis show that they are able to make voluntary "contributions"? I mean, if they could make voluntary contributions, why would they be needing your service?

Mr. CASE. Sir, there is a negotiation period which takes normally between 30 and 45 days with the creditors to make sure all these proposals are——

Senator DAYTON. You are charging $5 per account per month.

Mr. CASE. Per month, right, for maintenance fees.

Senator DAYTON. Five dollars per account per month?

Mr. CASE. It is actually $7, sir.

Senator DAYTON. Seven dollars per account per month.

Mr. CASE. Correct.

Senator DAYTON. That presumably is the cost, probably more than the cost, of actual time you are spending negotiating with these creditors. Why is there a voluntary contribution necessary at all?

Mr. CASE. Because we are charged monthly fees by the back-office company which helps us defer those costs.

Senator DAYTON. Who is a for-profit that owns these other operations, right?

Mr. CASE. It is two different companies, sir.

Senator DAYTON. Well, it is different companies but the same principals?

Mr. CASE. No.

Senator DAYTON. Some of the same?

Mr. CASE. No.

Senator DAYTON. No relationship at all between The Ballenger Group and AmeriDebt?

Mr. CASE. No.

Senator DAYTON. None at all between The Ballenger Group and——

Mr. CASE. Not at all.

Senator DAYTON. OK. Just one last question. You talk about the value that you have achieved for your customers. How do you quantify all these tangible benefits, I think you called them?

Mr. VIALE. Is this question to me?

Senator DAYTON. No, Mr. Case.

Mr. CASE. Oh, I am sorry, sir. What was the question?

Senator DAYTON. For years, AmeriDebt helped consumers save millions by providing these various services. How do you determine what those savings are? What are the benefits the clients receive?

Mr. CASE. We had an analysis done which we refer to, the Painter Analysis. It was a report done for our litigation in the State of Illinois and these are the numbers that the Painter Analysis came up with.

Senator DAYTON. So when you say they have received approximately $13,300 in tangible benefits——

Mr. CASE. That is correct.

Senator DAYTON [continuing]. What are tangible benefits?

Mr. CASE. If, in fact, they stayed, making minimum payments on their unsecured debt throughout—until the payment was paid off or go onto this debt management program and reap the benefits of re-aging the accounts, getting the interest dropped down, and getting the debt paid off in a 3- to 5-year time period, sir.

Senator DAYTON. But what constitutes the tangible benefit?

Mr. CASE. If, in fact, the interest rates were not lowered and they paid the minimum payments, it would take them, I forget the number, it is approximately, I believe, 20 years or so pay off this debt.

Senator COLEMAN. Senator Dayton.

Senator DAYTON. Is $13,300 in tangible benefits the sum of the money that they paid off? What are you calling a tangible benefit?

Mr. CASE. It is a tangible benefit because they are not paying the interest rates they were once paying, sir.

Senator DAYTON. So the interest rate differential, the value of that is $13,300 for an average client?

Mr. CASE. That is my understanding.

Senator DAYTON. You run the business, don't you? Wouldn't you know?

Mr. CASE. That is my understanding.

Senator DAYTON. Thank you, Mr. Chairman.

Senator COLEMAN. Thank you. Just to clarify one thing and we will dismiss this panel. The Ballenger Group bought DebtWorks. That chart, though, DebtWorks was originally—Ballenger is now DebtWorks, is that correct?

Mr. CASE. That is correct, sir.

Senator COLEMAN. So when you answered Senator Dayton, you said that there is no relationship between The Ballenger Group

and AmeriDebt, you are technically correct, but DebtWorks, which was the predecessor to The Ballenger Group, was started by Mr. Pukke, who was the husband of Pamela Pukke, is that correct?

Mr. CASE. That is correct, sir. They did not serve on the boards at the same time, though.

Senator COLEMAN. But you said there was no relationship. I just want to be very clear that there was very clearly a relationship when DebtWorks started this relationship with Debticated Scape, a relationship with DebtServe, a relationship with Dedicated Consumer Counseling, a relationship with CrediCure, a relationship with the Credit Network, a relationship with Fair Stream. All the folks who started those and were involved in those at one time were associated with AmeriDebt, is that correct?

Mr. CASE. I don't think that is correct, sir.

Senator COLEMAN. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman. If his answer to me was as clarifying as his answer to the average customer, I can see why there is so much trouble. Thank you, Mr. Chairman.

Senator COLEMAN. This panel will be excused. I want to thank you for your participation.

We do have a vote. I have 6 minutes, and what I am going to do is I am going to call the third panel. If Senator Levin gets back, I will turn the gavel to him. Again, I want to thank everybody for appearing, Ms. Craig, Mr. Kroening, Mr. Viale, and Mr. Case.

I will warn the panel that we are in the midst of a vote and if my colleague, Senator Levin, gets back within the next 2 minutes, we will continue. Otherwise, I will simply adjourn, take a 10-minute break, and then reconvene.

But in the interest of time, I would like to welcome our third panel to today's hearing. This panel is comprised of the representatives of the for-profit companies that have contracts with some of the credit counseling agencies from panel two. I would welcome Andris Pukke, the President of DebtWorks; Michael Malesardi, the Chief Financial Officer of The Ballenger Group; and finally, Bernaldo Dancel, the Chief Executive Officer for Amerix Corporation. I do appreciate all of you being here and look forward to your testimony.

John Puccio, the Chief Executive Officer of Brighton Debt Management Services, was invited to testify at today's hearing. Yesterday afternoon, we learned that Mr. Puccio declined to testify because of health concerns. I understand that he is in the hospital. We certainly wish him a speedy recovery.

In order to provide the Cambridge-Brighton entities with an opportunity to testify before this Subcommittee today, we extended an invitation to Mr. Puccio's brother, Richard Puccio. Richard Puccio, like his brother, is a part-owner of entities in the Cambridge-Brighton enterprise and is involved in their activities. Richard Puccio declined to testify, as well.

Senator COLEMAN. Mr. Pukke, Mr. Malesardi, and Mr. Dancel, we are anxious to hear your testimony today. You each have a certain level of corporate responsibility to deal with non-profit agencies in a manner consistent with their non-profit status and a manner consistent with the Internal Revenue Code. Some of you have

changed your operations since the outset of the Subcommittee's investigation, some of you have not.

What I am going to do is I am going to swear in the panel and then we are going to take a 10-minute break because I think we are running close on the vote.

Before we begin, pursuant to Rule 6, all witnesses who testify before the Subcommittee are required to be sworn. At this time, I would ask you all to please stand and raise your right hand.

Do you swear the testimony you are about to give before the Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. PUKKE. I do.

Mr. MALESARDI. I do.

Mr. DANCEL. I do.

Senator COLEMAN. You may sit down, gentlemen, please. Mr. Pukke, you have somebody sitting next to you. Please identify that individual for the record.

Mr. WILLIAMS. Senator Coleman, my name is John Williams. I am an attorney for Mr. Pukke. As we have informed the Subcommittee staff in correspondence, in view of the pending litigation and investigations into DebtWorks and Mr. Pukke, we have advised Mr. Pukke to decline to answer any questions and to assert his constitutional privilege. We understand the staff has, despite this, insisted that Mr. Pukke be here personally to assert his privileges and so he is here today. I am going to say he will have no prepared statement, of course. If you choose to put questions to him, he will assert his privilege.

Senator COLEMAN. Thank you very much, Mr. Williams.

What I will do now is I will adjourn the hearing for at the most 10 minutes, but I ask all the members of the panel to please then be back after that 10-minute recess. So we will take a 10-minute recess.

[Recess.]

Senator COLEMAN. This hearing of the Permanent Subcommittee on Investigations is back in order.

Mr. Pukke, I understand that you have made a request by correspondence regarding Rule 11 of the Subcommittee's Rules of Procedure requesting that no television, motion picture, other cameras, or lights be directed at you. Rule 11 of the Subcommittee's rules and procedures states a witness may request on grounds of distraction, harassment, personal safety, or physical discomfort that during the testimony, television, motion picture, other cameras and lights should not be directed at him or her. Such requests shall be ruled on by the Subcommittee Members present at the hearing.

In considering Mr. Pukke's request, I note the Subcommittee has rejected similar requests in the past. Therefore, after consulting with Ranking Member Senator Levin, without objection, the witness's request to invoke Rule 11 is hereby denied.

Mr. Pukke, I understand from counsel that you have invoked the Fifth Amendment privilege. I want the record, however, to reflect that this Subcommittee has always taken care to treat respectfully a witness who asserts a Fifth Amendment privilege. The invocation of that right by American citizens should not and does not imply guilt. This right does not, however, allow one to refuse to appear

before the Subcommittee. A witness before the Subcommittee may assert a privilege against self-incrimination, refusing to answer specific questions, but cannot use the invocation of the Fifth Amendment to avoid appearing before the Subcommittee altogether.

In furtherance of this Subcommittee's hearing today, its ongoing fact finding responsibilities, and the Senatorial exercise of legislative duties, I will begin the questioning.

**TESTIMONY OF ANDRIS PUKKE, PRESIDENT, DEBTWORKS, INC., GERMANTOWN, MARYLAND, ACCOMPANIED BY JOHN WILLIAMS**

Senator COLEMAN. Mr. Pukke, when you first formed DebtWorks to offer back-end processing services to non-profit credit counseling agencies, your first customer was AmeriDebt. At this time, one of AmeriDebt's directors was your wife, Pamela Shuster Pukke, and your brother, Erik, was an employee. How did you ensure that the contract you signed with AmeriDebt did not cause it to overpay for the services you were performing for it?

Mr. PUKKE. Senator, based on advice from counsel, I invoke my right to not answer that question.

Senator COLEMAN. After you formed DebtWorks, friends and family members of yours created additional non-profit counseling agencies which promptly contracted with your company for services. Is it fair to say that the primary motive of setting up these additional agencies was to generate more revenue for DebtWorks?

Mr. PUKKE. On advice from counsel, I invoke my right to not answer that question.

Senator COLEMAN. In 1996, you pleaded guilty to a Federal charge of defrauding consumers by using your company, Infinity Resources, to falsely promise to broker debt consolidation loans. It is my understanding that customers of AmeriDebt and the other 10 non-profit agencies currently contracted with The Ballenger Group are still referred to your company. Is this correct?

Mr. PUKKE. Senator, on advice of counsel, I am asserting my right to not answer that question.

Senator COLEMAN. Last question, Mr. Pukke. I also understand that you own Fidelity and Trust Mortgage Company and F&M Mortgage Company. Are customers of AmeriDebt and the other 10 non-profit agencies still referred to those companies?

Mr. PUKKE. Again, I am asserting my right to not answer that question.

Senator COLEMAN. Mr. Pukke, you have been asked several specific questions about DebtWorks and about your practices within the credit counseling industry. In response to each of the questions, you have asserted your Fifth Amendment privilege. Is it your intention to assert the Fifth Amendment privilege to any question that might be directed to you by the Subcommittee, any other questions that might be directed to you by the Subcommittee regarding the organization of DebtWorks and its practices?

Mr. WILLIAMS. Senator Coleman, in view of what we understand to be the pointed questions, I can't imagine a question that you are going to put to him that we will not assert the Fifth, although we will respond to any question that you may put to us.

Senator COLEMAN. Given the fact that you are asserting your Fifth Amendment right against self-incrimination to any more questions asked by the Subcommittee, you are hereby excused.

Mr. WILLIAMS. Thank you.

Senator COLEMAN. Mr. Malesardi.

**TESTIMONY OF MICHAEL MALESARDI,[1] CHIEF FINANCIAL OFFICER, THE BALLENGER GROUP, LLC, FREDERICK, MARYLAND**

Mr. MALESARDI. Good morning, Mr. Chairman and Senators. My name is Michael Malesardi and I am the Chief Financial Officer of The Ballenger Group. Thank you for inviting me to speak before you today and thank you to the Subcommittee staff for their help and courtesy in helping us respond to your data requests and prepare for our face-to-face meetings.

Ballenger began doing business on January 1, 2003, as an independent solutions provider of custom software development, payment processing services, back-office functions, and marketing programs, with a specialization in consumer debt management. Our clients are credit counseling agencies and we receive no direct funding from consumers or credit card companies.

Clearly, the status quo in the credit counseling industry is not acceptable. We are committed to the establishment of fair and efficient Federal regulations that protect consumers and preempt the confusing and costly patchwork of State regulations.

By way of background, from 1982 to 1992, I spent 10 years as a certified public accountant with Price Waterhouse. From 1992 until 2002, I was controller or CFO of three SEC registrants. In July 2002, I joined a company by the name of DebtWorks as CFO. Along with several other newly-hired executives, I was hired to help the owner of DebtWorks, Andris Pukke, prepare for and execute a sale of his company to a third party.

In the summer of 2002, the new management team solicited bids from third parties who were interested in acquiring a majority stake in DebtWorks, primarily private equity firms. Ultimately, the negotiations were unsuccessful and we mutually terminated them in November 2002.

Following termination of negotiations with the third parties, the management team then approached Mr. Pukke in December 2002 about forming a new independent company and executing a management buyout of a majority interest in the operating assets of DebtWorks. The management team retained its own counsel, separate from DebtWorks, and after extensive negotiations, we reached an agreement to form The Ballenger Group and began doing business on January 1, 2003.

The Ballenger Group did not acquire the stock of DebtWorks and DebtWorks continued as a separate, unrelated legal entity with its own separate management and business operations. The Ballenger Group is not a successor to DebtWorks.

From January 1 through October 31, 2003, The Ballenger Group was 51 percent owned by the management team, with the remain-

[1] The prepared statement of Mr. Malesardi with attachments appears in the Appendix on page 153.

ing 49 percent owned by DebtWorks. To ensure the managerial independence of The Ballenger Group, our purchase agreement virtually eliminated any possibility of control or influence by DebtWorks, including the removal of any of their management, voting, or board rights.

On October 31, 2003, the management team then increased its ownership of The Ballenger Group to 100 percent, completely removing all of DebtWorks' ownership.

Mr. Chairman, in plain English, I want to reemphasize that since our inception as an operating business, neither Mr. Pukke nor DebtWorks have had anything to do with the management, operations, or control of The Ballenger Group. There is no ongoing relationship between The Ballenger Group and DebtWorks other than payments associated with our purchase of the assets.

Concerning the three companies the Subcommittee asked us about as to their relationship with DebtWorks, I am not familiar with either F&M Mortgage or Fidelity and Trust Mortgage. My knowledge of Infinity Resources Group is limited to an understanding that it is a debt consolidation loan business in which Mr. Pukke has been involved, but The Ballenger Group does not and has never performed any service for or on behalf of Infinity.

Since the formation of The Ballenger Group, we have added two new CCA clients and have had one existing client reinitiate counseling operations. The Ballenger Group has never initiated the formation of a credit counseling agency and has no plans ever to do so.

At the request of their banks, The Ballenger Group agreed to act as a back-up guarantor to the start-up loans that these three agencies obtained. Our guarantee falls in line behind the obligation of the agency and the personal guarantees of their principals.

Since the launch of The Ballenger Group in 2003 as an independent company, we have been steadfast in setting The Ballenger Group apart from DebtWorks and Mr. Pukke. In fact, during 2003, we terminated a client relationship with Dedicated, an agency that was headed by his brother.

Mr. Chairman, we can't change the historic fact that The Ballenger Group acquired the assets of DebtWorks, but in creating The Ballenger Group, we created a new entity operating under new management and have held ourselves to a new standard for the company, our client agencies, and the consumers that they serve. We appreciate the chance to set the record straight with respect to our complete independence from Mr. Pukke and DebtWorks.

We are actively engaged in proposing reforms we believe will make the industry more consumer-friendly, including national regulation and competition. Our written testimony, which we would ask be placed in the record, addresses our thoughts on reforms.

Thank you for the opportunity to be here today and I would be pleased to take any questions.

Senator COLEMAN. Your written testimony will be placed in the record, without objection.

I will stand corrected, Mr. Malesardi. I think in questioning the previous panel, on a number of occasions, I called The Ballenger Group a successor to DebtWorks and your testimony has made it

very clear that you are not a successor to DebtWorks, and so the record will be corrected on that account.

Mr. MALESARDI. Thank you, Senator.

Senator COLEMAN. Thank you. Mr. Dancel.

**TESTIMONY OF BERNALDO DANCEL,[1] CHIEF EXECUTIVE OFFICER, AMERIX CORPORATION, COLUMBIA, MARYLAND**

Mr. DANCEL. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Bernie Dancel. I serve as the CEO of Ascend One Corporation. I appreciate the opportunity to discuss with you important issues concerning credit counseling. The Subcommittee's inquiry is important, and at least for our company has stimulated constructive self-examination.

I want to make two points today. First, I do not believe the term "profiteering" in the title of this hearing applies to our company, as I will explain in discussing several aspects of credit counseling and our company. Second, since there is always room for improvement, I will briefly discuss important initiatives we have undertaken, in no small part as a result of our interaction with the Subcommittee.

I would like to begin with a word about how my own experience led me to the credit counseling field. Growing up, I watched my mother struggle financially and ultimately file for bankruptcy. And at age 25, after struggling to support two households as a divorced dad, I ended up filing for bankruptcy myself. This was one of the worst experiences of my life.

Later, I worked as a counselor with a credit counseling agency. I saw firsthand that there was a better way to reach financially distressed consumers like myself. I realized that CCAs needed to be more accessible, offer more privacy, and become more efficient by using modern technology to meet this growing demand.

Now let me turn to my main points. First, the term "profiteering" does not apply to our company. Of course, we are a for-profit business and we serve non-profit entities, but I am sure you agree that there is nothing wrong with that. The real question is whether we offer good service at a fair price, and the answer to that is clearly yes.

First, we offer unique and valuable services that agencies can purchase more efficiently from us than performing these services themselves.

Second, our prices are clearly fair. The bottom line is that consumers working with the CCAs we serve typically contribute the same or less than what consumers pay with other CCAs.

In addition, as the documents we produced to this Subcommittee show, we operate on a very low profit margin, generally less than 3 percent before taxes annually.

With respect to debt management plans, we recognize that DMPs are not right for everyone, and in fact, consumers, CCAs, and Amerix are all best off when DMPs are limited to consumers who are qualified for them. More than 70 percent of callers to CCAs we serve do not enroll on a debt management plan, as is true for CCAs that are members of the two leading trade associations.

[1] The prepared statement of Mr. Dancel appears in the Appendix on page 175.

Also, and Mr. Chairman, this is critical, the CCAs we serve do not charge large up-front fees. They charge nothing. So we can only recoup our costs if the consumer sticks with their plan. Some other entities, including AmeriDebt and Cambridge, charge hefty up-front fees that let them recoup their cost on day one. So where these other CCAs make money if the consumers immediately drop off their debt management plans, we actually lose money on consumers who don't stick with their plans for an extended period of time.

We agree with the Subcommittee that education and counseling for all consumers is crucial. The CCAs we serve provide a variety of educational resources through community programs, web-based materials, and monthly publications. And we publish and update a comprehensive online educational library available to any visitors to the Care One website. In addition, DMPs themselves are a very valuable educational tool—indeed the best—when they are right for a consumer. By making regular payments and exercising financial discipline, consumers learn to stick to a plan, modify their behavior, and get back on their feet.

At the same time, we recognize we can do better. In that spirit, we recently announced a number of new initiatives summarized in our March 16 letter to this Subcommittee. These initiatives are designed to ensure that all consumers get a useful education and counseling experience, whether or not they use a DMP.

First, we are adopting enhanced licensing standards for Care One that require agencies to provide patient counseling to every consumer, devote significant time to community outreach, and comply with standards established by the two leading trade associations. We will also offer each consumer a personalized budget worksheet whether or not they enroll in a DMP.

Second, we will assist our CCA clients in revising scripts consistent with this objective.

Third, we no longer offer overflow origination services.

Fourth, we are eliminating from our service contracts certain provisions relating to debt management plans, such as assist rates and revenue standards.

Finally, we have made a $5 million commitment to the Ascend One Fund for Financial Literacy to educate children and young adults about how to manage their finances responsibly.

Mr. Chairman, Ascend One is committed to playing a positive role in the credit counseling field so that all consumers can get the help they need, like myself, delivered in a fair and straightforward manner. Thank you, and I look forward to your questions.

Senator COLEMAN. Thank you very much, Mr. Dancel.

If we can get Exhibit 3 up,[1] to both you gentlemen, what we are struggling with here is the reality of individuals being processed through non-profits. I mean, that is the voice that they hear, and you heard from the consumers here and even some of the employees. There is something about being a non-profit that makes people feel safe.

And the concern we have is the relationship between the non-profits and the for-profits. In many cases, as with one of the in-

[1] See Exhibit No. 3 which appears in the Appendix on page 242.

stances we had here, what you have got are non-profits that have relationships, either marital relationships or friendship relationships. So I am trying to sort out, what is the right way to go here? I mean, is it at all possible for consumers to benefit when you have situations such as what The Ballenger Group is trying to do and Amerix is trying to do?

One of the issues, one of the criteria that I think I would like to see in place is the for-profit shouldn't be in a position to substantially influence the non-profit so that the non-profits can't do things independently.

Mr. Dancel, I would ask you, looking at Amerix, and we had folks here from American Financial, can you talk to me about the independence of the non-profits in dealing with you? Was there a point in time where you actually had what I might call quotas in terms of the number of folks that had to be signed onto DMPs?

Mr. DANCEL. The CCA clients that we have are completely independent organizations. There is no overlap in governance or board membership or executive or any kind of management positions. They make decisions independent of one another as well as independent of Ascend One or Amerix. In fact, we have had CCA clients in the past who have terminated particular services that we provide and in other cases have terminated their relationship with us altogether. So I believe that is a demonstration that there is complete independence of these organizations from us.

We have had in the past certain standards within our agreements with them. At one point, we had a transaction-based pricing model where we had a fairness opinion as to the fairness of the price that we provided.

Senator COLEMAN. I just want to make sure I understand what transaction-based models mean. Can you, in lay terms, explain that?

Mr. DANCEL. Sure. That is where, based on the activity, we charge them a flat amount for that service. It is not connected with any kind of sharing of revenue or other types of pricing models.

Senator COLEMAN. I just want to clarify my notes here, looking back at some of the responses given earlier—did you at one time require credit counseling agencies to enroll 30 percent of their calls into a debt management plan?

Mr. DANCEL. Yes, we did. There was a contractual standard that was set which we used—an industry standard, as you heard earlier today from the gentleman from Minnesota, that has been published through the NFCC as well as AICCCA—in terms of the number of customers who sign up for debt management enrollment after they have been counseled. It is approximately 30 percent.

Senator COLEMAN. Doesn't that really fly in the face of allowing credit counselors to make some independent judgment as to the needs of their particular client when you are actually setting a target, you have got to do 30 percent?

Mr. DANCEL. This 30 percent simply allowed us in the event that over an extended period of time we could not recoup our costs for the services we provided, that we would be able to terminate the contract.

Senator COLEMAN. I would suggest, though, that it flies in the face of what you would want from your credit counselors, to make independent judgments. Have you changed that policy, by the way?

Mr. DANCEL. We have heard the Subcommittee's concern about that and we have changed that.

Senator COLEMAN. I appreciate that.

Mr. Dancel, one other question. Our investigation showed that you started up a non-profit called, was it Genus Credit Management, is that correct?

Mr. DANCEL. Yes, Mr. Chairman.

Senator COLEMAN. And that Genus later sold its portfolio of debt management plan accounts to American Financial Solutions, and I think the figure was around $17 million.

Mr. DANCEL. Yes, Genus Credit Management sold their portfolio to American Financial Solutions, I believe for $17 million in 2001.

Senator COLEMAN. And can you tell us what happened to the proceeds from that sale?

Mr. DANCEL. The proceeds for that sale, sir, went to Genus Credit Management, or the In-Charge Institute, the parent of Genus Credit Management.

Senator COLEMAN. For what purposes?

Mr. DANCEL. The In-Charge Institute sold the Genus Credit Management Portfolio to American Financial Solutions. They had independent—both parties, Genus Credit Management and AFS, had independent reasons for why that made sense to them. AFS wanted to grow their credit counseling business and the number of consumers that they were serving through counseling and education, and I believe Genus Credit Management and In-Charge Institute wanted to capitalize on that portfolio for other business ventures that they were looking at.

Senator COLEMAN. I am just trying to get where the proceeds went. Again, where did those proceeds go?

Mr. DANCEL. They went to In-Charge Institute.

Senator COLEMAN. And who are the principals in that?

Mr. DANCEL. I only know that Dave Jones, at the time, was the chairman of In-Charge Institute. I don't know who the other principals were.

Senator COLEMAN. Mr. Dancel, one further question, and I do appreciate some of the changes that you have made. Do you support the standards that NFCC or AICCCA provide?

Mr. DANCEL. We do support those standards. In fact, in the standards that we have for Care One agencies that license that service mark, they are required to comply with those standards.

Senator COLEMAN. Mr. Malesardi, does The Ballenger Group support those same standards?

Mr. MALESARDI. We support industry standards. We don't have any NFCC clients, but I can tell you that the standards that we do offer exceed any industry standards out there and we do—we are ISO certified and have five metrics that do exceed those.

Senator COLEMAN. How does The Ballenger Group exercise some sense of corporate responsibility to ensure that its counseling agency truly educates its consumers? I mean, you have heard a lot of testimony today that is not occurring the way it should. So what

do you do? Talk to me a little bit about corporate responsibility, what you do to make sure that happens.

Mr. MALESARDI. OK. Well, we are definitely pro-consumer and you can see that in the fulfillment agreement that we have provided to the Subcommittee. We did add last year three best practices that really cover three different areas, and that is that the credit counseling agencies that we serve should be providing full disclosure of material facts, that they should be doing things to maximize consumer satisfaction, and also minimize consumer confusion, and the agreement provides that if they don't adopt the best practices that we have provided, which include sample contracts, sample disclosure statements, that we can terminate that relationship.

Senator COLEMAN. Are these best practices mandatory or voluntary?

Mr. MALESARDI. We consider them to be mandatory in the sense that if they don't follow them, we can terminate the relationship.

Senator COLEMAN. Do we have a chart [1] that is the organization chart for AmeriDebt? And again, I want the record to correct that The Ballenger Group is not the successor to DebtWorks.

Mr. MALESARDI. Thank you.

Senator COLEMAN. But is The Ballenger Group still serving, for instance, Fair Stream?

Mr. MALESARDI. Fair Stream is one of the two new clients that we actually started providing services for in 2003 after the company was formed.

Senator COLEMAN. And I believe Mr. Case would not affirm for the record that the entities Fair Stream and Credit Network, DebtServe, DebtScape, Debticated, all those have the names of individuals who we believe, the Subcommittee investigation believes were involved in AmeriDebt. It appears that, for instance, Andrew Smith, originally involved in AmeriDebt, is now involved in Fair Stream.

I am sitting in your shoes and AmeriDebt is the poster child for ills in this industry. How do you generate a level of confidence that the folks who are working through agencies with folks who are former AmeriDebt officers, that they are serving their clients in a proper fashion?

Mr. MALESARDI. I think you have to look to the fact that these are distinct entities, that The Ballenger Group is providing only certain services for these agencies. So they take the consumer through the counseling and education process, and that is the point at which time The Ballenger Group takes over responsibility. I can tell the Subcommittee that the data entry and the payment processing and the customer support we provide are superior to anything we think they can get elsewhere in the industry.

Senator COLEMAN. Thank you, Mr. Malesardi.

I would note that Mr. Puccio cannot be here today. We will be keeping the record open. There are questions that we still need to have answered, and so we will keep the record open in regard to questions that Mr. Puccio can answer.

With that, I will turn to Senator Levin.

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[1] See Exhibit No. 2 which appears in the Appendix on page 241.

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Dancel, American Financial Solutions testified that as a result of the PSI, our investigation, it wants to renegotiate the contract that it has with you for processing. Are you aware of that?

Mr. DANCEL. Yes, we are.

Senator LEVIN. That they have made that announcement? Are you willing to renegotiate?

Mr. DANCEL. Yes, Senator, we are.

Senator LEVIN. When does your contract with them run out?

Mr. DANCEL. August 2005.

Senator LEVIN. And your contract charges them $30 per plan per month, is that correct?

Mr. DANCEL. No, that would not be correct. The cost depends on the level of service that we are providing to them on a per account basis. So that would range anywhere from 50 percent of their revenue to 85 percent of their revenue.

Senator LEVIN. Depending on the services you provide?

Mr. DANCEL. Depending on the number of services we are providing, yes.

Senator LEVIN. What does that average, do you know, per plan, per debt management plan per month?

Mr. DANCEL. Our average across the AFS customer base, the average would be in the $15 to $16 level.

Senator LEVIN. Per month?

Mr. DANCEL. Yes, sir.

Senator LEVIN. Now, Southern New England pays an outside vendor $1.20 per plan per month and Consumer Credit Counseling Services of Los Angeles pays an outside vendor $2 per plan per month. Why is there such a huge difference between what you charge and what they charge?

Mr. DANCEL. I don't know what list of services they are providing. I don't believe we are comparing apples to apples.

Senator LEVIN. How many competitors do you have?

Mr. DANCEL. Processing entities?

Senator LEVIN. Yes, that do the same type of work you do.

Mr. DANCEL. I am not sure how many there are out there.

Senator LEVIN. Would there be a handful?

Mr. DANCEL. Again, that depends on the level of—what services are being provided——

Senator LEVIN. The type of services, the range of services you provide. How many would there be?

Mr. DANCEL. I believe there probably are just a handful of companies that provide all the services that we provide.

Senator LEVIN. Is The Ballenger Group one of them?

Mr. DANCEL. I don't know the business of The Ballenger Group.

Senator LEVIN. Have you competed with any other company for a service contract?

Mr. DANCEL. Yes, we have. American Financial Solutions, in fact, has put out a request for proposal——

Senator LEVIN. Now?

Mr. DANCEL. They put out a request for proposal in 2001 when they were looking at purchasing the Genus portfolio and they put it out to many suppliers within the industry as well as processors

outside the industry and they were not able to get any comparable price to what we were——

Senator LEVIN. So the contract that you won was a contract that was bid on by others?

Mr. DANCEL. They put out a request for proposal. I don't know what types of bids came in, but they came back to us and said they couldn't get it at a price that we were offering.

Senator LEVIN. They solicited proposals on the contract that you are now under with them?

Mr. DANCEL. Yes.

Senator LEVIN. Is the 50 to 80 percent of all the income that they generate a large percentage compared to what other processors like you get?

Mr. DANCEL. We don't believe that AFS or any of our other credit counseling agency clients can get the services that we provide at the price that we provide it anywhere, and evidence of that is that our CCAs are able to pass that savings on to consumers, where they have no up-front contribution or fee and they meet, if not lower, the monthly amount of voluntary contribution that they ask for from the consumer is either at the NFCC or AICCCA standards or lower than most, as well as they are able to do quite a lot of education and counseling activity. For example, I believe AFS in just the last 12 months has provided to their foundation over $4 million towards education and scholarships.

Senator LEVIN. You are saying that your clients do not charge up-front fees, is that what you said?

Mr. DANCEL. Yes. They charge no up-front fee whatsoever.

Senator LEVIN. None of them?

Mr. DANCEL. None of them.

Senator LEVIN. Mr. Malesardi, you charge AmeriDebt a monthly processing fee of about $25 per month, is that about right?

Mr. MALESARDI. That is correct.

Senator LEVIN. Per plan?

Mr. MALESARDI. Per DMP, that is correct.

Senator LEVIN. These figures, again, are a multiple of the $1 to $2 per month processing fee that the vendors that I referred to in New England and Los Angeles charge. What is your justification of that large fee, the larger fee?

Mr. MALESARDI. I agree with Mr. Dancel's comment that I don't think these are apples to apples comparisons.

Senator LEVIN. Your services are different from theirs?

Mr. MALESARDI. We are providing a comprehensive service, software solution, and other things that go beyond that.

Senator LEVIN. Have you had competitors for your contract with AmeriDebt?

Mr. MALESARDI. AmeriDebt has—we haven't done anything new with AmeriDebt since we assumed responsibility in 2003. We have, as I said in my statement, added two new clients in 2003. I don't know what process they went through, but we were successful in getting that business.

Senator LEVIN. And you don't know if there were bids for those contracts or not?

Mr. MALESARDI. I do not.

Senator LEVIN. Were they negotiated directly with those other customers of yours?

Mr. MALESARDI. We did negotiate them directly. We are independent entities. We went through a negotiation process, as would be typical for any service provider.

Senator LEVIN. They didn't tell you whether or not there were other people they were considering?

Mr. MALESARDI. They did not disclose that to us.

Senator LEVIN. All right. Did you hear the testimony about the voluntary contributions?

Mr. MALESARDI. Is that directed to me?

Senator LEVIN. From Mr. Case, did you hear that testimony that they——

Mr. MALESARDI. Yes, I did.

Senator LEVIN. Were you troubled by it?

Mr. MALESARDI. I can't comment, really, on their business practices. We have a fixed fee that we charge to the credit counseling agencies. They are our client and not the ultimate consumer.

Senator LEVIN. Were you troubled when they heard that they acknowledged that they pressured consumers into buying their service? Did you hear that?

Mr. MALESARDI. I did hear his comment.

Senator LEVIN. That amounted to pressure?

Mr. MALESARDI. We are pro-consumer, and as I said, our best practices push on full disclosure of these facts and treating consumers in a fair manner so that they are satisfied, so we would promote any practice that leads to that.

Senator LEVIN. You are benefitting from pressure being placed on somebody who is vulnerable. That is what it amounts to.

Mr. MALESARDI. I would disagree with that assertion, because we get a flat fee from the credit counseling agency regardless of whether a consumer makes a contribution to them or not. So we don't really benefit or get hurt by the amount of their contribution.

Senator LEVIN. So the stronger that non-profit is has no effect on how much money you are paid?

Mr. MALESARDI. No. I mean, our——

Senator LEVIN. It doesn't make any difference how many customers they have?

Mr. MALESARDI. Oh, we would benefit by if they have more customers in the sense that we get more of the revenue stream. But that is the extent of it.

Senator LEVIN. Let me ask you again, because it seems to me it is so obvious. If they are not paid by any of their customers, you are not going to get paid, either, are you?

Mr. MALESARDI. I think, ultimately, that is the risk in this business. That is the risk of being an outsourcer.

Senator LEVIN. And if they pressure people into signing up with them, which they acknowledge that pitch does, since you are the indirect beneficiary of that, shouldn't that trouble you just a little bit?

Mr. MALESARDI. As I have said, we want them to follow best practices and if they didn't follow best practices and didn't change that, then we could terminate that relationship, as we have done.

Senator LEVIN. As you have done?

Mr. MALESARDI. Not with one client.

Senator LEVIN. Thank you, Mr. Chairman.

Senator COLEMAN. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman.

Mr. Malesardi, I am trying to understand how this works. These non-profits are called credit counseling agencies and the people who come to them believe then that they are getting credit counseling services. I am going to use AmeriDebt as a prototype. I don't know how the other 10 of your non-profits operate, but this is the only one I have any information on. They stated in the testimony we just received that AmeriDebt, and I am quoting on Mr. Case's statement, page two, "AmeriDebt helped consumers save millions by providing credit counseling services and debt management plans to reduce monthly payments, lower interest rates, and reduce or eliminate late payment and overtime penalties."

It goes on to say, then, that "Correcting financial problems years in the making is no easy task. It is time and labor intensive for credit counselors, so as a result," and this is a Visa board suggesting that credit counseling agencies contract with private sector companies to perform back-office administrative tasks. Is that you?

Mr. MALESARDI. That is The Ballenger Group, yes.

Senator DAYTON. And then you are stating in your testimony that you are an independent, for-profit provider of customer service solutions, custom software development, payment processing services, back-office functions, and marketing programs to credit counseling agencies. So your clients, as you view them, are these 11 agencies.

Mr. MALESARDI. Absolutely.

Senator DAYTON. So when Ms. Troy testifies that she was pitched this plan by a "counselor," and when she was calling back then to talk with the counselor, she was sent to a "customer service"—somebody in customer service. Is that under your entity or is that under AmeriDebt's?

Mr. MALESARDI. It would depend on what time it happened. If it was during the initial——

Senator DAYTON. Now.

Mr. MALESARDI. No, I am saying, if it was during the initial counseling process, the back and forth that happens happens with a counselor at the credit counseling agency. Only once a consumer makes a decision to enroll in a debt management plan does that file get transferred to The Ballenger Group and does our work really begin on it.

Senator DAYTON. So at that point of——

Mr. MALESARDI. So if a consumer then called up after that to ask questions about the status of payments, the status of the creditor proposal process, any of those types of administrative things, that would come to a customer service center that is under The Ballenger Group. But if a consumer then asked for additional follow-up counseling or education, that again goes back to the credit counseling agency and that is their responsibility.

Senator DAYTON. Well, as I understand it from the testimony of Ms. Troy and also from what Mr. Allen said, they think that is your responsibility. As I understand it, Mr. Allen and his contemporaries at AmeriDebt are in sales. What you call counseling, it

sounds to me like it is a sales pitch and then negotiation, and at that point, once this agreement or whatever is signed, then it goes to you.

According to Ms. Troy—again, I don't know the experience of other clients, but if she called for "counseling" at that point, they are getting somebody in your operation, not somebody in AmeriDebt.

Mr. MALESARDI. That is not correct.

Senator DAYTON. Who is providing the service? Who is providing what service, then, to the client for which they are paying $7 an account per month?

Mr. MALESARDI. On a monthly basis for the process of providing the payment processing—they send their payments in and they get distributed to their creditors—and any follow-up customer support that they need related to that, that service is provided by The Ballenger Group.

Senator DAYTON. And they are paying——

Mr. MALESARDI. If they have follow-up questions on their counseling or budgeting, that service is provided by the credit counseling agency.

Senator DAYTON. But according to the testimony of at least one person today, they go to you when they call for "counseling." Who establishes this plan? Who takes the information from the client and establishes this DMP?

Mr. MALESARDI. The credit counseling agency does that.

Senator DAYTON. Based on what?

Mr. MALESARDI. They do it based on guidelines from the creditors as to what they are willing to do in terms of applying debt management plan benefits.

Senator DAYTON. And you have no role in that whatsoever?

Mr. MALESARDI. That is correct.

Senator DAYTON. So they establish this and then they hand that over to you and then you just take the payments and process them and——

Mr. MALESARDI. Well, they would transmit the proposed plan to The Ballenger Group. We would then, in turn, issue proposals that would get sent electronically to their creditors, or by paper if they don't accept it that way, and the creditors then respond back either accepting or denying and making changes to that. That is where the kind of back and forth negotiation process begins that is very time and labor intensive.

Senator DAYTON. So the credit counseling agency is establishing the framework of the plan or the concept of the plan and then you negotiate that actual arrangement with those various creditors?

Mr. MALESARDI. If it is a major creditor, they have established guidelines as to what they are willing to do.

Senator DAYTON. So it is a no-brainer. That is established——

Mr. MALESARDI. If the——

Senator DAYTON. You are just plugging in numbers.

Mr. MALESARDI. Yes. If the proper information is provided by the consumer, then it is a no-brainer. If they understate, for example, how much they owe to a particular creditor, then the creditor will deny that proposal and insist on a few more dollars. If their creditors are not one of the major creditors, I mean, it can be doctors,

dentists, or people like that who don't have established policies, then there is more interaction with that creditor.

Senator DAYTON. There is millions of dollars to savings to consumers by credit counseling services and debt management plans. Where does that come from? Where do they save money in this whole process? They are paying more in the voluntary contribution. They are paying more—in addition to everything else they owe, they are paying more to you and to AmeriDebt. Where do they realize savings in this?

Mr. MALESARDI. I can't speak to the specific example you gave, but I do know that relative to the high interest rate and the overlimit fees and the late payment charges that they are incurring, that when those are reduced by the creditors to the benefits they offer under a DMP, there are dramatic savings to be made, and over time, that is significant.

Senator DAYTON. Who determines what those dramatic savings are? Are you quantifying those dramatic savings?

Mr. MALESARDI. We do not. That would be——

Senator DAYTON. But you are negotiating the final arrangement. Is AmeriDebt computing that? They don't even know what the final arrangement is. You are handling that. Who is keeping score for the consumer?

Mr. MALESARDI. The credit counseling agency would quantify for the consumer what kinds of savings they can get from enrolling in a DMP.

Senator DAYTON. Based on a plan that they submit to you, but then you negotiate those actual arrangements with the creditors?

Mr. MALESARDI. I am sorry if I am not being clear, but when the proposed debt management plan comes in to us, it has already been set up by the credit counseling agency and the savings or the costs of that program——

Senator DAYTON. I thought you said you were negotiating with the creditors.

Mr. MALESARDI. I did say we transmit that proposal that the CCA has made. We transmit that to the creditors, and if there is a need for an adjustment based on what the creditors want, then there is a back and forth process. I am not sure negotiation is the proper term, and I know I used that, but——

Senator COLEMAN. Senator Dayton——

Mr. MALESARDI. It is an administrative back and forth.

Senator DAYTON. I just don't understand where this millions of dollars of savings——

Mr. MALESARDI. To the consumers?

Senator DAYTON [continuing]. Where it comes from. The consumer, it seems to me, is paying—I mean, you are just setting up arrangements for them to pay what they owe and then you are getting something back from the creditors for doing so, and then they don't in your case even see their fair share or whatever it is called of that. And then they are paying an additional surcharge of $7 an account per month of which you are getting $25 per month per account. I mean, I see where you are making your money. I see where AmeriDebt is making its money. I don't see where the consumer is getting anything. It is apparent to me that it has got to be more costly.

Mr. MALESARDI. I don't think that is the case. I think if you look at a lot of the industry information, the consumers are being charged penalty rates of interest that may be 25 percent or higher, and by enrolling in a DMP, they get that reduced.

Senator COLEMAN. Senator Dayton, we are going to have to rest——

Senator DAYTON. I just want to thank you for this——

Senator COLEMAN. I will give you an opportunity for follow-up questions, if you want.

Senator DAYTON. Thank you. I am going to have to leave, but I want to thank you for this hearing. It has been extremely valuable and you have gotten into an area that is very disturbing and I thank you very much for your leadership on this.

Senator COLEMAN. Thank you, Senator.

I just have one follow-up, perhaps two questions. Mr. Malesardi, just to follow up on Senator Levin's question, he asked if you were concerned. May we have Exhibit 14?[1] I want to make it first very clear that you make your money off of folks who enrolled in DMPs, right? In other words, your income is dependent—the relationships you have with the credit counseling agencies are based on the number of folks involved in debt management plans, is that correct?

Mr. MALESARDI. That is correct. That is our business.

Senator COLEMAN. So Senator Levin asked whether you were at all concerned about pressure tactics and you really didn't answer that very directly. The reality is that you benefit if folks use pressure tactics, is that a fair statement?

Mr. MALESARDI. I will say that we are concerned about pressure tactics because we are pro-consumer. We would not want to see somebody pushed into a DMP that they shouldn't be in.

Senator COLEMAN. So my question, then, is if we look at Exhibit 14 where we have folks saying, "would you rather have that payment go to us to help people like you get out of debt or would you like it to go to the creditor's pocket? Would you rather support a non-profit company or help a bank get richer?" Do you know if these practices are being used by the other credit counseling agencies that you provide services for?

Mr. MALESARDI. They are not to my knowledge, and I am not comfortable with the way that is worded.

Senator COLEMAN. Do you have a process by which you are aware of the scripts or the sales pitch that is being made by the credit counseling agencies that you service?

Mr. MALESARDI. No. We don't review the scripts of our credit counseling agency clients.

Senator COLEMAN. I would suggest that you do, Mr. Malesardi, and Mr. Dancel, I would suggest that you do.

The last thing, Mr. Dancel, Amerix is getting 50 to 85 percent of the non-profit's clients' revenue. How do you respond to the charge that you are siphoning off the bulk of the revenues from non-profits?

Mr. DANCEL. We provide a level of services that are very valuable, and for them to do the services or provide the services themselves that we provide to them, we bring tremendous economies of

[1] See Exhibit No. 14 which appears in the Appendix on page 260.

scale, technological advance, which allows them to not only operate and put more funds toward their educational and counseling mission, but it also allows them to operate and provide debt management plans to consumers at a low cost up front as well as on a monthly voluntary contribution level that is commensurate with what is in the industry, if not lower. In fact, many consumers of our client agencies, over 32,000 consumers, get their service on a monthly basis for free and another 105,000 consumers of our credit counseling agency clients pay just a partial amount of the voluntary contribution that is requested.

Senator COLEMAN. Your revenues have increased from $43 million to $95 million in 3 years between 1999 and 2002?

Mr. DANCEL. Yes, that is correct.

Senator COLEMAN. That is about a 120 percent increase?

Mr. DANCEL. Yes, that is correct.

Senator COLEMAN. Mr. Malesardi, one last——

Mr. MALESARDI. May I make a follow-up comment?

Senator COLEMAN. Please.

Mr. MALESARDI. I misspoke on one thing, and that is in the written testimony that we provided, on page 12, our best practices actually do include a form disclosure script to assist the CCAs in making adequate disclosures. So that is something we are involved with.

Senator COLEMAN. I appreciate that, Mr. Malesardi.

Mr. Malesardi, Mr. Dancel, I want to thank you for appearing. We will excuse this panel.

I will note for the record that we will take Mr. Puccio's deposition. That deposition, once he recovers, will become part of this official record.[1]

Senator COLEMAN. We will now call the fourth and final panel.

I would like to welcome our final panel of witnesses for today's important hearing. I appreciate their patience in this process.

We have with us the Hon. Mark Everson, the Commissioner of the Internal Revenue Service. Mr. Everson, I welcome you back to the Subcommittee. You have testified before this Subcommittee numerous times in the past several months, including on tax shelter hearings and our focus on DOD contractors who cheat on their taxes. I appreciate your appearance once again.

I want to acknowledge the IRS's proposed 2005 budget request, which includes $300 million for enforcement efforts. On February 26 of this year, I, along with Senator Levin, Senator Collins, and Senator Lieberman, wrote a letter to the Subcommittee on Transportation, Treasury, and General Government Appropriations in support of this 10.7 percent increase in IRS funding for enforcement efforts that will target tax cheaters. I support your efforts to vigorously enforce our laws.

Today, however, I want to address the IRS's response to date regarding non-profit entities within the credit counseling industry whose practices appear to violate the tax code and conflict with the specific purpose of granting tax-exempt status to credit counseling agencies. Moreover, while progress has been made on this front, I believe that more is needed.

[1] See Exhibit No. 18 which appears in the Appendix on page 264.

I would also like to welcome the Hon. Thomas Leary, Commissioner of the Federal Trade Commission. I appreciate both of you being with us today and look forward to your testimony and getting your perspective on addressing the problems facing the credit industry.

As you are aware, witnesses before this Subcommittee are required to be sworn. I would ask you to please rise and raise your right hand.

Do you swear that the testimony you are about to give before this Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. EVERSON. I do.

Mr. LEARY. I do.

Senator COLEMAN. Thank you, gentlemen. You know about the timing system. When you see the yellow light goes on, please conclude your testimony. Your full statements will be entered as part of the official record.

With that, we will begin with Mr. Everson and then follow with Mr. Leary and then I shall have some questions. You may proceed, Commissioner.

## TESTIMONY OF MARK W. EVERSON,[1] COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. EVERSON. Thank you, Mr. Chairman. I am pleased to be before you today to discuss IRS oversight of not-for-profit credit counseling agencies.

Before turning to the subject at hand, I do wish to express my appreciation for your strong bipartisan support to the IRS and the President's 2005 budget request. In your letter to Senators Shelby and Murray of February 26, you wrote, "Lack of resources has encouraged abuse of the Federal tax system and hampered IRS collection efforts. As a result, honest taxpayers pay more than their fair share."

Mr. Chairman, you, Senator Levin, Senators Collins and Lieberman went on to say, "Increased funding for IRS tax enforcement is critical, not only to stop the tax cheating but to strengthen public confidence in the fairness and integrity of our tax laws."

I agree with these views wholeheartedly. It is my strong belief that tax administration is a subject about which there can and should be bipartisan agreement.

As you know, I have articulated four enforcement priorities for the IRS. They are up here on this chart.[2] These priorities align closely with areas of inquiry of this Subcommittee. They include discourage and deter non-compliance with emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap; assure that attorneys, accountants, and other tax practitioners adhere to professional standards and follow the law; and detect and deter domestic and offshore-based tax and financial criminal activity.

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[1] The prepared statement of Mr. Everson with attachments appears in the Appendix on page 181.

[2] The chart referred to appears as an attachment to the prepared remarks in the Appendix on page 189.

These first three objectives directly address concerns which you surfaced last fall in your hearings concerning the development and marketing of abusive tax shelters. I look forward to a continuing dialogue with the Subcommittee on this subject.

Our fourth enforcement objective is to discourage and deter non-compliance within tax-exempt and government entities and misuse of such entities by third parties for tax avoidance or other unintended purposes. This, of course, directly relates to your hearing today.

I am pleased that you are addressing the area of tax-exempt credit counseling and I want to commend the staff for what I, in contrast to one of your witnesses, consider a balanced and very penetrating report.

Although many credit counseling organizations provide important educational and charitable services, clearly, a growing number do not. We are concerned some organizations are preying on those in financial distress and using tax exemptions for reasons of profit rather than charity. We have selected over 50 organizations for examination. Over the course of this year, we will be examining about one-half of the total revenue of all known credit counseling organizations.

Our work to date is raising serious issues about a number of these tax-exempt organizations. Some appear to have as their principal activities selling debt management plans rather than providing credit counseling. Rather than counseling, many companies are promising to restore favorable credit ratings or to provide commercial debt consolidation services. Some appear to operate as "boiler room call shops" instead of charities.

Some tax-exempts have boards of directors that are not representative of the local community. A board may also be related by family or business ties to for-profit entities that service the debt management plans. That raises the question, just who benefits from the charity, needy people in debt or company insiders and their business connections?

We are also seeing tax-exempt companies that are supported by so-called "voluntary" fees from customers. I want to just note, my wife got a call last week, perhaps it was a poorly chosen target, but the first words out of the mouth of this lady were, "We are a charity and anything you put into the program is tax deductible." It went on from there. [Laughter.]

Mr. EVERSON. Often, these fees are in the hundreds of dollars and appear high in comparison to the nominal fees historically considered by the courts to be appropriate for such organizations.

Non-compliance involving tax-exempt entities is especially disturbing because it involves organizations that are supposed to be carrying out some special or beneficial public purpose. If we don't act to guarantee the integrity of our charities, there is a risk that Americans will lose faith in charitable organizations in general, damaging a vital part of our Nation's social fabric.

We are making an unprecedented effort to address abuses in the credit counseling industry. IRS examinations and investigations of credit counseling agencies may very well result in the lifting of some tax exemptions and, in fact, criminal referrals to the Department of Justice. Thank you.

Senator COLEMAN. Thank you, Commissioner Everson. Commissioner Leary.

**TESTIMONY OF THOMAS B. LEARY,[1] COMMISSIONER, FEDERAL TRADE COMMISSION**

Mr. LEARY. Yes, thank you, Mr. Chairman and Members of the Subcommittee. You have a written statement from me that represents the views of the Commission. Anything I say here orally, is on my own.

Senator COLEMAN. That written statement will be entered as part of the official record, without objection.

Mr. LEARY. Thank you. I personally want to thank the Subcommittee for putting a human face on the problems that we normally just see on cold pieces of paper and I am pleased to be here.

The Commission recognizes that credit counseling services can help financially distressed consumers. But some firms are deceiving consumers about who they are, what they do, and how much they charge. For example, we have brought a lawsuit against AmeriDebt and against Mr. Pukke, who was briefly here this morning. Our complaint specifically pleads deceptive conduct of the kind you have heard so much about: Misrepresentation of non-profit status, misrepresentation that consumers would get counseling services, and misrepresentation that there were no up-front fees but rather only voluntary contributions.

Your questions demonstrate that you know what this is all about, so I don't need to elaborate in this oral statement, but just let me comment on some things you have heard this morning.

You have heard a lot about practices that have changed very recently. I won't comment on the adequacy of these changes, but this fact illustrates the spillover benefits of this inquiry and of our individual enforcement efforts. I want to emphasize, however, that last-minute conversions do not expunge a law violation if there was one.

You have heard a lot about the disclosure of voluntary fees. Our concern is a practical one. Companies have every incentive to continue to obscure this issue. Ask yourself if people already in desperate shape, by definition, would otherwise volunteer to pay hundreds or thousands of dollar to a company that represents itself as a charity.

You have heard some mention that there are some satisfied customers. Yes, indeed, there are some satisfied customers. But you can still violate the law even though there are some customers who are ultimately satisfied. The question is whether you gave people what you said you would give them and whether you told the truth about the fees you charge, and that is what our investigations and our cases are all about.

Before I close, I want to mention some practices that were not discussed today that do continue to concern us. Number one is failure to pay creditors at all. Some credit counseling agencies that offer debt management plans may fail to pay creditors in a timely fashion or at all. This can result in serious consumer harm.

Number two, promising results that cannot be delivered. Some agencies promise that they will lower consumers' interest rates,

[1] The prepared statement of Mr. Leary appears in the Appendix on page 193.

monthly payments, or overall debt by an unrealistic amount. Some are also making false promises that they can eliminate accurate negative information from consumers' credit reports.

And number three is a failure to abide by telemarketing laws. To the extent that these agencies are not bona fide non-profit organizations, they must comply with the FTC's telemarketing sales rule, including the new national Do Not Call Registry.

I don't know whether you are on that registry, Commissioner——

Mr. EVERSON. No, I am not, but I should be. [Laughter.]

Mr. LEARY. We are continuing to address all these issues together with others using both law enforcement and consumer education. Our current efforts include joint education with the IRS and State regulators, and we have recently issued a joint press release that highlights troubling practices within the industry and provides tips for choosing a credit counselor. We have independently issued a variety of consumer educational materials so that consumers can spot fraud and deception and take action to avoid it.

We remain concerned about deceptive practices in the credit counseling industry and will continue to work to protect consumers in this critical area. Thank you very much, Mr. Chairman.

Senator COLEMAN. Thank you very much, Mr. Leary.

I am going to go in reverse order here. And, I appreciate the human face that you put on this and the focus on the consumer, on the individual.

Does the FTC have jurisdiction over non-profits?

Mr. LEARY. We don't have jurisdiction over genuine non-profits, Mr. Chairman, but the courts thus far have been very clear that we have jurisdiction over entities that are nominally non-profits but that are in practical import run on a for-profit basis. If for some reason or other that situation ever should change in the courts, we may be asking for something.

Senator COLEMAN. And we appreciate your efforts to work in these areas and to have the willingness to address those situations where companies who are in the guise of non-profits may actually be operating as for-profit entities.

Mr. LEARY. That is correct.

Senator COLEMAN. I want to thank you for your involvement in this area. Are you troubled by the sales pitch that was being made or has been made, in this case it is AmeriDebt but certainly may be others, where individuals are being pushed to get involved in a debt management plan, are told, "Would you rather support a non-profit company or help a bank get richer? Would you rather have that payment go to us to help people like you get out of debt or would you like it going into the creditor's pocket?" Does that kind of language trouble you?

Mr. LEARY. Well, I think that is an illustration of just what I was talking about, Senator. You know there is no magic formula for making a disclosure adequate to consumers. There are no magic words that will do it. As long as the incentives are there for people financially to benefit in a big way from deception on the issue of payments, they are going to try to do it one way or the other. It is an ongoing struggle.

Senator COLEMAN. What kind of remedies are available? You have indicated that the FTC has brought actions against Ameri-

Debt, its back-office processing facility, for deceptive practices, and Andris Pukke for deceptive practices. What kind of remedies is the FTC seeking?

Mr. LEARY. We can go to court, Mr. Chairman, and we can get injunctions. We can get consumer redress. We can get disgorgement of unearned profits. The monetary remedies, we can get only through going to court. The longer administrative process on our own can provide the injunctive remedy, but well down the road. So we tend to bring these cases in court because the most important thing is to shut off the deception as fast as possible.

Senator COLEMAN. I understand that AmeriDebt is winding up its operation. I don't think they accept new customers. How does that affect your actions and will the FTC monitor entities affiliated with AmeriDebt after it has closed its doors?

Mr. LEARY. I don't want to comment on what we may or may not be doing with reference to other AmeriDebt affiliates that are not respondents in a particular action, Mr. Chairman, but I can assure you that we will seek and hopefully obtain relief that will give us the opportunity to remedy the situation across the board.

Senator COLEMAN. Thank you, Mr. Leary.

Commissioner Everson, you talked a little bit about tax-exempt entities, non-profits. You have made a very good point about the impact this has on all non-profits. If there are those out there who claim to be operating as non-profits that are not, it really has an impact on consumer confidence in non-profits.

If an entity is involved in selling debt management plans as a primary focus or principal focus, maybe not sole but exclusive, selling a product, would that cause some concerns for the IRS if that entity is claiming to be an educational non-profit?

Mr. EVERSON. It is important that the organization first comply with the representations it makes when it originally comes in for a determination as to its tax-exempt status. It has got to be consistent with what they have told us. What they have told us in order to be approved, would have to show that they are doing something for the public good. In this arena, that has traditionally meant education and counseling. Debt management has been in there, but largely for the lower-income folks and in a very targeted area.

What you have seen here is a real expansion, and I would note one point that I haven't heard raised so far is we saw a very significant increase in these applications for the establishment of these organizations after a short lag from when the new law, the Credit Repair Organization Act, came into effect. And that law made these up-front fees that folks are talking about illegal. But at the same time, it didn't apply to the tax-exempts.

So it is pretty clear that the players learned how to navigate the system and escape the regulation from the FTC and also these prohibitions that came in. So very clearly, this has all changed and gotten way out of line from traditional public good organizations.

Senator COLEMAN. Does it trouble you when you hear testimony about what appear to be boiler room call shops, scripts to sell debt management plans? Does it trouble you when we are talking about entities that are operating in the guise of a 501(c)(3)?

Mr. EVERSON. It troubled my wife when she received this call. I think that the testimony you have received today is shocking and that the report very clearly documents problems. In fact, you made reference to our hearing last fall. This reminds me of that hearing, where you have these interrelationships amongst parties established for mutual benefit. The difference there was that at least those were all profit-making businesses. Here, you have polluted charitable organizations. That is a terribly serious problem.

Senator COLEMAN. Is this something in which one can actually have kind of a bright line test, FTC, are there bright lines? I am trying to figure out whether there are standards, whether we can kind of set some bright line standards, or does all of this have to be determined on a case-by-case basis?

Mr. EVERSON. I think that this is more a case of looking at the individual facts and circumstances, and because of the complexity that has been established, that takes some time. There are some red flags, of course, and you have gone over some of them, these salaries, the extent of dealings with other related party profit-making entities. What we have to do as we conduct these audits is to look at the whole web and sift through it and see whether there is a private benefit that is being channeled to some related party which might be bad even if the entity itself that is making the call to the taxpayer is actually a not-for-profit.

Senator COLEMAN. From the IRS perspective, and actually, I will ask both witnesses here, principally, there are enforcement concerns and enforcement efforts going on. Are you aware of any legislative changes that you would suggest that would increase or enhance your ability to provide enforcement in this area? Commissioner Everson, and then Commissioner Leary?

Mr. EVERSON. Well, there is——

Senator COLEMAN. Aside from money for enforcement that we are working on.

Mr. EVERSON. If I could indulge you for just one minute on that point. This chart shows you the decline in our enforcement personnel more broadly that took place and that you are familiar with. I want to show you just the impact on this tax-exempt piece of our business.

Since starting here—the baseline is 1995—this is the increase in assets in 501(c)(3) organizations. There are almost a million of these organizations. This is the increase in returns filed. This is the decrease in staffing trying to do this work, and this——

Senator COLEMAN. This is IRS staffing, Commissioner?

Mr. EVERSON. IRS staffing within the piece of the IRS that does this work. And this is this line adjusted for the returns filed. It takes into account the volume increase.

I would suggest to you that that is a real challenge. Now, we are addressing that. We have the bill that we requested. But I would also say this gap doesn't even take into account the changes in behavior which, of course, means that it is a much more complicated problem. You don't have the same profile of abuse that you had back at the beginning.

Senator COLEMAN. On the other hand, Commissioner Everson, would it be fair to say that if the IRS took aggressive action

against a few individuals, that might impact the behavior of other individuals in this area?

Mr. EVERSON. This is very much our hope, because we have at present an expectation that by the end of this calendar year, something like a third of the revenues, the actual examinations will have been closed already. I would hope these closures and the actions that would be taken if there are revocations, or as I mentioned, criminal referrals, the word will get out and people will come back to us to clean up their act.

That is exactly what the Commissioner is saying. It doesn't mean you can excuse the past behaviors. There could be sanctions. But I am hopeful that we don't have to go as far down the road with as many audits as we are currently contemplating if there are adjustments like some of the adjustments you have already seen.

Senator COLEMAN. And Commissioner Leary, the question about legislative changes or anything that you believe is required to enable you to do the work you need to do in this area?

Mr. LEARY. Mr. Chairman, I think the Congress has been relatively generous with us in times of great budget pressure. At the moment, we are not asking for any legislative fix. However, as I indicated, in the event that we run into difficulties in the courts, and I don't anticipate it, but in the event that we run into difficulties on this jurisdictional issue, we may be asking for some relief.

Senator COLEMAN. I appreciate the work that you are doing, Commissioner.

Commissioner Everson.

Mr. EVERSON. Could I just second that point? Every time that you exempt a certain sector of organizations from, be it consumer protection laws or other areas, you will see a channeling into the tax-exempt area, I think, and you have to very carefully weigh when you make those exclusions. There are valid reasons for the good organizations, such as one that you had present here today, to enjoy exemptions, but you end up in a situation where the IRS acts as a proxy for the Federal Trade Commission. I am not sure that is wise public policy.

Senator COLEMAN. I appreciate your perspectives, gentlemen. I want to thank you for appearing before this Subcommittee. I want to thank you for the good work that you do.

The record of this hearing will be held open for 30 days.

This hearing is now adjourned.

[Whereupon, at 1:17 p.m., the Subcommittee was adjourned.]

# APPENDIX

## PREPARED STATEMENT OF SENATOR DURBIN

The "Roaring 1990s" was an era of unprecedented prosperity. Yet for many Americans families, it was also a "Decade of Debt" that left them entering the new millennium with uncertainties about their financial health.

Stagnant incomes. Job losses. Longer hours for lesser pay. Increasing healthcare expenses. Rising prescription drugs. Housing costs beyond reach. Soaring college tuitions. These are just some of the unrealistic demands made today on the fixed budgets of the American family.

At a time when our Nation is continuing to suffer from economic troubles, many of us continue to be under siege financially. So where does the American family turn to for help? The unfortunate answer, for many, is "plastic."

Every day across this Nation, millions of families receive multiple solicitations in the mail from a variety of eager creditors. No matter what your particular financial situation may be, all you have to do is sign the short, customized, user-friendly application form on the dotted line, and you can activate your own personal line of credit today for tens of thousands of dollars in instant cash.

It is literally that simple, and the aggressive marketing works.

The credit card companies sent out over five billion solicitations in 2001 alone. Between 1993 and 2000, the amount of credit the industry extended grew from $777 billion to almost $3 trillion.

An important study called, *"Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s,"* released in September 2003 by Demos, a nonpartisan nonprofit public policy research organization based in New York City, found that low and moderate-income families who are struggling financially, were forced to take on credit card debt at rates unprecedented in American history.

Ironically, this took place during the 1990's, the same decade that brought unprecedented prosperity to so many in our country.

The Demos study also found that over the last decade, credit card debt among Americans over the age of 55 has increased more than it has among the general population. The increase is even more substantial among those over age 65. One reason for this demographic trend is the similar rise in prescription drug costs that has moved beyond reach for many seniors who live on fixed income.

The study concludes that a combination of structural and economic trends, coupled with abusive credit card practices have left working families and older Americans with few options other than to borrow heavily just to make ends meet.

Those lucky enough to own homes were able to rely on cash-out refinancing, home equity lines or credit lines secured by the roofs over their heads. But for the vast majority and for the low-income families without homes of their own, plastic was their only choice.

Between 1989 and 2001, the total amount of credit card debt that Americans took on collectively almost tripled, from $238 billion to $692 billion, while the average American family experienced a 53 percent increase in credit card debt.

This dangerous increase in personal debt took place during the same time that the personal savings rate for Americans continued to decline.

This same period of time also saw the number of people filing for bankruptcy jump 125 percent. Each year, over 1.5 million Americans resort to bankruptcy as the only realistic option to escape from their financial dead end street.

It is not just the low and moderate-income families facing bankruptcy. According to a ground breaking book by Harvard Law Professor Elizabeth Warren and Amelia Warren Tyagi, *"The Two Income Trap: Why Middle-Class Mothers and Fathers are Going Broke,"* the coming years will turn out to be most difficult for the average middle-class American family.

It may sound counterintuitive, but Professor Warren makes a compelling argument that in today's economy, it is the suburban home-owning family with two wage earners and school-age children who are most at risk financially, especially when one of the working parents loses a job or faces a medical emergency.

More importantly, this book demonstrates that the major responsibility for the problem lies with the credit card industry and the unscrupulous practices that the industry engages in as it continues its greedy drive for more and more credit-hungry customers.

The deregulation of Federal and State laws governing interest rates during the 1970's and 1980's created incentives for credit issuers to take advantage of the laws in States with the most lender-friendly policies. The credit card industry flourished, as did its creative adoption of abusive penalty fees, late fees, and other hidden tricks designed to keep consumers in debt as long as possible. These practices correlated with skyrocketing profits for the industry.

When consumers can no longer tolerate spiraling personal debts, they are left with little choice but to seek bankruptcy protection in court. Yet this Congress for years has been ready to pass harsh legislation to block even that relief from being granted to the consumer.

The bankruptcy bill pending in the Senate today would do this while providing even more opportunities for the credit card industry to prosper.

Today we will learn from this Subcommittee about another factor that has contributed to the gathering of the economic "Perfect Storm" facing indebted and financially desperate Americans.

While the credit counseling industry was originally created to serve debtor-consumers navigate their way out of financial trouble, the industry as we know it today seems to lead the unwitting consumer directly into the eye of the Perfect Storm.

Instead of serving as a good faith mediator between the debtor and creditor, many of these agencies have become nothing more than automated debt collectors for the credit card companies.

Worse, today's "nonprofit" counseling service provider is sorely mislabeled—it seeks profit and provides no counseling.

The abusive credit counseling agency practices, together with the abusive credit card industry practices provide a potent one-two punch that knocks out most consumers' hope of staying away from the bankruptcy court.

I am glad that the abuses of the credit counseling industry are finally coming to light through this hearing.

Last year, my home State of Illinois took an important first step by becoming the first State in the Nation to seek legal recourse against AmeriDebt, a national credit counseling agency, which, I should note, is represented at this hearing today. I am also glad to note that several other States have followed suit.

On February 5, 2003, Illinois' Attorney General Lisa Madigan filed a lawsuit alleging violations of my State's consumer protection laws.

For example, under the Illinois Debt Management Services Act, a debt counseling agency cannot charge more than a $50 initial fee and cannot charge more than $30 average monthly fee per debtor.

As our State's Attorney General and this Subcommittee learned, however, AmeriDebt charges an average of approximately $305 for an initial fee, and averages intakes of approximately $35 per month per Illinois consumer.

Similar to the findings of this Subcommittee, the suit in my homestate alleges that AmeriDebt violated Illinois' Consumer Fraud Act by:

- Failing to disclose hidden fees and payments;
- Failing to tell consumers that their first payment under a debt management plan is kept by the company instead of being sent to the creditors as the consumers were led to believe;
- Representing that AmeriDebt will bring debtors' accounts up to current status then failing to make timely payments to creditors;
- Representing that consumers' payments are "voluntary contributions" when they are in practice mandatory fees; and
- Representing itself as a not-for-profit when the debt management work is done by a for-profit company.

Additionally, we discovered that AmeriDebt was never licensed in Illinois to operate as a debt management company, yet it took on over 11,000 clients in Illinois during years of marketing in the State.

I would like to commend Chairman Coleman and Ranking Member Levin for undertaking a bipartisan investigation into this troubling industry and for holding this important hearing today.

I hope this effort results in some serious and much-needed Federal legislation being adopted in this Congress, and I pledge to work with you and other interested members to make that happen.

Ever since I drafted the first comprehensive bankruptcy reform bill in the 105th Congress, I have been concerned about some of the aggressive practices of the credit card industry and their growing influence in our economy.

I believe we need to address these concerns and offer possible solutions in an open and honest way if we are going to change the course of the economic trend that is so intricately tied to the practices of that vast industry.

I would also like to see us continue to look for reasonable reform in the bankruptcy area, and, in particular, focus on the conditions that lead American consumers to bankruptcy. Still, any serious reform effort has to take into consideration the significant role of the credit counseling industry, and I hope this industry, as a whole, will work with us in crafting some solutions that are unquestionably necessary.

It is good to see representatives from the credit counseling industry here ready to explain their side of the story. I think we should be fair in listening to the legitimate voices on that side.

We should be careful not to paint a picture with a broad brush that raises unfair suspicion about every single credit counseling agency in the Nation. I have no doubt that there are many credible agencies doing the counseling and educational work in the true spirit of their nonprofit missions.

So I ask you—especially the agencies that are already living up to the high standards established by the associations—to join us in promoting stronger standards for everyone.

I know that the bankruptcy bill currently pending in the Senate contains a provision that proposes standards for the credit counseling industry, which is a positive step. But I agree with the Subcommittee's report and its recommendation that changes may be necessary to strengthen this provision in the bill, and I look forward to working on those changes.

Finally, I urge the government representatives here today—the Internal Revenue Service and the Federal Trade Commission—to continue your diligent pursuit of the wrongdoers.

As I know from my homestate's experience, a few States have already shown leadership in protecting the citizens within their borders. But this is a problem with national implications and it is time for the Federal agencies to do all they can to curb these abusive practices.

Please let us know what, if any, tools you need to carry out your pursuit of this matter.

Thank you.

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## PREPARED OPENING STATEMENT OF SENATOR LAUTENBERG

Mr. Chairman: Thank you for holding this hearing on a very important subject: fraud and abuse in the credit counseling industry.

This hearing is important because consumer debt has exploded in this country—it now exceeds 2 trillion dollars. Revolving credit—mostly in the form of credit cards and overdraft protection—exceeds 750 billion dollars. That's about seven thousand dollars per household. And because so many people have lost their jobs over the last 3 years, more and more Americans are having trouble paying their bills. Our economy went into a recession in March 2001.

In part because of overly aggressive marketing by the credit card industry, more and more Americans have tried to make ends meet in a bad economy by borrowing. And now many of them are in trouble.

When they get in trouble, many of them turn to non-profit credit counseling companies for help. The problem, as it turns out, is that some of the largest credit counselors have the same management as for-profit debt consolidation firms. The non-profit counselor steers people with credit problems to the for-profit consolidator.

Given such a scenario, it's difficult to imagine that the counseling being given is truly objective and always in the customers' best interests. I look forward to learning to what extent the business ties between the counselors and the consolidators are made known to the customers desperate to work out their debt problems.

The Subcommittee has learned that some of these "non-profits" pay their officers excessive wages—in one case as much as $624,000 a year.

And the Subcommittee has learned that representatives of some non-profits deceive their customers with hidden fees and deliberately make promises they know

they cannot keep with regard to lowering monthly payments and improving credit scores.

We're talking about an industry with one billion dollars in annual revenues.

Mr. Chairman, I certainly don't want to indict the entire industry. There are counselors and consolidators who are truly helping customers dig out from a mountain of debt. But there is enormous cause for concern here in Congress when 9 of the top 15 non-profit credit counselors—whose firms account for 40 percent of that one billion dollars—are being investigated by the Internal Revenue Service.

We need to sort out the "bad apples" in this industry and I think this hearing is a useful first step in that process.

Thank you Mr. Chairman.

Statement
of
**RAYMOND SCHUCK**
Before the
U.S. Permanent Subcommittee on Investigations
Hearing On
*Profiteering In a Non-Profit Industry:*
*Abusive Practices in Credit Counseling*
March 24, 2004

Good morning Mister Chairman and members of the Committee. I thank you for the opportunity to share my story with you. I am Raymond Schuck and I am here today to share my experience with you in dealing with Cambridge Credit Counseling.

In the summer of 2001, after retiring from 20 years of serving as the Director of a museum in Ohio, I found myself in a strained financial situation. I was having difficulty managing my debt, which had risen to the amount of approximately $90,000 distributed among nine credit cards and banking institutions.

I heard about Cambridge on the radio. I decided to look into what this non-profit credit counseling agency could do for me to help me manage my debt. I called Cambridge and spoke with a credit counselor. The counselor suggested a debt management plan. I was promised a considerable reduction in interest rates and that Cambridge could handle all my accounts. After answering a list of questions about my various credit cards, the counselor told me my monthly payment would be $1,946. He said that Cambridge would charge me 10% of my monthly payment for their services, $194 a month. I thought this was high but I knew very little about the industry and what were appropriate fees. Also, I made the apparently naïve assumption that because it was a non-profit agency, I could trust them.

The counselor told me to hurry and send my first monthly payment to Cambridge to get the program started. I sent in a cashier's check and felt optimistic that I was on the right path. I put every credit card I could on the program except for one I retained for emergencies. Then I started getting calls from some of my creditors. I received calls from three of my creditors asking why I had not made any payments. I told them I was with Cambridge on a debt management plan. Each of these creditors was unaware of this fact and told me that no payments had been received on my behalf.

I called Cambridge to find out what was going on. Getting in touch with someone who knew about my debt management plan and the status of my payments was an exercise in frustration. When I was finally able to speak with someone in customer service who could tell me about my account, I was informed that the first payment I sent to Cambridge, almost $2,000, was a fee for constructing my debt management plan. I was absolutely shocked by this information. Had I known this policy in advance, I would have searched for a different credit-

counseling agency. I would not have agreed to give Cambridge $2,000 when that money could have gone to my creditors.

I made numerous attempts to get matters straightened out with my creditors and the late status of my accounts. Meanwhile, I was receiving no help from Cambridge. In fact, I found out that two of my cards actually never received payment from Cambridge even though I had been on their plan for several months. Taking all this into consideration, I felt obligated to file a complaint against Cambridge with the Better Business Bureau of Massachusetts. Not only was I disappointed by Cambridge's failure to provide any financial counseling or assistance to me, but also I was actually financially worse off after dealing with this company. My credit rating was completely ruined because of late payments. In addition, I was even penalized for these late payments on my one credit card that I left off the debt management plan. That card raised my interest rate from 9.9% to 24% because they saw the late payments on the other accounts.

After the mess of dealing with Cambridge, I went to a local credit counseling service. This agency accepted a monthly donation and there was no set up fee like Cambridge charges. I was on a debt management plan with this agency for about two months when it became clear to me the only reasonable option was to file for bankruptcy; which, in retrospect, is what I should have done in the first place.

It seems that if Cambridge had done a reasonable analysis of my financial circumstances, the proper recommendation would have been to advise me that a debt management plan was not a feasible option. Putting me on a debt management plan that costs $2,000, plus a high monthly maintenance fee, seems irresponsible and far from what one considers a normal practice for a non-profit agency. Having directed a non-profit organization myself for twenty years, I know that if I operated my organization the way Cambridge operates their agency, my non-profit status would have been revoked. I can only conclude that credit counseling agencies such as Cambridge are more interested in making profits than they are in providing financial advice and education.

Thank you for allowing me to tell my story, and I look forward to answering any questions you may have.

Statement
of
**JOHN POHLMAN**
Before the
U.S. Permanent Subcommittee on Investigations
Hearing On
*Profiteering In a Non-Profit Industry:*
*Abusive Practices in Credit Counseling*
March 24, 2004

Mister Chairman, Senator Levin, and members of the Committee, it is an honor to be here today to testify about working in the credit counseling industry and specifically, working at Cambridge Credit Counseling. I began working in the credit counseling industry in 1991. I worked for two different National Foundation of Consumer Credit agencies until I was laid off by Consumer Credit Counseling Services of Southern New England who was downsizing due to the state of the market. Large national credit counseling agencies were acquiring significant portions of the market causing National Foundation of Consumer Credit agencies to merge among themselves or close their offices all together.

With this in mind, I decided to look for a job with one of these larger agencies. So I applied and was hired as a counselor with Cambridge in September of 2003. It did not take long to realize that Cambridge's approach to credit counseling fundamentally differed from mine. I disagreed with most of Cambridge's practices, particularly those that related to how they treated, managed, and served their customers.

On my first day at Cambridge, I had to pick a fake name. I chose my son's name "Daniel." I thought this practice was very strange although almost every Cambridge employee uses a fake name when they are on the telephone talking to customers. I did not understand why I was unable to use my own name when I was dealing with customers as I had always used my own name in the past. Even management personnel used a different name.

This was my first clue that I was about to take a trip down a disheartening path. I was immediately uncomfortable with the environment at Cambridge. It was what I would describe as a "boiler room" mentality. All the counselors worked in a large room with video cameras on us all day. You had to clock in and out to go to the bathroom, eat lunch, or make a personal call. There was an electronic board at the front of the room that reminded me of the leader board in a golf tournament. It had the names of the counselors who had the top sales for the month flashing in red and yellow lights. This exhibited an obvious emphasis on the sale of debt management plans.

In addition, I was surprised to learn that Cambridge paid commissions to its counselors based on the size of the up-front fees that are charged to their consumers. A counselor could earn 25% of this amount. Some counselors were rewarded two-week trips to Florida for high sales volume. This was unusual to me as it was clear that it would give the counselor a motive to enroll consumers on debt management plans regardless of their financial situation. Along with

positive incentives for sales, Cambridge used negative incentives when a counselor had low sales. On the refrigerator in the Cambridge lunch room, a sign hung that said quote: "The two lowest producing counselors will be cleaning the refrigerator on Saturdays."

Cambridge's overall approach to the consumer was the most troubling matter for me. I was entirely dissatisfied with the level of scrutiny this company gave to a consumer's financial circumstances when making such important decisions as whether to go on a debt management plan. There are many options out there in addition to the plan – education and self-budgeting, financial restructuring, and, in the worst case, bankruptcy. I never heard any of these options discussed by anyone at Cambridge. It was focused solely on the debt management plan.

In my experience working at National Foundation of Consumer Credit agencies, I would spend between an hour to an hour and a half working with a consumer and their finances. When I was at Cambridge, this process was expected to take roughly 10-15 minutes. This was all the time we needed however, because the only information we got from the consumer was account information. There was no true budget analysis done for the consumer, just an analysis to determine whether their creditors would allow the consumer to enroll in a debt management plan. I was uneasy with the fact that I did not know anything about a person's mortgage payment, health care costs, car insurance, etc. How could I recommend that this person go on a debt management plan? I knew nothing about them except that they were in debt.

With the time spent with the consumer so limited, I had little confidence that they understood that the first payment was kept by Cambridge. In fact, I was trained to tell the customer "I will be faxing you the paperwork – it is very simple and easy to fill out – shouldn't take you ten minutes." The service agreement was five pages single-spaced. But this was a pressure tactic we were supposed to use. The goal was to authoritatively take them through the process of getting signed up on a plan as quickly as possible so they did not have time to consult a spouse or their family. I was even instructed by one member of management to quote: "Treat them like alcoholics." In other words, they know they need help – make them get it. Be authoritative and forceful. I truly believe that Cambridge preyed on a consumer's desperation.

In fact, I was reprimanded regularly for being too nice to customers. I was told to stick to the scripts - there was no need for conversation or pleasantries. Those words cost money and defeat the purpose.

I only worked for Cambridge for two weeks, long enough to realize that the practices of companies like Cambridge can impact an entire industry giving it a bad name. Agencies like Cambridge abuse the trust and vulnerable position of financially stressed consumers and fail to provide any meaningful counseling or education. I came here today to help this committee understand that something must be done about credit counseling agencies like Cambridge. The industry must be reformed for the good of the American consumer.

Thank You.

Statement
of
**JOLANTA TROY**
Before the
U.S. Permanent Subcommittee on Investigations
Hearing On
*Profiteering In a Non-Profit Industry:*
*Abusive Practices in Credit Counseling*
March 24, 2004

Good morning Mister Chairman, and members of the Committee. My name is Jolanta Troy and it is an honor to sit before you this morning to tell you about my experience with a company called AmeriDebt. In 1999, shortly after my divorce, I found myself in a terrible financial situation. I am a Behavior Specialist Consultant. I work with mentally ill children and children with behavior problems. I love working with the kids, but I don't necessarily make a lot of money. I have two young children who I have been raising by myself since my husband and I split up. With my husband's income gone, I had to use my credit cards to help support my children and myself. The expenses started adding up and my credit card debt reached a level I could not manage. I was $30,000 in credit card debt.

I didn't know what to do. I was very upset and depressed at this time in my life. I was in terrible financial trouble. My marriage ended and I was worried about my bills and losing my house. I have no family here that I could turn to – to borrow money from - or for support. I saw a commercial for AmeriDebt on television. They said they were a non-profit company that would help people with their credit card debt. Because AmeriDebt said it was a non-profit, I thought that I could trust them. So I called AmeriDebt and spoke with a counselor. I told her about my situation and she said AmeriDebt could help me by negotiating with my creditors to reduce my payments and interest rates. The counselor wanted me to go on a debt management plan. I wasn't sure what to do and I wanted to think about it for a while. So I did nothing at that point. After this call, the counselor called me back **four** different times. Every time the counselor called, she would tell me how bad my situation was and that I needed to do something about it. This counselor also said that AmeriDebt was a non-profit organization - like a charity - and that I needed their help. She was very pushy and almost degrading. She made me feel embarrassed and ashamed, but I eventually decided to go on he program.

The AmeriDebt counselor told me there would be a monthly charge of $5 per account. I only had a few accounts so I thought this fee was okay – it would cost maybe 15 or 20 dollars a month and since they were a non-profit I was not worried about their fees. The counselor told me to send a money order to AmeriDebt right away for $783 so they could start my payment program as soon as possible. So I sent AmeriDebt $783 and believed my debt management program would be set up immediately and money would be going to my creditors.

Then, I started receiving calls from the credit card companies asking why I had not paid them. I tried to get in touch with my counselor at AmeriDebt. Every time I called, I was on hold for 20 minutes. I was not able to talk with the counselor who had helped me set up my debt management plan even though she had called me four times before I enrolled in the plan. I was sent to customer

service. This was frustrating because no one knew about my situation and I would have to explain it every time I called. Customer service told me that AmeriDebt kept the money as a voluntary contribution. I knew that I agreed to a monthly charge, but I knew nothing about them keeping my first payment as a voluntary contribution. This was the first I heard of this. I could not believe it. I told AmeriDebt that I wanted a refund. They said it was too late and they would not give me a refund. I was devastated. I wrote to the Better Business Bureau, but AmeriDebt still would not refund my money. AmeriDebt wrote a letter saying that I had agreed to make a contribution. That was not true. They never refunded my money to me. I could not afford to give AmeriDebt almost $800. I thought that money would go to my credit cards to pay down the balances.

That was all the money I had at that time. I did not have any money left over to pay my credit card bills that month. I was still getting calls from my creditors. They were now charging me late fees because they had not received any payments. I was in a worse position than before I went to AmeriDebt because I was getting late charges on every account. I felt that I had no choice but to go to a lawyer to help me file for bankruptcy. That was the last thing I wanted to do but it was the only option. I wanted to be able to pay my bills but my income only stretched so far.

I am here today so that no other person has to go through what I did. AmeriDebt took advantage of me. They present themselves as some kind of charity there to help people. Instead they took almost $800 from me when they knew how bad my finances were. This company preyed on me when I was most vulnerable – when I was frightened and unsure of how to manage my finances. I feel like my fears were manipulated by AmeriDebt for their own benefit. Something must be done to stop companies like AmeriDebt who are making money off of good people who are just trying to do the right thing.

Thank you.

Statement
of
**JOHNPAUL ALLEN**
Before the
U.S. Permanent Subcommittee on Investigations
Hearing On
*Profiteering In a Non-Profit Industry:*
*Abusive Practices in Credit Counseling*
**March 24, 2004**

Mister Chairman, Senator Levin, and members of the Committee, my name is Johnpaul Allen. I am speaking to you this morning because of my experience as an employee with AmeriDebt. I worked at AmeriDebt as a credit counselor during the summer of 2003. My experience at AmeriDebt was frustrating and a disappointment.

I was interested in being a credit counselor because I enjoy working with people and helping them. I thought that working for a non-profit would be a great way to interact with people and make a difference in someone's life. What I found at AmeriDebt was nothing short of a sweatshop -- a telemarketing outfit taking advantage of thousands of people in bad financial situations.

I should have seen a red flag during my interview with AmeriDebt when I was asked by my interviewers to sell them a stapler to prove that I could make a sales pitch. That is really what AmeriDebt is about -- sales. The goal for AmeriDebt's counselors was to sell consumers a debt management plan regardless of whether they needed it or not. When I was training for my position as a counselor, I asked about the education provided to consumers on financial matters. I was told by management to quote: "concentrate on getting them on a debt management plan."

Throughout my time working at AmeriDebt, I was reprimanded for spending too much time with consumers on the phone. When I was trained, I was told that each call should take no more than 20 to 25 minutes. I would generally spend at least that long with each caller explaining our program. Several times, I was instructed to spend less time on each call, and that my calls should be no more than 15 minutes. This bothered me because I didn't want to have to rush through such important things with consumers who really needed my help.

Another thing I was repeatedly reprimanded for was the information I was giving to customers. AmeriDebt charges a set up fee and a monthly fee -- or as they call it, a quote: "voluntary contribution." The consumer was supposed to have a choice whether they wanted to pay the contributions. I would always tell the consumer that they did not have to pay the voluntary contribution or, if they wanted, they could make the initial contribution <u>or</u> the monthly contribution and not necessarily both. At least two or three times a week, I would get pulled aside by my managers and instructed to make sure the consumers paid the voluntary contribution. My managers would say things to me such as, "do you know that you are letting them choose to not pay your salary?" or "think of all the money you could make if you collected those voluntary contributions."

What they were referring to were the bonuses that could be made for enrolling people on debt management plans. AmeriDebt would pay you a commission every two weeks for the number of debt management plans you signed up or if you hit a certain amount of voluntary contributions.

The pressure to get people signed up on debt management plans was significant. In fact, the only time we were allowed to go off the script on a call was when a customer was not going to give the voluntary contribution. We were instructed to say things like "Don't you want us to be around for the next person?" or we would tell them that we were a non-profit and thus subject to being audited by the IRS in an effort to gain their trust in our fees and their reasonableness. These were practices that seemed strange for a non-profit.

In addition to feeling like a used car salesman pushing these debt management plans, I also had concerns about the service these consumers were getting after they got set up on a plan. I would get calls from people two and three months after I set them up on a plan complaining that their creditors had still not received a payment. The only thing I could do was refer them to The Ballenger Group. I did not have access to the consumer's payment information. One time, I took a special interest in a particular client's predicament. This man was named Derek and he kept calling me because his creditors weren't getting paid. I tried several times myself to get in touch with someone at The Ballenger Group, so I could help this man, and could never get in touch with anyone. I felt helpless and responsible since it was me, personally, who had enrolled Derek on the debt management plan.

I made the decision to leave AmeriDebt shortly after that. I wanted to help these people, but in the end I felt I had done them a disservice. I can relate to these people. I have been through tough financial times myself and had to file bankruptcy several years ago. I know how these people feel. No one wants to declare bankruptcy. The average person wants to pay their bills. These are good people trying to do the right thing and AmeriDebt just pulls the rug right out from underneath them.

I am thankful for the opportunity to be heard on the real need for change in the practices of companies like AmeriDebt. Thank you very much.

**CHRIS VIALE, COO**
**CAMBRIDGE CREDIT FAMILY OF COMPANIES**

**HEARING TESTIMONY:**
**U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**
**MARCH 24, 2004**

Mr. Chairman and Members of the Committee:

Good Morning. My name is Chris Viale. I am the Chief Operating Officer of the Cambridge Credit Family of Companies.

While I have submitted a longer statement for the record, I will use my time now to specifically address three things:

- How we lead the industry in full disclosure;
- How we have rebated more than $14 million to our clients through our Good Payer Program; and
- How we are committed to providing financial education.

**Disclosure**

At Cambridge the benefits, limitations and costs of our program are spelled out clearly in writing and then reinforced by our counselors to ensure that there is full understanding before any consumer joins our program. At two critical points in the decision-making process we provide a clear written description of our fees and a summary of what this means in dollars and cents to the prospective client.

The first example is our Service Agreement. As you can see, Section I covers "Cambridge's Services, Fees and Sign Up Instructions." This explains our "Service

Design Fee", which is equal to one month's payment, for the creation of the payment plan, and our "Payment Program Service Fee", which is 10 percent of the amount the client pays Cambridge each month or $25, whichever is higher. These fees are summarized and presented in an easy-to-understand format at the end of the section. As you can see, the amount paid to Cambridge and the amount paid to creditors is clearly identified. While our Service Agreement has always contained the simplified "Summary of Cambridge's Fees," the example in the box was added in July 2002 as one more way we can be as clear as possible on this issue.

The purpose of the signed service agreement is that it establishes that the potential client understands our services and fees, prior to blinding the consumer's decision-making process with quotes of benefits and savings. We deliberately present this to clients before proposing a payment plan because they need to view the plan within the context of what it will cost them. About 30 percent of people decide not to join our program at this point. Most companies do the opposite; they present savings first, disclosing their fees and terms of service later.

The second example is the Debt Management Plan Summary, which lays out the proposed payment plan based on the client's existing balances and our knowledge of the various creditors' guidelines. As you can see, the plan summary lists each creditor, the approximate balance with each creditor, and the portion of the proposed DMP payment that will go to each creditor. The monthly service fee to Cambridge is also listed as a portion of the total monthly DMP payment.

The summary further lists:

- The estimated repayment term;
- The total approximate managed debt;
- The one-time payment design fee (noting that it is not paid to the creditors);
- The total estimated monthly fees;
- The average expected good payer rebates;
- The estimated net DMP repayment amount;
- The estimated "on own" repayment amount; and
- The estimated savings the client will experience if they complete the program.

This summary is a relatively new addition to our communications. While it's more information than we are required to provide, we invested in the technology to make it possible because it's helpful to our clients and it again reinforces both the costs and benefits associated with our services.

So, it is not until this point – when the potential client has acknowledged the benefits and fees associated with our services and has been advised of the monthly payment plan – that a consumer makes the decision of whether to join our program.

**The Cambridge Good Payer Program**

It's important to understand that in most cases, if a client sticks with their payment plan, their upfront design fee will be refunded through our Good Payer Program. Cambridge is the only company in the industry that actually takes the Fair Share money received by creditors and shares it with our clients. The philosophy behind the program is simple: Give clients an incentive for making regular, on-time payments that will also help them financially to get out of debt sooner. For each dollar we receive from creditors for payment on a client's debts, we hold 50 cents in a trust for that client. Contrast this with every other credit counseling company that keeps these Fair Share fees for themselves.

As a client's potential earnings in the Good Payer Program accrue, it is clearly illustrated on their monthly statements. We have submitted information to the subcommittee that contains the details of how this money has been disbursed to our clients. It an enormous amount of data, but the highlights are that, to date: $14,096,000 has been refunded to 75,832 clients. The amount refunded is proportional to the amount of debt managed. A consumer with a higher monthly payment will have higher fees and also receive larger rebates. It is all relative to the debt we are handling, as illustrated in the information submitted to the subcommittee. As you can see on our display, several clients with high debt loads and a high initial fee were refunded over $3,000, even one at $6,000.

We believe this is a tremendously valuable program and would encourage you to ask other companies why they don't do the same.

**The Cambridge Commitment to Financial Education**

One of the most accurate criticisms of our industry is the lack of true financial education offered to indebted consumers by credit counseling companies. As long as consumers remain ignorant of how the lending and financial communities work, personal debt will always be a problem for Americans. At Cambridge, we're working to change this dynamic. The vast majority of the 40,000 consumers who contact us each month take advantage of nothing more than free access to financial education. Only about 12 percent of consumers who contact us ever join a debt management program.

We offer education through one-on-one counseling; community presentations; a 2 ½ hour video featuring respected credit expert Deborah McNaughton that is given to all clients; monthly financial newsletters covering topics like understanding credit, budgeting, saving for retirement, and buying a home; and our comprehensive financial education web site, GoodPayer.com. We are also working with Junior Achievement to conduct a pilot education program for high schools that we hope to roll out nationally. I have copies of our education materials for you.

**Conclusion**

I'd like to make one final point and that is to dispel the notion that credit counseling clients are poor, uneducated people with little means or intelligence to help themselves. This is absolutely not true. It has been our experience that credit counseling clients come from productive, tax paying, middle-class households. Statistics show that approximately 30 million households are struggling with credit card debt today. These are people that expect a level of service that is on par to their experiences with other parts of the financial services sector. Credit counseling services of the 21st Century

cannot be based on the social service welfare model of the 1950's. Any regulations that ignore this fact will ultimately harm consumers much more than help them.

At Cambridge we are committed to providing credit counseling services to all consumers with a high level of transparency, respect, compassion, and professionalism.

Thank you.

**CHRIS VIALE, COO**
**CAMBRIDGE CREDIT FAMILY OF COMPANIES**

**SUPPLEMENTAL WRITTEN SUBMISSION TO:**
**U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**
**MARCH 24, 2004**

These written comments supplement those provided orally by Mr. Viale and cover several additional topics relevant to the Subcommittee's investigation of the consumer credit counseling industry:

- **The face of consumer debt today:** The fact is that educated, middle-class, working people are bearing the largest burden of the current personal debt crisis in this country.
- **The role of fees in providing a quality service:** Consumers of credit counseling services today require a level of service and professionalism that cannot and should not be supported solely by commissions from creditors. Reasonable fees, proportional to the services rendered, are essential to meeting our obligations to our customers and to the public at large.
- **The Cambridge Good Payer Program:** Cambridge is the only credit counseling company that actually pays its clients for paying their bills regularly and on time. To date more than $14 million has been rebated through Cambridge's Good Payer Program.
- **Professionalism and pay in the credit counseling industry:** Simply put, there is an overall lack of professionalism in the industry today. Cambridge has worked to change this by making credit counseling a career – by providing training and certification and professional-level compensation.
- **Disclosure:** Full disclosure is an absolute must. At Cambridge, the benefits, limitations and costs of our program are spelled out clearly in writing and then reinforced by our counselors to ensure that there is full understanding before any consumer joins our program.
- **Financial education:** As long as consumers remain uneducated about how lending and financial institutions work, personal debt always will be a problem for Americans. Cambridge is working to change this.

**The Face of Consumer Debt Today**

It is critical to first understand the consumers on whose behalf we work. The notion persists in some quarters that the consumers calling for help, or who enroll in Debt Management Plans, are largely poor, uneducated, and financially dysfunctional to the point where they have problems putting food on the table for their families. This profile of a credit counseling client is outdated and untrue. It has been our experience that the average credit counseling clients share the following characteristics:

- Our clients are working people from middle and lower-middle class backgrounds, with an average gross income of $3,583 per month, or $43,000 per year.
- 50.3% of clients who have enrolled in our DMP in the past year are homeowners
- Their average length of residence at one place is seven years.
- The average age of a client is 42 years old.
- About half of our clients have children.
- The median number of school years completed is 13 years for high school graduates, and 16 years for those that have spent at least some time in college.

As you can see, this profile describes the average middle-class family. This is a trend that by all indications will continue for the foreseeable future. Approximately 1 in 3 households in this country are struggling with consumer debt. In fact, Professor Elizabeth Warren of Harvard University, who specializes in bankruptcy law, estimates that 1 in 7 households are destined for bankruptcy. Looking a bit further into the future, college students, and even those still in high school today, are taking on unprecedented amounts of credit card and student loan debt before receiving their first real paycheck, forcing many to drop out in order to pay their bills. Last year, 150,000 young adults between 18-25 filed for bankruptcy, and 24 percent of students that complete or leave college are moving back in with their parents due to their debt loads. The fact is that educated, middle-class, working people are bearing the largest burden of the current personal debt crisis in this country.

**The Role of Fees in Providing Quality Service**

Our clients' backgrounds lead them to expect a certain level of service and support from any company they do business with, particularly one that is helping them with their finances. These consumers are accustomed to services such as online access to their accounts, prompt and courteous customer service, and a general level of professionalism that is lacking in much of our industry. We have recognized this for years, and have fashioned our service around the wants and needs of consumers, not creditors, unlike the majority of credit counseling companies today. Here is a partial list of the services we offer all of our clients:

- Certified counselors and client services representatives that are thoroughly trained and educated on topics of personal finance.
- Credit references that assist our clients in obtaining financing, and even buying new homes.
- A hardship program that can reduce the normal DMP payment temporarily to assist clients who are severely overextended.
- 24-hour access to all account information both online and over the phone.
- Free financial education and educational materials, such as a 2 ½ hour video called "Your Financial Future," featuring respected credit expert Deborah McNaughton and monthly newsletters covering topics like understanding credit, budgeting, saving for retirement, and buying a home.
- Daily, electronic dispersal of clients' payments to creditors.
- Our Good Payer Program through which we have refunded over $14 million to our clients to both assist and reward them for making timely payments.

None of these services would be possible without the ability to charge reasonable fees that are proportional to the services we provide. Placing a cap on fees not only will fail to make it any easier for a consumer to join a DMP, it will also make it much more difficult for credit counseling agencies to obtain the revenue necessary to service their

clients properly. We've seen this already. Credit counseling organizations that mandate fee caps on their members have seen offices close and education programs disappear. Many offices cannot even provide such basic necessities as customer service departments or online access to account information.

Our fees also allow us to provide free financial education to consumers and the general public. Out of the 40,000 consumers that call us each month, only about 12 percent actually enroll in a DMP. The other 88 percent may receive simple budgeting advice to extensive online interaction with a counselor depending on the consumer's wants and needs. This education is provided free of charge. Restricting the ability to charge reasonable fees would make this impossible, leaving consumers nowhere to turn.

Importantly, the evidence suggests that fees are not a problem for consumers. According to a survey by Visa, one-third of consumers who left a DMP before completion said they did so because the creditor's concessions were not sufficient. Forty percent of these consumers filed for bankruptcy, clearly illustrating that creditor policy could be much more effective in aiding clients enrolled in DMPs.

**The Cambridge Good Payer Program**

In most cases, if a client sticks with their payment plan, their upfront design fee will be refunded through our Good Payer Program. Cambridge is the only company in the industry that actually takes the Fair Share money received by creditors and shares it with our clients. The philosophy behind the program is simple: Give clients an incentive for making regular, on-time payments that will also help them financially to get out of debt sooner. For each dollar we receive from creditors for payment on a client's debts, we hold 50 cents in a trust for that client. Contrast this with every other credit counseling company that keeps these Fair Share fees for themselves.

As a client's potential earnings in the Good Payer Program accrue, it is clearly illustrated on their monthly statements. We have submitted information to the

subcommittee that contains the details of how this money has been disbursed to our clients. It an enormous amount of data, but the highlights are that, to date: $14,096,000 has been refunded to 75,832 clients. The amount refunded is proportional to the amount of debt managed. A consumer with a higher monthly payment will have higher fees and also receive larger rebates. It is all relative to the debt we are handling, as illustrated in the information submitted to the subcommittee, which shows that several clients with high debt loads and a high initial fee were refunded over $3,000, even one at $6,000.

We believe this is a tremendously valuable program and encourage the committee to ask other companies why they don't do the same.

**Professionalism and Pay in the Credit Counseling Industry**

Simply stated, the level of professionalism in the credit counseling industry is poor. In order to avoid this problem, Cambridge compensates its counselors in a manner that aligns their interest with the interests of the clients. Our counselors average a yearly income of approximately $43,000. Their pay is based on factors such as how many consumers they assist, the education delivered, and more importantly, the success of our clients.

There is a popular notion that performance incentives encourage counselors to act in their own best interests, rather than in the interests of consumers. This is not true. With the right incentives (at Cambridge we focus on education and retention as well as enrollment) and compliance measures (our processes are ISO certified and our computer systems are set up to prevent the unauthorized or inappropriate enrollment of clients), we have been able to attract and retain quality counselors, transforming the counseling position from a social service job to a true career. It's been our experience that providing a high quality service in a compassionate, professional manner gets good results for consumers: Fewer than 3 percent of our clients file for bankruptcy, and approximately 34 percent graduate from our program. We feel that these results are

much stronger than any other company in the industry can produce, or is willing to publish, and our pay structure is a big part of this success.

**Disclosure**

Consumers deserve absolute disclosure of services and fees prior to joining any program. Full disclosure is an absolutely vital part of what we do. Following is the process of how a consumer joins the Cambridge program.

A potential client expresses an interest in debt management and inquires about our services. Our counselors are trained to ask potential clients several questions about their debt and the types of bills they have in order to determine whether a DMP can help them.

When we believe that we can help a client, the counselor will explain our services in detail. This includes reminding the potential client that we are a debt management firm, not a loan company; that we consolidate unsecured bills into a single monthly payment and pay all of the individual creditors each month upon receipt of the client's monthly payment; that as the client pays their bills through our company, we are able to gain certain benefits from creditors that will help the client save money; and that by staying current in their payments to us, we can help them get out of debt quicker than they could on their own and save them money in the process.

Once the counselor is confident the potential client understands the service we provide, they will fax out a service agreement for the client to review and sign. The service agreement provides all of the relevant information about our program. Importantly, it lays out our fee structure in explicit terms: that there is a one-time "design fee" equal to one monthly payment, and that there is an ongoing "program service fee" equal to 10 percent of each month's payment or $25, whichever is greater. (This is a general description of our fees, they will vary slightly depending on state law.)

The purpose of the signed service agreement is that it establishes that the potential client understands our services and fees, prior to blinding the consumer's decision-making process with quotes of benefits and savings. We deliberately present this to clients before proposing a payment plan because they need to view the plan within the context of what it will cost them. About 30 percent of people decide not to join our program at this point. Most companies do the opposite; they present savings first, disclosing their fees and terms of service later.

Beyond the written disclosures, which are very clear, our counselors are given very specific instructions on how to talk to potential clients about our fees so that there can be no misunderstandings. This is one scripted example from their handbook:

> "The first payment is our initial fee to work with the banks to get the benefits you're entitled to on line with your creditors so that from the second month on, when your payment comes in, it goes out the following day, and that's what the banks would be expecting. Then, from the second month on, 10 percent of your monthly payment is our service charge to handle the bills for you. ..."

Once we have put together the proposed payment plan based on the client's existing balances and our knowledge of the various creditors' guidelines, we will send this to the client and walk them through it. The plan summary lists each creditor, the approximate balance with each creditor and the portion of the proposed DMP payment that will go to each creditor; the monthly service fee to Cambridge is also listed as a portion of the total monthly DMP payment. The summary further lists:

- The estimated repayment term;
- The total approximate managed debt;
- The one-time payment design fee (noting that it is not paid to the creditors);
- The total estimated monthly fees;
- The average expected good payer rebates;
- The estimated net DMP repayment amount;
- The estimated "on own" repayment amount; and
- The estimated savings the client will experience if they complete the program.

This summary is a relatively new addition to our communications. While it's more information than we are required to provide, we invested in the technology to make it

possible because it's helpful to our clients and it again reinforces both the costs and benefits associated with our services.

So, it is not until this point – when the potential client has acknowledged the benefits and fees associated with our services and has been advised of the monthly payment plan – that a consumer makes the decision of whether to join our program. And, until the client remits the first month's payment to us, we do not contact any creditors regarding the client's accounts.

Once the client decides to join our program and remits payment, their counselor will call and provide an orientation to the program, which includes what happens during the coordination period with creditors and other helpful information. The counselor will again pro-actively reconfirm that the client understands that the first month's payment is our fee. Specifically, the script says, "... The whole first month's payment is our fee to get everything on line ..."

If at any time we cannot help a client or the client does not wish to participate in a DMP, we will provide advice on budgeting or other tips relevant to their situation and encourage them to visit our educational website, goodpayer.com, or to call our free advice line.

**The Cambridge Commitment to Financial Education**

One of the most accurate criticisms of our industry is the lack of true financial education offered to indebted consumers by credit counseling companies. As long as consumers remain ignorant of how the lending and financial communities work, personal debt will always be a problem for Americans. At Cambridge, we're working to change this dynamic. The vast majority of the 40,000 consumers who contact us each month take advantage of nothing more than free access to financial education. Only about 12 percent of consumers who contact us ever join a debt management program.

We offer education through one-on-one counseling; community presentations; a 2 ½ hour video featuring respected credit expert Deborah McNaughton that is given to all clients; monthly financial newsletters covering topics like understanding credit, budgeting, saving for retirement, and buying a home; and our comprehensive financial education web site, GoodPayer.com. We are also working with Junior Achievement to conduct a pilot education program for high schools that we hope to roll out nationally. One of the most accurate criticisms of our industry is the lack of true financial education offered to indebted consumers by credit counseling companies.

**Conclusion**

As the premier debt management firm in the nation, Cambridge is committing to leading a credit counseling industry that serves all consumers with a high level of transparency, respect, compassion, and professionalism. It is our view that the answer to these problems does not lie in capping fees, but rather in federal rules-of-the-road for how this industry should operate in the future. We would support federal legislation to:

- Strengthen disclosure requirements that ensure consumers fully understand the costs and benefits of any debt management program prior to joining;
- Clearly establish federal jurisdiction through the FTC of consumer protection and other business practice issues to ensure strong and equal application of federal regulations as opposed to piecemeal regulation by states; and
- Federal pre-emption of state laws that mandate that credit counseling companies operate as non-profits in order to administer DMPs.

In our view, this last point is critical to the future viability of this industry. While we operate in compliance with all IRS requirements for a 501 (c) (3) organization, we would fully support the ability of credit counseling companies to operate as either non-profit or for-profit companies, giving consumers a choice of the type of organization with which they wish to work. Currently, there is no choice. Most states mandate that credit counseling organizations be set up as non-profits. As noted earlier, credit counseling organizations that charge little or no fees and rely almost exclusively on commissions

from creditors to operate are struggling to survive. Should they survive, they can continue to provide one level and type of service to customers. Cambridge on the other hand has created a business model that is updated and focused on the needs and wants of today's consumer of credit counseling (professional service, online access, instant disbursement) and that charges a reasonable fee for service.

Some people are attempting to prevent an evolution in the industry by proposing things like mandated fee caps. This is the absolute wrong way to go. Credit counseling should be no different than any other financial services business. Consumers should know what they're paying for, get what they're paying for, and the federal government should enforce disclosure and fair business practices. There's simply no reason to try to prevent this industry from evolving to a for-profit model, when the consumer demand for credit counseling services is huge. The federal government needs to step up and regulate an evolving industry, not try to roll back the clock on the industry and keep it limited to a model that is now 20 or more years out of date.

We look forward to working with this committee and others in Congress to devise an appropriate set of federal guidelines and enforcement policies that will work for this industry and its consumers.

# ANSWERS TO QUESTIONS CLIENTS MAY HAVE

## I. REGARDING OUR FEES

### 1. WHAT ARE MY FEES? (BEFORE PAPERWORK IS FAXED.)

We provide a free budget analysis and evaluation to determine the advice needed for your financial situation. Through this evaluation, if together we find our debt management plan is right for you, the fees we charge will be included inside the payment we set up to handle the bills for you. Once we go over your bills in detail, we will send you a full breakdown going over the fees we're charging you and what you'll be saving. Then, if what we set up is good for you, we'll start helping you right away.

### 2. I NEED TO KNOW WHAT THE FEE WOULD BE.

The first payment is our initial fee to work with the banks to get the benefits you're entitled to on line with your creditors so that from the second month on, when your payment comes in, it goes out the following day, and that's what the banks would be expecting. Then, from the second month on, 10% of your monthly payment is our service charge to handle the bills for you. Of the fees we're charging you, you get some of that back through what's called The Good Payer Program. The creditors give back to us anywhere from 5% to 10% on average of the money we send them. It's called a Fair Share contribution for the service we provide the banks. The money they send back to us, we place into a client trust account, and you're eligible to receive half of that back after every six months by making your payments on time and in full. We're the only organization that offers this type of incentive program to help offset some of the fees that we are charging you.

### 2A. (MI ONLY) I NEED TO KNOW WHAT THE FEE WOULD BE.

The first payment does not go out to the creditors. $25 of the first payment is our initial fee. The remainder will be held in a client trust account. Once we get the consent of 51% of your creditors, the rest of the first payment will be used for the maintenance of your account throughout the program so that from the second month on, when your payment comes in, it goes out the following day, and that's what the banks would be expecting. Then, from the second month on, 10% of your monthly payment is our service charge to handle the bills for you. Of the fees we're charging you, you get some of that back through what's called The Good Payer Program. The creditors give back to us anywhere from 5% to 10% on average of the money we send them. It's called a Fair Share contribution for the service we provide the banks. The money they send back to us, we place into a client trust account, and you're eligible to receive half of that back after every six months by making your payments on time and in full. We're the only organization that offers this type of incentive program to help offset some of the fees that we are charging you.

### 3. EXPLANATION OF ONE MONTH FEE.

The first payment you make to our firm is our initial fee. Let me explain what that allows us to do. When we receive your first payment, we send out legal documents to each and every one of your creditors to inform them that you have hired our services to handle the bills from this point on. This whole first month we are working with your creditors to gain the benefits of reduced interest rates and other benefits you're entitled to, to make sure your accounts are online so that from the second month on, when your payment comes in, it is sent out the following day and that is what your creditors will be expecting. The entire first month is a transition period, which allows us to save you the type of money you're looking to save in paying your bills down.

## 4. WHEN WILL THE CREDITORS RECEIVE MY PAYMENTS?

As you know, the first payment is our fee, so the creditors do not get paid in the first month. What we do is send proposals to let them know that you've hired us as your debt management firm. From the second month on, once we have confirmation that we've received your payment, the money is disbursed to all of your creditors immediately, unlike most other credit counseling companies who will hold each payment for up to 15 days before disbursing to your creditors.

## 4A. (MI ONLY) WHEN WILL THE CREDITORS RECEIVE MY PAYMENTS?

As you know, the first payment does not go out to the creditors. $25 of the first payment is our initial fee. The remainder will be held for the maintenance of your account throughout the program, so the creditors do not get paid in the first month. What we do is send proposals to let them know that you've hired us as your debt management firm. From the second month on, once we have confirmation that we've received your payment, the money is disbursed to all of your creditors immediately, unlike most other credit counseling companies who will hold each payment for up to 15 days before disbursing to your creditors.

## 5. WHAT ABOUT THE 10% YOU CHARGE?, OR HOW CAN YOU CHARGE A FEE AND BE NON-PROFIT?

The fees we charge are for the overhead of the company, the staff and facilities. Some of the fees we charge come back to you through the Good Payer Program. Let me explain. Creditors give back anywhere from 5% to 10% on average of the money we send them. After every 6 months you're current on our program we give back to you half of the money we have collected as a bonus for simply making your payments on time to us, so that helps offset some of the fees that we are charging you.

## 6. DO YOU CHARGE ADDITIONAL FEES IF I SEND EXTRA MONEY?

Yes, we charge 10% of the money you send to us monthly as a service fee. You may have read about our Good Payer Program. This is a great program! Let me explain. Creditors give back anywhere from 5% to 10% on average of the money we send them. After every 6 months you're current on our program we give back to you half of the money we have collected as a bonus for simply paying your bills on time. Sending more money to the creditors through us would increase the amount of money you get back from the Good Payer Program, which would help offset some of the fees that we are charging you.

## 6A. DO YOU CHARGE ANY ADDITIONAL FEES IF I WANT TO PAY AN ACCOUNT OFF IN FULL?

No. We don't charge any additional fees for our Account Payoff Services. As a matter of fact, it would cost you less to pay an account off through us. Let me explain. An example being, if you have a balance of $10,000 on an account and that creditor contributes 10% to the Good Payer Program, if you pay it off through us, we would get back $1,000, and then you would get a check back for $250, so it would only cost $9,750 to pay it off through us!

## 7. ARE YOU LICENSED IN MY STATE?, OR YOU CAN'T CHARGE FEES FOR YOUR SERVICE IN MY STATE!

We're not located in your state. Cambridge Credit Counseling Corp. is located in Massachusetts and we help people nationwide. Our services are executed in Massachusetts, and we are in full compliance with Massachusetts State Law, so we can help you.

## 8. WHAT'S YOUR INTEREST RATE?

That is the great part! We are not a bank. We don't charge an interest rate. We work directly for you to lower the high interest rates the banks are charging you. That's what allows us to save you money. Actually, we are a non-profit community service working directly for consumers to help them become debt free much faster.

## GOOD PAYER DISBURSEMENTS BY AMOUNT DISBURSED

| CUS_NUM | REBATED MONEY EARNED AND SENT TO CLIENTS | REBATES IN EMERGENCY CLIENT TRUST | INITIAL FEE |
|---|---|---|---|
| M0010046 | $ 6,352.75 | $ - | $ 2,495.00 |
| M0016722 | $ 4,528.62 | $ - | $ 2,079.00 |
| M0017060 | $ 3,881.20 | $ 128.26 | $ 1,468.00 |
| M0011215 | $ 3,835.94 | $ 119.75 | $ 2,207.00 |
| M0093652 | $ 3,666.80 | $ 4.77 | $ 1,495.00 |
| M0029505 | $ 3,637.71 | $ 268.18 | $ 1,680.00 |
| M0018980 | $ 3,603.14 | $ - | $ 1,023.00 |
| M0024580 | $ 3,596.17 | $ - | $ 1,799.00 |
| M0029568 | $ 3,535.32 | $ - | $ 1,000.00 |
| M0098963 | $ 3,447.38 | $ 12.22 | $ 1,895.00 |
| M0038368 | $ 3,446.51 | $ - | $ 2,000.00 |
| M0017118 | $ 3,369.29 | $ - | $ 1,688.00 |
| M0118212 | $ 3,330.62 | $ 10.93 | $ - |
| M0017016 | $ 3,269.96 | $ - | $ 1,622.00 |
| M0011208 | $ 3,217.85 | $ - | $ 1,295.00 |
| M0032844 | $ 3,186.68 | $ - | $ 2,004.00 |
| M0010174 | $ 3,163.50 | $ - | $ 899.00 |
| M0028506 | $ 3,141.40 | $ - | $ 1,148.00 |
| M0013076 | $ 3,136.70 | $ - | $ 1,485.00 |
| M0080527 | $ 3,087.30 | $ - | $ 1,922.00 |
| M0010014 | $ 3,048.95 | $ - | $ 312.00 |
| M0032194 | $ 3,043.43 | $ 227.63 | $ 2,211.00 |
| M0024193 | $ 2,928.61 | $ - | $ 1,555.00 |
| M0027391 | $ 2,902.26 | $ - | $ 1,327.00 |
| M0067666 | $ 2,893.90 | $ 338.56 | $ 1,385.00 |
| M0011320 | $ 2,868.65 | $ - | $ 1,458.00 |
| M0027069 | $ 2,845.23 | $ 85.53 | $ 1,850.00 |
| M0028887 | $ 2,829.07 | $ 9.29 | $ 746.00 |
| M0023204 | $ 2,810.98 | $ 1.02 | $ 815.00 |
| M0010433 | $ 2,800.07 | $ - | $ 1,748.00 |
| M0020792 | $ 2,736.15 | $ - | $ 1,474.00 |
| M0086969 | $ 2,696.94 | $ - | $ 2,638.00 |
| M0025980 | $ 2,680.80 | $ - | $ 1,385.00 |
| M0013791 | $ 2,678.91 | $ - | $ 1,409.00 |
| M0022484 | $ 2,670.01 | $ - | $ 871.00 |
| M0015282 | $ 2,664.45 | $ - | $ 2,377.00 |
| M0020255 | $ 2,640.06 | $ - | $ 484.00 |
| M0036651 | $ 2,632.73 | $ 87.25 | $ 985.00 |
| M0011154 | $ 2,605.75 | $ - | $ 1,089.00 |
| M0019367 | $ 2,602.06 | $ - | $ 1,936.00 |
| M0019054 | $ 2,588.26 | $ - | $ 1,523.00 |
| M0012747 | $ 2,579.99 | $ - | $ 1,292.00 |
| M0032125 | $ 2,554.03 | $ - | $ 1,233.00 |
| M0014209 | $ 2,544.23 | $ 6.25 | $ 1,078.00 |
| M0012800 | $ 2,520.89 | $ - | $ 1,353.00 |
| M0026733 | $ 2,516.15 | $ - | $ 800.00 |
| M0086467 | $ 2,486.87 | $ 403.02 | $ 2,000.00 |
| M0025732 | $ 2,482.90 | $ - | $ 727.00 |
| M0023386 | $ 2,475.20 | $ - | $ 1,459.00 |
| M0061697 | $ 2,473.10 | $ - | $ 1,816.00 |
| M0028110 | $ 2,463.37 | $ - | $ 1,572.00 |

**Statement Date:** 03/18/2004

**Congratulations!**
**You have earned $140.89**
**through the Good Payer Program ***

* SEE REVERSE FOR ELIGIBILITY AND INSTRUCTIONS

**Payment Received:** **03/04/2004** **Payment Amount:** **$893.00**

| Name | Account Number | Payment | Reference Number |
|---|---|---|---|
| CHASE BANK CARD (EFT) | 549104289375XXXX | $ 198.00 | 5-852109 |
| CITIBANK CCS(5424180 EFT)MA11 | 542418043248XXXX | $ 117.00 | 5-852123 |
| FIRST BANKCARD CTR FNBO (EFT) | 441853917568XXXX | $ 172.00 | 5-904809 |
| FIRST USA BANK (EFT) | 441712115283XXXX | $ 101.00 | 5-852184 |
| GECS (JC PENNEY) (EFT) | 318060XXXX | $ 27.00 | 5-852200 |
| GECS (WALMART) (EFT) | 603220708017XXXX | $ 32.00 | 5-852212 |
| KOHLS | 032203XXXX | $ 10.00 | 5-291416 |
| MBNA (749 ACCOUNTS)(EFT) | 7498106675XXXX | $ 147.00 | 5-852281 |
| CAMBRIDGE MONTHLY CHARGE | | $ 89.00 | |

**Next Payment Due:** **04/04/2004** **Amount Due:** **$893.00**

PLEASE NOTE: No changes or adjustments of any kind (such as payment amount, payment due date, checking account information) will be made to your account within seven (7) business days of your scheduled due date.

Reminder: Any changes to your account must be submitted in writing.

----------(DETACH AND RETURN WITH PAYMENT)----------

**You are enrolled on our ACH program. Funds will automatically be withdrawn, as per your request.**

M0183XXXX 000893008

**Phone Number Change:** _____

DUE DATE: **04/04/2004**

CUSTOMER NAME:

CUSTOMER NUMBER: **M018XXXX**

PAYMENT DUE: **$ 893.00**

PAYMENT SENT: _____

**Address Change Information**

_____

_____

_____

# IMPORTANT PROGRAM INFORMATION

**Good Payer Program**
Our Good Payer Program gives you money back for paying your debts on time and in the required amount each month. We base this upon Cambridge collecting what is known as Fair Share from your creditors. This is a voluntary contribution we receive from participating creditors for the helpful services we provide to you. For every six-month period you complete through our program, making your payments on time and in the required amount, you will earn 50% of all funds collected on your behalf. If we collect $250, at your request, we will GIVE YOU $125 just for paying your bills! And this is continuous over the life of our program. After every six months of timely payments, the front of your statement will reflect approximately how much you have earned.

To receive your Good Payer Program bonus, simply visit us at www.cambridgecredit.org. You can enter the Client section of our website and request your Good Payer Program bonus. You may also contact our Client Services Department at 413-821-8900 to request your bonus. Otherwise, you can allow the funds to build in the client trust account for savings or emergency purposes. You can also have the money applied to your monthly payment if you encounter unexpected expenses or some other difficulty making the full payment on your own.

**Cambridge Bucks Program**
This exciting program rewards you with cash incentives for something you are probably already doing; telling your personal friends, neighbors, and family about us. Here is how the program works: through Cambridge Bucks you will receive $20 for your initial referral that joins our program. Our Double Bucks program will reward you with $40 for your second referral that joins. For your third referral on, you will again receive $20 for each person that joins our program. One of the great things about this program is that you can still earn cash even after you have repaid your debts through our organization.

Simply tell your friends, neighbors, and family about Cambridge Credit Counseling Corp. and have them call our Savings Line, exclusively for your referrals, at 1-800-403-3433, Extension 682. Be sure to give them your telephone number so that we can forward your "Bucks" and "Double Bucks" to you.

**Mortgage Referral Program**
Upon your request, we can introduce you to a variety of mortgage companies through our Nationwide Mortgage Referral Program. This program includes first and second mortgages. Our Mortgage Referral Program is performed on a non-fee basis.

**Reference Letters**
By maintaining your commitment to our program, you create a positive payment history. If at any time in the future you are trying to obtain financing, we can provide you with a letter of reference that will back you up and actually enhance your ability to achieve your goals.

**ACH *(Electronic Funds Transfer)***
The easiest method of payment is to have Cambridge withdraw your monthly payment from your checking account. Because this is so simple, most of our clients utilize this method. You will still receive your monthly statement showing your payments. To get an application, please contact our office at 413-821-8900, Extension 5092.

**24-Hour Access**
Our **toll-free** Account Information Line, **1-800-527-7595**, allows you 24-hour access to information regarding your progress on our program. There are a variety of options available to you when using this system.

**Remember to keep this statement for your records**

Cambridge Credit Counseling Corp.
P.O. Box 1300
Lewiston, ME 04243-9404

DEBT MANAGEMENT PLAN SUMMARY

| CREDITOR NAME | ACCOUNT NUMBER | APPROX BALANCE | DMP PAYMENT |
|---|---|---|---|
| CITIBANK | xxxxxxxxxxxx4458 | 2,500.00 | 60.00 |
| SEARS | xxxxxxxxxxxx5784 | 892.12 | 25.00 |
| CHASE | xxxxxxxxxxxx5874 | 4,231.19 | 95.00 |
| BANK OF AMERICA | xxxxxxxxxxxx8745 | 3,218.12 | 72.00 |
| MBNA | xxxxxxxxxxxx4577 | 4,242.18 | 85.00 |
| MONTHLY FEE | | | 37.00 |
| | | REGULAR MONTHLY PAYMENT: | 374.00 |

PRO FORMA STATEMENT

| | |
|---|---|
| ESTIMATED* REPAYMENT TERM: | 55 MONTHS |
| TOTAL APPROXIMATE* MANAGED DEBT: | 15,083.61 |
| PAYMENT DESIGN FEE:(THIS PAYMENT IS NOT PAID TO YOUR CREDITORS) | 374.00 |
| TOTAL ESTIMATED* MONTHLY FEES: | 2,035.00 |
| AVERAGE EXPECTED* GOOD PAYER REBATES: | 593.12 |
| ESTIMATED* NET DMP REPAYMENT AMOUNT: | 20,350.88 |
| ESTIMATED 'ON OWN'** REPAYMENT AMOUNT: | 58,307.79 |
| ESTIMATED SAVINGS: | 37,956.91 |

CAMBRIDGE
CREDIT COUNSELING CORP.
67 HUNT ST.
AGAWAM, MA 01001

BILL GREEN
123 MAIN ST
SPRINGFIELD, MA 01001

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* ALL DMP ESTIMATES ARE BASED UPON THE EXPECTED CREDITOR ACCEPTANCE OF THESE PAYMENT ARRANGEMENTS AND THEIR STANDARD DMP CONCESSIONS.

** 'ON OWN' ESTIMATES ARE BASED UPON REPAYMENT OF REVOLVING CHARGE ACCOUNTS AT 18% APR WITH A 2% MONTHLY PAYMENT. INDIVIDUAL 'ON OWN' REPAYMENT AMOUNT AND SAVINGS MAY VARY. LATE OR MISSED PAYMENTS WILL CAUSE LONGER REPAYMENT TERMS AND HIGHER REPAYMENT AMOUNTS.

TO AUTHORIZE DIRECT DRAFT THROUGH THE ACH NETWORK, PLEASE HAVE THE FOLLOWING AUTHENTICATION CODE AVAILABLE FOR YOUR NEXT COUNSELING SESSION, AS WELL AS YOUR CHECKING ACCOUNT NUMBER AND ABA ROUTING NUMBER FOR ACH TRANSACTIONS (CALL YOUR BANK FOR THIS.) ALSO, THIS CODE WILL BE USED FOR CONFIRMATION OF RECEIPT OF THE PRO FORMA STATEMENT.

AUTHENTICATION CODE: W3768

*PREMIER* *BONDED*

CAMBRIDGE
CREDIT COUNSELING CORP.

67 Hunt Street
Agawam, MA 01001

Tel: (413) 821-8900
Fax: (413) 821-0925
Cust. Service: (413) 821-6901



monthly payment amount. CAMBRIDGE's Monthly Payment Design Fee for creating an acceptable proposed Monthly Payment will be equivalent to one proposed Monthly Payment and will be payable upon the CLIENT's acceptance of the proposed Monthly Payment. This proposed Monthly Payment will not increase by more than 15% without your consent when the Payment Program is put into effect as explained below, unless the debt actually owed to any of your creditors is greater than the amount reported by you to CAMBRIDGE. The proposed Monthly Payment will include the 10% Payment Processing Fee described below. Any reductions in the CLIENT's monthly payment amount will normally be achieved by increasing the total number of payments but not by reducing the principal amount of the debt owed.

**CAMBRIDGE's Creditor Cooperation and Payment Services and Payment Program Fee**

Upon receipt of a signed Agreement and Monthly Payment Design Fee, CAMBRIDGE will do the following: CAMBRIDGE will set up a creditors payment account in its computerized system. It will use its best efforts to obtain your creditors' cooperation in the acceptance of their respective shares of the proposed Monthly Payment or of an amount that will increase the amount you must pay monthly to no more than 15% higher than the original proposed Monthly Payment without your consent ("Modified Monthly Payment"). However, the Monthly Payment Design Fee is earned for the services rendered based upon the information you originally provide to CAMBRIDGE. CAMBRIDGE will request a reduction or waiver of the Client's interest rate and any late charges and seek rebates for the Client Bonus Payment Program described below. Each month thereafter, you will pay the Monthly Payment, or Modified Monthly Payment if there is any modification, to CAMBRIDGE and CAMBRIDGE will pay your creditors. CAMBRIDGE is a not for profit corporation. CAMBRIDGE is not a loan company. It may, however, at its own discretion, advance its own money to pay your creditors. CLIENT agrees to repay any such advance within 30 days from the date CAMBRIDGE makes the advance on your behalf. In the event any of your payments is less than the amount required above, CAMBRIDGE shall have the right to return such payment to you, or to, after deducting its Payment Program Fee, disburse the remainder of the money to your creditors in the manner that CAMBRIDGE determines would be most beneficial to you. If any of your payments is more than the amount required above, CAMBRIDGE shall have the right to disburse the additional amount, after deducting its Payment Program Fee, to your creditors in the manner that CAMBRIDGE determines would be most beneficial to you. In addition, if any of the information identifying your account with any of your creditors is incorrect and prevents CAMBRIDGE from making payment on your behalf to that creditor, CAMBRIDGE will hold the funds allocated to that account in trust for you until CAMBRIDGE is able to obtain sufficient information to make the payment on your behalf.

CLIENT understands that in the event that the CLIENT removes an account that was originally included on the program, the CLIENT will not be entitled to a partial refund of the Monthly Payment Design Fee. CLIENT also understands that any interest rate reductions that CAMBRIDGE is able to obtain on the CLIENTS behalf may not occur immediately. Some creditors require that they receive a certain number of consecutive payments before they make any interest rate adjustments.

CAMBRIDGE's Payment Program Fee for setting up the creditor accounts, obtaining the cooperation of your creditors to any interest rate or other reductions that may be obtained, and receiving and paying out your monthly payments to your creditors will be ten (10%) percent of the amount you pay to CAMBRIDGE each month or $25, whichever is greater. This Payment Program Fee shall be included in and deducted from each payment received from the CLIENT. If you desire to add additional creditor accounts at a later date, an additional monthly service charge will be due for those additional accounts.

**SUMMARY OF CAMBRIDGE'S FEES**

Monthly Payment Design Fee = proposed Monthly Payment - one time only.

Payment Program Fee = 10% of each payment made to CAMBRIDGE to be distributed to your creditors or

_____ _____
Date Client (Primary)

_____
Client (Secondary)

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ver 112197.2

**CAMBRIDGE** *ISO 9001:2000 REGISTERED* *BONDED*
CREDIT COUNSELING CORP.
A 501(c)(3) NOT-FOR-PROFIT ORGANIZATION (NOT A LOAN COMPANY)
Page 1
67 Hunt Street
Agawam, MA 01001
Tel: (413) 821-8900
Cust.Service: (413) 821-6901

# SERVICE AGREEMENT

AGREEMENT, entered into as of the _____ day of _____, 20_____, by and between

First Name(1):_____ M.I.____ Last Name(1)_____

First Name(2):_____ M.I.____ Last Name(2)_____

SSN(1): _____ SSN(2):_____

Address:_____ Apt. _____ Phone (H):_____

City:_____ State:_____ Zip:_____ Phone (W):_____

E-mail Address: _____

and CAMBRIDGE CREDIT COUNSELING CORP. You are referred to in this Agreement as the "CLIENT" or "you" or "your" and CAMBRIDGE CREDIT COUNSELING CORP. is referred to in this Agreement as "CAMBRIDGE."

**Reason For The Agreement**

You would like to consolidate into one convenient monthly payment all your monthly payments to creditors such as your credit card companies and/or other consumer lenders. In addition, if possible, you would like to reduce the size of your total monthly payment to these creditors to a more manageable level and reduce the interest rate you are currently paying. CAMBRIDGE has offered to:

1. Consolidate your payments into one convenient monthly payment (CLIENT understands that accounts included in the Debt Management Plan will be closed),
2. Use its best efforts to reduce the amount of your monthly payments,
3. Use its best efforts to reduce the interest rate you are currently paying to your creditors, and
4. Pay to you as a bonus, fifty (50%) percent of any creditor contributions that CAMBRIDGE is able to obtain from your creditors in accordance with the Good Payer Program described below.

**ACCORDINGLY, YOU, THE CLIENT, AND CAMBRIDGE AGREE AS FOLLOWS:**

**I. CAMBRIDGE'S SERVICES, FEES AND SIGN UP INSTRUCTIONS**

**Payment Design Services and Fee**

Upon receipt of a copy of a signed Service Agreement and Creditor Listing Sheet, CAMBRIDGE will do the following: using the credit card and other debt information provided by the CLIENT, CAMBRIDGE will analyze the CLIENT's debt structure, research creditor practices and calculate a proposed monthly payment amount acceptable to the CLIENT ("Monthly Payment"). It is extremely important that the debt information that you provide to CAMBRIDGE is correct and does not underestimate the amount owed by you. CAMBRIDGE will use its best efforts to create a Monthly Payment based upon this debt information that reduces the CLIENT's monthly payment amount. CAMBRIDGE's Payment Design Fee for creating an acceptable proposed Monthly Payment will be equivalent to one proposed Monthly Payment and will be payable upon the CLIENT's acceptance of the proposed Monthly Payment. This Agreement will be executed upon CAMBRIDGE's receipt of CLIENT's signed Service Agreement and Payment Design Fee in accordance with Massachusetts' law.

_____ Date

_____ Client Signature (1)

_____ Client Signature (2)

**CAMBRIDGE** *ISO 9001:2000 REGISTERED* *BONDED*
CREDIT COUNSELING CORP.
A 501(c)(3) NOT-FOR-PROFIT ORGANIZATION (NOT A LOAN COMPANY)
Page 2

67 Hunt Street
Agawam, MA 01001

Tel: (413) 821-8900
Cust.Service: (413) 821-6901

This proposed Monthly Payment will not increase by more than fifteen (15%) percent without your consent when the payment program is put into effect as explained below, unless the debt actually owed to any of your creditors is greater than the amount reported by you to CAMBRIDGE. The proposed Monthly Payment will include the ten (10%) percent Payment Program Service Fee described below.

**CAMBRIDGE's Creditor Cooperation and Payment Services and Payment Program Service Fee**

Upon receipt of a signed Agreement and Payment Design Fee, CAMBRIDGE will do the following: CAMBRIDGE will set up a creditors payment account in its computerized system. It will use its best efforts to obtain your creditors' cooperation in the acceptance of their respective shares of the proposed Monthly Payment or of an amount that will increase the amount you must pay monthly to no more than fifteen (15%) percent higher than the original proposed Monthly Payment without your consent ("Modified Monthly Payment"). However, the Payment Design Fee is earned for the services rendered based upon the information you originally provide to CAMBRIDGE. CAMBRIDGE will request a reduction or waiver of the Client's interest rate and any late charges and seek rebates for the Client Good Payer Program and Account Pay-Off Services described below. CAMBRIDGE will use its best efforts to obtain these benefits, however, there is no guarantee that your particular creditors will extend these benefits in your case. Each creditor has their own policies regarding what accounts may or may not qualify for a Debt Management Plan. Each month thereafter, you will pay the Monthly Payment, or Modified Monthly Payment if there is any modification, to CAMBRIDGE and CAMBRIDGE will pay your creditors. In the event any of your payments is greater or less than the amount required above, CAMBRIDGE shall have the right to, after deducting its Payment Program Service Fee, disburse the remainder of the money to your creditors at CAMBRIDGE's discretion, or to return such payment to you. In addition, if any of the information identifying your account with any of your creditors is incorrect and prevents CAMBRIDGE from making payment on your behalf to that creditor, CAMBRIDGE will hold the funds allocated to that account in trust for you until CAMBRIDGE is able to obtain sufficient information to make the payment on your behalf. If you do not provide the required information, CAMBRIDGE shall have the right to disburse these funds to your creditors at CAMBRIDGE's discretion. CLIENT understands that in the event that the CLIENT removes an account that was originally included on the program, the CLIENT will not be entitled to a partial refund of the Payment Design Fee. CLIENT also understands that any interest rate reductions that CAMBRIDGE is able to obtain on the CLIENTS behalf may not occur immediately. Some creditors require that they receive a certain number of consecutive payments before they make any interest rate adjustments.

CAMBRIDGE's Payment Program Service Fee for setting up the creditor accounts, obtaining the cooperation of your creditors to any interest rate or other reductions that may be obtained, and receiving and paying out your monthly payments to your creditors will be ten (10%) percent of the amount you pay to CAMBRIDGE each month or twenty-five ($25) dollars, whichever is greater. This Payment Program Service Fee shall be included in and deducted from each payment received from the CLIENT. If you desire to add additional creditor accounts at a later date, an additional monthly service charge will be due for those additional accounts.

**Summary of CAMBRIDGE's Fees**

Payment Design Fee = proposed Monthly Payment - one time only.

Payment Program Service Fee = *ten (10%) percent of each payment made to CAMBRIDGE or twenty-five ($25) dollars, whichever is greater.

*THIS IS NOT A FINANCE CHARGE OR INTEREST RATE

| | | | | | |
|---|---|---|---|---|---|
| **This is not your proposed Monthly Payment** | THIS IS ONLY AN EXAMPLE | proposed Monthly Payment on Program = | $300 | THIS IS ONLY AN EXAMPLE | **Example of Payment Program Service Fee** |
| | | *10% Payment Program Service Fee = | $30 | | |
| | | Disbursement to Creditors = | $270 | | |

• Your actual payment amount may be greater or less than this example •

Date

Client Signature (1)

Client Signature (2)

SA01-112302.23

**CAMBRIDGE** *ISO 9001:2000 REGISTERED* *BONDED*
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**CAMBRIDGE Program Sign up Instructions**

When you are satisfied with the proposed Monthly Payment amount and understand and agree to the rest of the terms of this Agreement, you simply mail your Payment Design Fee in the amount equal to the proposed Monthly Payment. Note that all payments must be in the form of a CERTIFIED CHECK, POSTAL MONEY ORDER, OR ELECTRONIC BANK PAYMENT payable to CAMBRIDGE. IMPORTANT! If you are current on your creditor payments and you wish to maintain your current status AND you can afford to, you must make this month's payment to avoid your creditors reporting to credit reporting agencies that you were thirty (30) days late. CAMBRIDGE's payments to creditors will not start until after it receives your second payment which is due thirty (30) days after you pay the Payment Design Fee.

**II. CANCELLATION AND REFUNDS**

CLIENT may cancel this Agreement and receive a full refund of the Payment Design Fee by giving CAMBRIDGE written notice of cancellation by certified mail, return receipt requested. The written notice of cancellation must be received by CAMBRIDGE within seven (7) days (not including Sundays and U.S. Postal Service holidays) after CAMBRIDGE receives the CLIENT's Payment Design Fee. Your money will be refunded within ten (10) days after receipt of notice of cancellation. At any time, you may discontinue making any further monthly payments to CAMBRIDGE without further obligation to CAMBRIDGE. However, the CLIENT will remain liable to pay the balance of the debts owed to the creditors in accordance with your agreement with your creditors. Failure to make payment to CAMBRIDGE for any ninety (90) day period will, at CAMBRIDGE's option, cause termination of this Agreement.

**III. GOOD PAYER PROGRAM**

CAMBRIDGE has instituted a program to try to obtain contributions from your Creditors for CAMBRIDGE's prompt and professional efforts, which we feel are the best in the debt management business. In appreciation for your loyal and continuing participation in our program, for every six (6) month period that you complete by making all your payments on time and in the required amount, we will pay to you a bonus of fifty (50%) percent of any such creditor contributions that we receive from your creditors. For example, if CAMBRIDGE receives contributions totaling one hundred fifty ($150) dollars from your creditors during the first six (6) months that you are on the program, we would pay a seventy-five ($75) dollar bonus to you. If you continue to make timely and appropriate payments for a second six (6) month period, we will again pay to you fifty (50%) percent of any creditor contributions received by us during that second six (6) month period. While there is no guarantee that we will be able to achieve creditor contributions for the Good Payer Program, we will do our best. Many creditors will pay such contributions. If we are successful, at your request, we will mail you a bonus check after the completion of each six (6) month period. Otherwise, any monies collected on your behalf will remain in your client trust account. Upon completion or discontinuation of your Debt Management Program, any monies remaining in your client trust account that were collected on your behalf (your fifty (50%) percent of funds collected for each six (6) month period of Proper Payments not previously remitted to you) will be mailed to you along with your letter of closure.

**IV. RE-EVALUATION**

If the CLIENT makes at least six (6) months of payments on time and in the appropriate amounts, at the request of the CLIENT, CAMBRIDGE will use its best efforts to reduce the CLIENT's regular Monthly Payment amount. Re-Evaluation can be attempted after each six (6) month period of on time payments. If successful, each Re-Evaluation will extend the CLIENT's debt repayment over a longer period of time.

Date

Client Signature (1)

Client Signature (2)

**CAMBRIDGE** *ISO 9001:2000 REGISTERED*
*BONDED*
CREDIT COUNSELING CORP.
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67 Hunt Street
Agawam, MA 01001

Tel: (413) 821-8900
Cust.Service: (413) 821-6901



**V. ACCOUNT PAY-OFF SERVICES**

In the event you would like to pay-off any or all of your accounts on our program, we will refund you twenty-five (25%) percent of any creditor contributions we collect on your behalf. For example, if CAMBRIDGE receives contributions totaling five hundred ($500) dollars from your creditors, we would refund you one hundred twenty five ($125) dollars. This refund will be forwarded to you within ninety (90) days after you make the pay-off through CAMBRIDGE. The Account Pay-Off Services only pertains to creditor contributions that were collected on actual pay-offs received and does not include creditor contributions received on behalf of the CLIENT during the normal course of the CLIENT's debt repayment.

**VI. PROTECTION OF CAMBRIDGE**

The CLIENT agrees to take full responsibility for and protect CAMBRIDGE, its employees, personnel, or agents from any claim, suit or demand of creditors ("Claim") arising out of this Agreement and any credit application containing information supplied or approved by you that we submit at your request; provided, however, such client indemnification shall not be applicable where CAMBRIDGE is deemed grossly negligent by its actions. The CLIENT will reimburse CAMBRIDGE for any legal fees, expenses or monies paid relating to any such claim. The CLIENT agrees that CAMBRIDGE is not liable for any damages to the CLIENT, including garnishments, levies, late fees, negative credit history or repossessions, caused by anyone else including your creditors, the postal or other widely used parcel or mail delivery. CAMBRIDGE's liability for any breach of this Agreement shall be limited to payment of late fees and additional interest charges incurred, if any, or refund of all fees collected for Payment Program Implementation, at CAMBRIDGE's option. You shall immediately give CAMBRIDGE written notice of any problems with payment that you become aware of. CAMBRIDGE shall not be liable for any damages that occurred after you could have given notice to CAMBRIDGE if such damages could have been avoided had you given such notice.

**VII. DEBTOR'S CREDIT RATING AND ACCOUNTS**

The CLIENT understands that CAMBRIDGE makes no representation about any aspect of the CLIENT's credit rating. Creditors will sometimes report participation in CAMBRIDGE's program as a "consumer credit counseling" item on your credit report. Persons with perfect credit histories may have their credit record adversely affected. CAMBRIDGE has no control over reporting or interpretation, as it is strictly a creditor and lender decision. The CLIENT's credit rating is outside of the scope of this Agreement, however, at the CLIENT's request, CAMBRIDGE will provide CLIENT with credit references based upon CLIENT's payment history with CAMBRIDGE. For such credit references to be helpful, it is extremely important that the CLIENT's payments are made on time and in the appropriate amount to CAMBRIDGE.

**VIII. NO OTHER REPRESENTATIONS**

CAMBRIDGE has not authorized any person or other company to make any representations on its behalf concerning fees, credit, any services to be performed by CAMBRIDGE or any other matter. In the event you were referred to CAMBRIDGE by another company, you understand that the other company was not authorized to make any representations about CAMBRIDGE or its services. You agree that all the representations concerning fees, credit, refinancing or any services to be performed by CAMBRIDGE that were made by CAMBRIDGE or relied upon by you when you signed this Service Agreement are set forth in this Agreement. No fees paid to any other company shall be considered fees paid to CAMBRIDGE. Except as provided herein, CAMBRIDGE will not divulge any CLIENT information to third parties unless requested by CLIENT and approved by CAMBRIDGE. All the obligations of CAMBRIDGE are set forth in this Agreement.

I have reviewed the terms of this Agreement, agree to all terms, and acknowledge receipt of a copy of this Agreement.

_____
Date

_____
Client Signature (1)

_____
Client Signature (2)

**CAMBRIDGE** *ISO 9001:2000 REGISTERED*
*BONDED*
CREDIT COUNSELING CORP.
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67 Hunt Street
Agawam, MA 01001

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Cust.Service: (413) 821-6901



# AUTHORIZATION TO RELEASE FINANCIAL DATA

DATE: _____ CLIENT: _____

To Whom It May Concern:

You are hereby authorized to release to my agent, CAMBRIDGE CREDIT COUNSELING CORP., all financial records and other data pertaining to my above referenced account.

Further, my agent is authorized to negotiate all matters pertaining to my account.

Please be further advised that all future monthly payments will emanate from my agent, CAMBRIDGE CREDIT COUNSELING CORP.

I understand that my account with your organization may be current. I have employed the services of CAMBRIDGE CREDIT COUNSELING CORP. to restructure my debt in order to assist me with my present budget.

Thank you for your attention to and cooperation in this matter.

# PRIVACY NOTICE

Over the years, clients have trusted Cambridge Credit Counseling Corp. ("Cambridge Credit") to protect the security and confidentiality of their personal information. We are grateful for this trust, and would like to take this opportunity to familiarize clients with the manner in which Cambridge Credit gathers, uses and maintains nonpublic personal information about consumers and clients. This Privacy Notice complies with Federal Law and regulations concerning the privacy of the nonpublic personal information of individuals.

We collect nonpublic personal information about you from the following sources:

- Information we receive from you on an application or other forms *(examples include, but are not limited to: name and address, social security number, account numbers, balances, creditors and unsecured loans)*;
- Information about your transactions with us, our affiliates, or others.

We do not disclose any nonpublic personal information about our customers or former customers to anyone, except as permitted by law.

We restrict access to nonpublic personal information about you to those employees who need to know that information to provide services to you. We maintain physical, electronic and procedural safeguards that comply with federal regulations to guard your nonpublic personal information.

_____
Date

_____
Client Signature (1)

_____
Client Signature (2)

November 25, 2003

To Whom It May Concern:

This is to confirm that Cambridge Credit Counseling Corp. ("Cambridge Credit") and its affiliates have attained 100% credit counselor and client services representative participation in Cambridge Credit's Counseling Certification and Training Program. This internal training program has been certified to the standards established by the American Society of Training and Development and exceed the quality standards represented by ASTD's best practices. A recent site visit, follow up telephone interviews with key stakeholders, and ongoing monitoring of customer feedback assures us that these high standards of training excellence continue to be met.

It is worth noting that most training certification programs focus on the CONTENT of the training, but not on the necessary PROCEDURES and processes for training to occur and to be retained. High quality training programs, such as those we evaluate for the U.S. Department of Education, focus on the training PROCESS as well as the training content and the quality of instructors.

The Counseling Certification and Training Program created by Cambridge Credit is a comprehensive program that focuses on important and relevant content, is delivered by instructors of considerable expertise, and is conducted using established procedures and processes that are solidly entrenched in Learning Theory. Listed below are behavioral anchors representing Cambridge Credit's Counseling Certification and Training Program that MEET or EXCEED the standards for certification for each training criterion:

**I. Transfer of Training**

| | |
|---|---|
| Meets standards: | Re-testing conducted periodically to ensure training permanence |
| Exceeds standards: | Training behaviors are reinforced on the job to ensure permanence |

**II. Training Objectives**

| | |
|---|---|
| Meets standards: | Objectives of training are clearly stated and based on job descriptions |
| Exceeds standards: | Tested knowledge and skills correspond with current customer feedback |

**III. Training Maintenance**

| | |
|---|---|
| Meets standards: | On-the-job effectiveness of the training process is measured; Counselors given training updates ("sharpening the saw") |
| Exceeds standards: | On-the-job performance and customer feedback is incorporated into training materials to improve ongoing training |

**IV. Training Antecedents and Consequences**

| | |
|---|---|
| Meets standards: | Measure turnover rate among counselors; measure counselor perceptions of training |
| Exceeds standards: | Explore the role that training plays in turnover; train Customer Service Representatives in addition to credit counselors |

**V. Training Support**

| | |
|---|---|
| Meets standards: | Sufficient resources invested in training; training receives full support across the organization |
| Exceeds standards: | Training viewed not as a single event but as ongoing process that is necessary for continuous improvement |

**VI. Psychometrics and Performance**

| | |
|---|---|
| Meets standards: | Establish reliable and valid scoring procedures; consequences for failure |
| Exceeds standards: | Establish test/re-test procedures |

It is notable that Cambridge Credit's training program had at least one incident that exceeded the standards on all six criteria. Cambridge Credit's program is also the only known counseling training program in the nation that exceeds the "training maintenance" criteria by continually modifying and updating the training content to reflect actively solicited customer feedback and concerns.

As the independent third-party evaluator of Cambridge Credit and its affiliates, IOTA Solutions hereby certifies that the Cambridge Credit Counselor and Client Service Certification Process meets or exceeds the established standards for credit counseling training.

Sincerely,

Matthew V. Champagne, Ph.D.
President, IOTA Solutions, Inc.

**Hearing on The Role and Tax Exempt Status of**

**Not-For-Profit Credit Counseling Agencies**

**Prepared Statement of AmeriDebt, Inc.**

**12800 Middlebrook Road – 4th Floor**

**Germantown, Maryland 20874**

**Before the Permanent Subcommittee on Investigations**

**Committee on Governmental Affairs**

**United States Senate**

**March 24, 2004**

## I. Introduction

Mr. Chairman and Members of the Permanent Subcommittee on Investigations ("Subcommittee"), AmeriDebt, Inc. ("AmeriDebt") appreciates the opportunity to submit written testimony concerning the substantial benefits that not-for-profit ("non-profit") credit counseling organizations deliver to consumers.

Demand for credit counseling has grown substantially in recent years. Several factors have led to the increased demand, including record high debts and debt-to-income ratios, variable incomes that make regular payment schedules difficult, and record-low savings. Traditionally, consumer options were limited. In many instances, the only

effective alternative to bankruptcy was credit counseling provided by agencies affiliated with the National Foundation for Credit Counseling ("NFCC"). The NFCC agencies advertised largely by word of mouth and as a result were relatively unknown to most consumers. In addition, these agencies relied almost exclusively on face-to-face dealings with consumers, limiting their geographic reach. Lastly, the NFCC-affiliates simply did not have the capacity to handle the increasing demand for service.

As consumer demand steadily increased, independent agencies, including AmeriDebt, began to appear in the 1990s. These agencies revolutionized the industry by taking advantage of modern advertising and communications technologies. Specifically, AmeriDebt employed modern advertising to inform consumers that there is a viable alternative to bankruptcy. The company used toll-free telephone numbers and the Internet to make its services available to consumers for whom credit counseling previously was unavailable. Likewise, AmeriDebt's reliance on professional service providers allows it to serve tens of thousands of consumers more efficiently and without the long waiting periods often associated with NFCC agencies. AmeriDebt has modernized credit counseling making it accessible, efficient, and convenient for the average consumer.

AmeriDebt has counseled hundreds of thousands of consumers, including more than 300,000 who enrolled in debt management plans ("DMPs"). Many of these consumers benefited substantially from the DMPs. Consumers who complete their DMPs on average receive approximately $13,300 in tangible benefits – an amount that far exceeds any voluntary contribution made to the company. Thus, the approximately 72,000

AmeriDebt consumers currently enrolled in DMPs stand to receive close to $1 billion in total planned benefits.

AmeriDebt consumers have embraced these benefits. Many have communicated to AmeriDebt their appreciation. The following statements by consumers are typical:

- "It is because of compassionate people as yourselves that people like us, who find themselves in financial trouble, have a way to pull themselves up without the embarrassment of bankruptcies and foreclosures. Thanks AmeriDebt. You've saved not only our finances but our marriage as well!"
- I have learned that I can live very comfortably within a budget and most importantly, without credit cards!"
- "I am now able to budget and cope with all our normal household bills, but most importantly I do not have any more harassing phone calls."
- "The service representatives I have spoken with have always been very knowledgeable and helpful with any questions I have had, and have also offered great advice."

"Non-profit organizations, such as AmeriDebt, uniquely are able to provide credit counseling services to consumers in need of financial guidance and discipline. In fact,

AmeriDebt's non-profit status, as well as the non-profit status of every credit counseling agency, is a function of creditor and state requirements. AmeriDebt is interested in working with federal legislators to develop uniform regulations regarding non-profit status. AmeriDebt, however, does not believe that consumers should be deprived of the many benefits it provides because of the inconsistent state law and creditor requirements that currently exist.

AmeriDebt is deeply concerned regarding the fate of consumers. The press coverage surrounding various federal and state investigations will alarm consumers who are contemplating debt counseling or are currently enrolled in sound DMPs. AmeriDebt has already ceased advertising and enrolling new consumers, opting to focus its resources on servicing the approximately 72,000 consumers currently enrolled in its programs. This decision takes away an option for the millions of consumers that viewed AmeriDebt's advertising and contacted the company for counseling. Further, AmeriDebt is concerned that regulatory action will make it impossible for the company to continue servicing their current DMPs. If this were to occur, nearly 72,000 consumers would be forced to leave their DMPs and face certain economic hardship, including bankruptcy in many instances.

## II. Overview of AmeriDebt

AmeriDebt is a non-profit corporation that provides credit counseling to consumers with debt problems. Although no longer advertising and enrolling new consumers, AmeriDebt has focused it resources on servicing the approximately 72,000 consumers currently enrolled in its program. It serves those consumers with credit counseling,

including DMPs, which provide a financial roadmap for getting out of debt. For those who have enrolled in an AmeriDebt DMP there are clear benefits. These benefits take many forms including counseling, education, simplified monthly payments, reduced interest rates, waiver of late-payment fees, and re-aging of debts. Together, the benefits permit consumers to pay off their unsecured debts faster and at less expense, significantly improving the consumers' financial status.

In the past, when a consumer contacted AmeriDebt, a credit counselor would gather information about the consumer's financial condition in the form of a budget analysis. The counselor would advise the consumer of the available options, which typically include (1) finding alternate sources with which to repay debt, (2) controlling financial obligations without debt restructuring, (3) restructuring debt by entering into a DMP, or (4) filing for bankruptcy. While no one option is right for every consumer, restructuring debt through a DMP typically reduces a consumer's required monthly payment compared to self-help or filing for bankruptcy.

AmeriDebt funds its operations through a combination of "fair share" payments from creditors and voluntary contributions from consumers. Creditors make fair share payments to credit counseling agencies in recognition of the assistance agencies provide creditors in recovering outstanding debts. Fair share payments have declined steadily in recent years from their historical levels near 15 percent to today's average of 6 to 8

percent.[1] Aside from fair share payments, AmeriDebt also requests voluntary contributions from those consumers it enrolls in a DMP. Those voluntary contributions defray the costs of setting up and maintaining the consumer's DMP, as well as subsidizing counseling and DMPs for consumers who enroll and make no contribution.

Several years ago, many non-profit credit counseling organizations realized that they could reduce their operating costs and bring greater focus to their primary mission by outsourcing various back-office administrative functions. Over time, several companies began to provide back-office services to CCAs, including (1) application review, (2) input of application data, (3) payment processing and accounting, and (4) customer-service and call-center operations. Such outsourcing saves money for CCAs and allows them to focus on their educational mission. Likewise, AmeriDebt recognized that performing those functions required a certain minimum investment in computerized infrastructure and human resources in order to perform various payment and accounting processes. In light of those fixed costs, AmeriDebt decided it could save money by outsourcing those functions to a service provider that would spread those costs over a greater volume of debtors by servicing multiple credit counseling agencies.[2]

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[1] *See, e.g.*, Gregory Elliehausen et al., *The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior* at 2 n. 4 (Jan. 2003) (www.federalreserve.gov/communityaffairs/national/CA_Conf_ SusCommDev/pdf/statenmichael.pdf).

[2] A 1999 report by Visa (the "*Visa Report*") identified these efficiencies and recommended that CCAs should rely more heavily on outsourcing. *See* Visa USA, Inc., "Credit Counseling: Debt Management Plan Analysis" (Jan. 1999) (available at http://www.watchtheweb.com/CredCounAnal.pdf) (hereinafter "*Visa Report*"). The *Visa Report* cited back-office operations as the single biggest operating problem for CCAs and a limitation on their ability to expand and serve consumers. According to the report, some of the areas where service providers can aid CCAs include reducing the time it takes to enroll consumers in DMPs, reducing the time it takes to pay creditors, and reducing the interest charges sought by creditors.

## III. Consumers Require Credit Counseling Now More Than Ever

There is no doubt that Americans are shouldering record levels of debt. The average American owes $14,500 compared to only $8,500 ten years ago. Many consumers do not earn enough to service their credit accounts and often make only the minimum monthly payment. Depending on the creditor, consumers pay interest on outstanding balances ranging from 4.75 to 35 percent. To make matters worse, creditors routinely impose "penalty" fees that further drain limited resources from debt-strapped consumers and prevent them from regaining control over their finances through discipline and self-help measures. For instance, one major credit grantor assesses a $39 late fee and a $39 over-the-limit fee monthly for outstanding balances over $1,000. Without assistance, many consumers facing such high interest rates and fees resort to bankruptcy. Credit counselors offer an alternative short of bankruptcy by negotiating on behalf of consumers, often lowering interest rates and putting an end to the collection calls and late and over-limit fees.

The credit counseling industry has its genesis in the mid-1960's when many credit grantors began looking for creative ways to recover debts that might otherwise be extinguished in bankruptcy. Until the last decade, the credit counseling field was populated by small, local operations associated with the National Federation of Credit Counselors ("NFCC"), a trade group which receives nearly seventy-five percent of its

funding from creditors.[3] These traditional CCAs advertised largely by word of mouth. As a result, this option was unknown to most consumers. Additionally, traditional CCAs relied almost exclusively on face-to-face dealings with their clients. Although such closeness had certain advantages, it also imposed severe restrictions on traditional CCAs. Most notably it limited the geographic reach of those CCAs and thus put their services outside the reach of most consumers.

Independent CCAs (that is, CCAs not affiliated with the NFCC or individual creditors), including AmeriDebt, revolutionized the field by taking advantage of modern advertising and communications technologies. Advertising has been critical to AmeriDebt's outreach efforts. AmeriDebt was among the first to realize that credit counseling services were worthless if consumers were not aware they existed. To remedy that, AmeriDebt employed modern advertising to inform consumers that they have alternatives to bankruptcy. Moreover, AmeriDebt used toll-free telephone numbers and the Internet to make its services available to consumers for whom credit counseling was previously unavailable. Likewise, AmeriDebt's reliance on professional service providers allows it to serve tens of thousands of consumers more efficiently and without the long waiting periods often associated with other counseling agencies.

## IV. AmeriDebt Provides Effective Credit Counseling to Consumers

[3] Gregory Elliehausen, et al., *The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior* at n.3 (Jan. 2003), www.federalreserve.gov/communityaffairs/national/CA_Conf_Sus CommDev/pdf/statenmichael.pdf. Indeed, the connectivity and alleged lack of independence of NFCC agencies from creditors was the subject of litigation in 1997. *See In re Consumer Credit Counseling Antitrust Lit.*, 1997 WL 755019 (D.D.C. Dec. 4, 1997) (mem. op.).

**Prepared Statement of AmeriDebt, Inc.**

AmeriDebt's primary mission is educating and counseling consumers. It modernized credit counseling and made it an accessible, efficient, and convenient option for millions of consumers. AmeriDebt counselors educate and counsel consumers by performing a budget analysis that assesses income, expenses, total unsecured debt and various other financial considerations. AmeriDebt's counselors also evaluate consumers' spending patterns, including a review of categories of monthly spending to identify where a consumer's expenditures may be imbalanced. Every consumer receives these services for free and without obligation, even though over 90 percent of these consumers never enroll in a DMP and never contribute anything to AmeriDebt.

The benefits of credit counseling are undeniable. The Federal Trade Commission ("FTC") long has recognized the benefits that credit counseling, including DMPs, offer consumers. In December 1997, the FTC advised that:

> If you can't resolve your credit problems yourself or if you need help, you may want to contact a credit counseling service. Nonprofit organizations in every state counsel consumers in debt. *Counselors try to arrange repayment plans that are acceptable to you and your creditors.*[4]

Similarly, the FTC has advised consumers that DMPs can help them reduce monthly payments to creditors, although cautioning that consumers must be financially responsible by reviewing monthly statements and confirming that creditors are allocating

[4] Federal Trade Commission, *Credit and Your Consumer Rights* (Dec. 1997) (emphasis added).

agreed-upon concessions.[5] The upshot of these Commission statements is that credit counseling and DMPs offer real benefits to consumers.

Research by creditors further confirms the potential benefits of credit counseling and DMPs. For instance, the *Visa Report* noted that:

> Clients who successfully completed a Debt Management Plan felt that it provided a wealth of different benefits, both immediately and long-term. Right from the start, 85.1 percent of clients felt the ability to pay off their debt was beneficial and 55.3 percent felt the plan helped stop collection calls. In the long-term, 32 percent of the clients felt the plan helped them balance their budget and 40.7 percent felt they learned new budgeting skills. A total of 37.6 percent felt they improved their credit worthiness and 50.8 percent felt they improved their overall financial status.[6]

Thus, the *Visa Report* confirms that DMPs afford wide-ranging financial benefits such as reducing debt, ending collection attempts, imparting budgeting education and improving consumers' financial condition.

## V. AmeriDebt Provides Substantial Benefits to Consumers

The average consumer comes to AmeriDebt owing nearly $14,000 to five or more creditors. Much of that debt is delinquent and many of the accounts are over-the-limit, resulting in substantial penalties. Many consumers make no more than the minimum payment due. By the time these consumers pays off their accounts, they will have spent

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[5] Federal Trade Commission, *Knee Deep in Debt* (Mar. 2000) (www.ftc.gov/bcp/conline/pubs/credit/kneedeep.htm).

[6] *Visa Report* at 5.

over $30,000 over more than twenty years in minimum monthly payments. AmeriDebt's DMPs allow the consumer to pay off this same debt in three to five years at substantial savings.

AmeriDebt consumers who complete their DMP, on average, receive approximately $13,300 in tangible net benefits – an amount that far exceeds any voluntary contribution made to AmeriDebt. In other words, the 72,000 consumers currently enrolled in AmeriDebt DMPs stand to receive total planned benefits approaching $1 billion.[7] AmeriDebt respectfully encourages the Subcommittee to allow consumers to continue to reap these benefits.

## VI. AmeriDebt's Operation is Consistent with its Non-Profit Exemption, State Laws and Credit Grantor Requirements

AmeriDebt's non-profit status is an outgrowth of state law and creditor requirements that restrict the provision of credit counseling services to non-profit organizations. Moreover, its provision of credit counseling, as discussed above, is consistent with its exemption from the Internal Revenue Code as a 501(c)(3) corporation.

Each state regulates non-profit corporations through licensing and registration. Many states have enacted laws applicable specifically to credit counseling agencies and/or

[7] These benefits do not account for other DMP aspects that confer important benefits on consumers, for example, (1) waiver of late payment fees; (2) waiver of over-the-limit fees; and (3) re-aging of consumer's accounts to remove them from "delinquent" status on the records of consumer reporting agencies. Other factors account for substantial non-quantifiable consumer benefits such as increased financial discipline and budgeting education. As noted in the *Visa Report,* 32 percent of the DMP participants felt the DMP helped them balance their budget and 40.7 percent felt they learned new budgeting skills.

the provision of DMPs. Certain states, such as Massachusetts, Montana, New Hampshire, North Dakota, Rhode Island and Vermont, require the credit counseling agency to be "non-profit." Other states, such as Wyoming, require "tax-exempt" status. Still other states provide exemptions or other preferences to non-profits engaging in credit counseling. Based on the patchwork of state laws and regulations, credit counseling agencies doing business in multiple states must be non-profit. Reinforcing this conclusion is the fact that creditors generally will not approve DMPs originating with for-profit entities.

In light of the foregoing, credit counseling agencies almost uniformly are non-profit organizations. In the case of AmeriDebt, the Internal Revenue Service issued a letter ruling to AmeriDebt that "we have determined you are exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3)." In May 2001, IRS again advised AmeriDebt that "[y]our exempt status under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) is still in effect." The IRS further advised that AmeriDebt was not a private foundation under section 509(a) of the Code, and that "[g]rantors and contributors may rely on this determination unless the Internal Revenue Services publishes notice to the contrary."

Some regulators have alleged that a non-profit credit counseling organization that contracts at arms length for services with third-party for-profit service provider companies may lose its non-profit designation. If that were the test of non-profit status, no non-profit would qualify for tax exemption under section 501(c)(3). Every non-profit organization

purchases a variety of goods or services – telephone services, office, electricity, accounting and legal services, etc. – from for-profit organizations. No organization could function in the modern U.S. economy – including the U.S. government, which presumably is not a for-profit enterprise – without substantial ties to for-profit organizations.

Moreover, an initiative to regulate contractual, outsourcing relationships between non-profit credit counseling agencies and for-profits or otherwise declare or define what is to be considered reasonable compensation would harm consumers, the credit counseling industry, and run afoul of fundamental constitutional rights. In AmeriDebt's case, it would imperil the DMPs of approximately 72,000 consumers. In this regard, AmeriDebt is not unique, as most non-profit credit counseling agencies now realize the need to outsource basic administrative functions.

The Supreme Court has struck down regulations defining reasonable expenses for nonprofits. In *Riley v. Nat'l Fed. of the Blind,* a state statute defined a fee exceeding 35 percent for a professional fundraiser presumptively unreasonable and required the nonprofit to disclose the relationship to consumers.[8] Applying strict scrutiny, the Court concluded that the disclosure requirement was an unconstitutional content-based restriction because it compelled speech by or on behalf of the non-profit:

> We believe, therefore, that North Carolina's content-based regulation is subject to exacting First Amendment scrutiny. The State asserts as its interest the importance of informing donors how the money they contribute is spent in order to dispel the alleged misperception that the money they

[8] *Riley v. Nat'l Fed. of the Blind,* 487 U.S. 781 (1988).

> give to professional fundraisers goes in greater-than-actual proportion to benefit charity. To achieve this goal, the State has adopted a prophylactic rule of compelled speech, applicable to all professional solicitations. We conclude that this interest is not as weighty as the State asserts, and that the means chosen to accomplish it are unduly burdensome and not narrowly tailored.[9]

## VI. Conclusion

Once again, AmeriDebt appreciates this opportunity to address the tangible benefits delivered by non-profit credit counseling agencies to consumers. AmeriDebt and its credit counselors care deeply about our clients. We are committed now more than ever to continuing to provide quality counseling and education.

Addressing and correcting financial problems some consumers have taken years to create is not easy, nor have we claimed it to be. Each day we work with consumers in need of an alternative to paying off creditors at inflated interest rates for extended periods. DMPs offer such an alternative. It has worked for countless AmeriDebt consumers. We eagerly accept the challenge of continuing to help our clients restore their financial well-being.

As lawmakers engage in the difficult process of understanding and resolving America's consumer debt crisis, AmeriDebt intends to do everything in its power to be part of the solution. Our good faith efforts to improve credit counseling can be seen in our prompt resolution of consumer complaints. Although AmeriDebt's complaint ratio is no worse than that of other companies of its size, we have made a special effort to respond to our consumers' concerns. See Letter from Glenn A. Mitchell to Katherine English,

[9] *Id.* at 798.

Esquire, Permanent Subcommittee on Investigations (March 15, 2004). Many problems, however, are outside of AmeriDebt's control. For example, telephone calls from debt collectors – something that ranks high on the list of customer complaints – often do not end until a customer has participated in a debt management program for a month or more. We have attempted to negotiate a more rapid end to such calls, but the ultimate responsibility for implementing this change rests with the creditors.

Once again, AmeriDebt appreciates the opportunity to participate in this hearing. We will continue our efforts to resolve all complaints and to work in a spirit of openness and cooperation with policymakers as they work to solve the multi-faceted problems arising from America's consumer debt crisis.

AmeriDebt respectfully requests that its prepared statement be made a part of the record of this hearing.

**Statement of Cuba M. Craig**
**President and Chief Executive Officer**
**American Financial Solutions**
**before**
**Permanent Subcommittee on Investigations**
**of the Committee on Governmental Affairs**
**United States Senate**
**March 24, 2004**

Mr. Chairman, Members of the Subcommittee. Good morning. I am Cuba Craig, President and CEO of American Financial Solutions ("AFS"), a nonprofit consumer credit counseling agency and a division of the North Seattle Community College Foundation ("NSCCF" or the "Foundation"). AFS has offices in Bremerton, Washington, near Puget Sound Naval Shipyard, across Puget Sound from Seattle. This testimony addresses seven enumerated topics as requested in the Subcommittee's letter of March 5, 2004, and also describes a recent tax audit and several actions that AFS is taking.

**1. The history of AFS**

AFS was founded in late 1998 as a supporting division of the NSCCF. North Seattle Community College is one of three campuses of the Seattle Community College District and has about 10,000 students. AFS was conceived as a community outreach organization, to help people achieve a secure financial future through education, counseling, and, where appropriate, debt relief plans that comply with legal and ethical requirements and that achieve good outcomes for our clients and their creditors.

AFS opened its doors in 1999, with two full-time employees: an accountant and me, and a part-time student with internet and computer skills. We began by learning about the industry, writing a business plan, obtaining licenses to operate in various states, setting up an office, and developing and introducing a website, financial education curriculum and a newsletter. To help us get started, we received a number of donations, including computer software from Microsoft, carpet for the office from Boeing (from a 747 plane), $118,000 from Amerix, a back-office processing firm, and free office space from a local developer. I focused, in particular, on learning why the retention rate of employees at most call centers is low. I then set about creating a working environment in which retention of employees would be higher. Because of the extended training we provide AFS counselors, it is important to protect our investment by working to retain our staff. In 2003, we were recognized by Washington CEO magazine as the "best nonprofit company to work for" in the State of Washington.

In 2001, AFS opened its Bremerton call center, with twelve counselors. Within a year, AFS had hired another thirty-six counselors and in 2003, it expanded to sixty

counselors, the number that it has today. AFS has devoted a great deal of time and effort to training its counselors and to developing systems to measure and maintain quality operations and services. Our counselors are well trained to respond to our clients' needs. In addition, we have management systems in place to measure and maintain quality operations and service for our clients.

Since its founding, AFS has grown substantially and now has approximately 200,000 clients enrolled in debt management plans. We also have provided counseling and education services to thousands of individuals who seek our counsel regarding their finances but who do not use our debt management services.

Almost all of our clients come to us by telephone. Our location on a peninsula does not lend itself to a high volume of walk-in traffic, although we also welcome clients who want to meet in person. Some of our clients prefer the convenience and privacy of connecting with us via the internet, although about 75% of those who use the internet to enroll in a debt management plan also talk to a counselor. Roughly 30% of our callers are likely to benefit from and be able to complete a debt management plan. This is a plan under which the client makes regular payments over a period of time to meet his or her outstanding obligations, and creditors typically agree to accept a lower rate of interest and perhaps make other concessions that enable the client to pay off his unsecured debts. This is valuable for both the client and the creditors. The client is able to pay off his debts and get a fresh start without going into bankruptcy, and the creditors are able to recoup their principal and some interest.

By far the greater number of calls that we receive (about 70%) are from clients who would not benefit from a debt management plan, for one of several reasons. Some callers have a higher income-to-debt ratio than is appropriate for a debt management plan and are merely seeking to take advantage of credit counseling to obtain better terms on their credit card debts. Some callers truly can benefit from credit counseling and education but appear able to remedy their financial situation on their own, after counseling; they do not need the formality of a debt management plan. Finally, some callers have too much debt and too little income to benefit from a debt management plan, and they are referred to Legal Aid or other public resources for assistance. Our counselors are trained and certified to discuss with each caller his or her financial problems and help the client find appropriate solutions.

Before a client decides to enter into a debt management plan, a counselor helps the client identify the outstanding unsecured debts, typically credit card debts, and the monthly income. Based on this information, the counselor helps the client build a monthly budget. Based on our experience with the creditors and the needs of the client, we develop a debt management plan proposal to submit to the creditors. We may ask the creditor to "re-age" an account (that is, make it current), reduce the applicable rate of interest, and accept a monthly payment that the client can afford and that is different from

the creditor's minimum pay. The goals are to set up a plan that the client can afford and can stick to and that offers an acceptable return to the creditor. Assume, for example, a client who owes $7500 to two credit card issuers. The monthly payment of $750 is too high for her income, and she is falling behind and incurring late fees and more interest charges, with no end in sight. With a debt management plan, she may be able to reduce her monthly payment to $165, with a pay-off date 55 months in the future. After she and the creditors have agreed to the plan, AFS will collect the payments from the client and see that the creditors are paid. The client will receive monthly statements of her payments on the debt management plan that she can check against the statements from her creditors, to verify that the plan is working.

We do not charge our clients a fee for consumer credit counseling or for debt management plans. Given the diminishing amount of "fair share" that we receive from creditors, however, we ask for contributions from our clients who enter into debt management plans. On average, "fair share" contributions from creditors have declined from about 15% of the sums paid to them to about 6%. At AFS, client contributions are voluntary, we tell the clients that the contributions are voluntary, and a client may cancel the contribution at any time without affecting the level of service that we provide. A voluntary contribution may be in any amount; the maximum we allow anyone to contribute is $50 per month. If it becomes clear during an interview that a client cannot afford to make a contribution, we do not ask for one. The average contribution from an AFS client is about $20 per month. About 12% of AFS clients elect not to make a voluntary contribution.

AFS strives to participate in our community. AFS provides funds to the Foundation Board for scholarships. In 2002, we transferred $550,000 to the Foundation Board; in 2003, we transferred $3,560,000. We sponsor the annual Armed Forces Day parade in our home town of Bremerton. We have created the AFS Employee Community Service Fund, with $100,000, that the AFS employees use for projects that they select. For example, they recently built a ramp for access to the home of a wheelchair-bound child. Last year, our Christmas Angel/Foster Child Fund provided gifts for 550 children. Sailors from the U.S.S. Carl Vinson delivered the gifts to the children. We also provided dictionaries to every third grade child in Kitsap County. One mother told us that her child slept with his dictionary, because it was his and had his name in it. AFS also contributes to local organizations, including the Chamber of Commerce, the Admiral Theatre Foundation, the Citizens for Bremerton Fire and Police, the Kitsap County Fair and Rodeo, and the County Historical Society Museum. We also participate in the Welfare-to-Work Program, and some of our outstanding counselors are from that program.

### 2. Acquisition of the Genus client portfolio

In June 2001, AFS acquired Genus's ongoing client files and client contracts, rights to the income stream from those client contracts, rights to the Genus name, and computer systems and software and hardware relating to Genus consumer credit counseling. The purchase price for the assets was $17 million, which was calculated based on the future revenue from the transferred Genus accounts. I worked with the AFS Oversight Committee to put together a formal presentation for the Foundation Board. The Board passed a resolution to go forward with the purchase, and negotiations followed over a period of weeks.

Genus agreed to finance $6 million of the purchase price, and Amerix loaned the remaining $11 million. The loans are scheduled to be paid off later this year. The transaction closed June 29, 2001, after agreement had been reached and the Board had approved the terms.

AFS now serves about 200,000 clients and manages over $3 billion in debt. AFS acquired approximately 200,000 Genus accounts in 2001. As those clients have paid off their debts, the number of Genus accounts, *i.e.*, clients who signed up with Genus for a debt management plan before the acquisition, has declined to approximately 90,000, and this number is expected to continue to decline dramatically in the next few years. By the end of 2006, most of the Genus accounts will have been completed and closed. Meanwhile, the number of AFS-originated clients has continued to grow.

### 3. The relationship with Amerix

AFS purchases back office support services from Amerix, which is AFS's largest single supplier. Amerix has the systems to make sure that the clients' payments get to the appropriate creditors in a timely manner and to provide regular reports of those payments as well as daily internet access to accounts for clients. From our perspective, Amerix provides automated payment, document processing and technology support services that permit us to provide consumer credit counseling and educational services and debt management programs to our clients. Amerix has developed specialized and, as we understand it, proprietary integrated telephone and computer systems and automated payment and document flow systems that major creditors now require. Creditors have told us that the Amerix electronic systems are the best in the country for debt management plans. AFS has been unable to identify another single provider that offers the same combination of services that Amerix offers.

#### a. The loan from Amerix will be paid off this year

As discussed earlier, Amerix extended a loan to help AFS with the purchase price for the Genus transaction. That loan is scheduled to be paid off later this year.

**b. The service agreement with Amerix**

AFS purchases and Amerix provides technical support services pursuant to negotiated agreements. The back office services that Amerix provides enable AFS to provide the credit counseling, education and debt management services that it offers to its clients. Among other things, Amerix systems ensure that payments from clients are properly debited, entered, credited and disbursed on a monthly basis and that both clients and AFS receive regular statements detailing this account activity. In addition to payment and account processing, Amerix services include technical support to clients, creditor account inquiries, account problem resolution, and substantial business reporting services, such as daily deposit summaries, weekly disbursements, fair share detail, active and new client detail, and receivables.

For the services that it renders, Amerix is paid a percentage of the monies received by AFS with respect to its clients from creditors ("fair share") and from the voluntary contributions of clients. In the past, we have retained consultants to obtain information about other back office service providers and market prices for the services. This has been a difficult task, because few firms offer the same specialized menu of services that Amerix provides. With the increase in the number of clients, the amount paid to Amerix under the agreements also has increased, and we are discussing with Amerix the possibility of alternative fee arrangements. Last year, we began gathering information about other providers and competitive prices for marketing services that Amerix now provides, to assist us in weighing alternative sources of supply.

**c. Amerix employees no longer serve as AFS counselors**

Although we always intended to handle all origination or counseling calls in-house, AFS initially used counselors employed by Amerix to cover incoming calls and to provide assistance as AFS worked to set up its own call center. Later, Amerix employees provided "overflow" call service for AFS. That is, if no AFS counselor was available to take a call, an Amerix employee would do so. The Amerix employees who took overflow calls for AFS were trained and certified credit counselors. This arrangement no longer exists. AFS now takes all counseling calls in-house.

AFS opened its Bremerton facility in 2001 with twelve counselors. When we reached sixty counselors, I began exploring options for further expansion, including plans to refurbish a former school and double our counseling capacity. Last fall, the Foundation Board decided not to purchase the new facility and asked AFS to develop financial plans to support the project and cost effective alternatives. Since then, I have been considering other ways to move all origination and counseling in-house. At midnight on March 14 of this year, we stopped having Amerix handle any origination or counseling calls. Although handling all origination and counseling in-house has always

been our plan, your investigation helped bring this about more quickly than otherwise might have happened.

**4. The AFS fee structure**

AFS does not charge upfront or other fees and does not have a fee structure for its consumer credit education and counseling or for its debt management plans. AFS offers its services without charge to consumers. Those who can afford to pay are asked if they would like to make a voluntary contribution. Those who cannot afford it are not even asked to contribute. AFS does not accept a contribution of more than $50 per month. AFS is careful to disclose that the contribution is voluntary when it enrolls a client in a debt management plan, and such contributions are labeled as voluntary on the debt management plan enrollment form and on each monthly statement. AFS clients are free to stop voluntary contributions at any time. All clients are provided the same level of service, whether or not they make a contribution.

**5. Counseling and education**

AFS provides counseling and educational services and materials regarding credit problems and debt management and works with clients and creditors to create debt management plans, as appropriate, to help clients work their way out of debt and pay off their outstanding unsecured obligations. AFS maintains an interactive educational class on its website. Hard copies of the educational materials are available to clients who do not have access to a computer. In addition, AFS provides instruction on how to manage personal finances through individual telephone sessions with clients and a client newsletter. Clients also learn through active participation in a debt management plan how to track their finances and manage their debt.

The education materials that AFS offers were developed in conjunction with the University of Pennsylvania. These materials offer information about how to calculate one's debt-to-income ratio and the importance of that ratio to access to credit and the ability to pay; about annual percentage rate and the various costs of using credit cards; and about monthly credit card statements, payment responsibilities, credit card fees, and how to comparison shop for credit cards. The educational materials and instruction help many clients put their financial house in order.

**6. Fair share**

Historically, credit counseling agencies were supported by creditors, which gave the agencies a "fair share" of the payments collected from clients to help support their services. The percentage at one time was 15%; now it averages about 6%, although it varies considerably among creditors. Some banks do not make any fair share payments, some change the percentage, depending on different variables. Creditors benefit from the services that AFS provides, and we believe that fair share should reflect that benefit.

**7. Compensation for AFS counselors**

Consistent with the AFS belief in high-quality service for our clients, our counselors receive bonuses based on the quality of counseling they give to clients, as reflected in the retention rate, *i.e.*, the rate at which enrolled clients remain in the debt management program. Compensation for AFS counselors is not based on the number of clients that a counselor enrolls in a debt management plan. The counselor's incentive is to match the client to an appropriate level of assistance, one that will work for the client, and that is not necessarily a debt management plan. AFS wages and salaries are commensurate with pay standards in the area and with individual experience and skill, assessed in periodic performance appraisals. Health and dental benefits, retirement, and vacation and sick leave also are provided for employees and their families.

**8. Changes AFS has undertaken**

Last fall, the NSCCF Board, which is composed of volunteers, installed a new President and AFS Oversight Committee. Since then, they have been studying our operations to ensure that our activities are appropriate and that our management systems are effective and efficient. Since the Subcommittee began its investigation, we have stepped up our efforts to ensure that AFS meets all applicable requirements. To that end, a review was conducted for AFS and the Board, and recommendations were prepared and considered. Earlier this month, the Oversight Committee made several recommendations for action.

First, AFS has stopped outsourcing origination. The Board may consider options for expansion, but any future expansion will be accomplished only by employing AFS counselors in-house.

Second, AFS counselors have always been trained to make all appropriate disclosures. We will review all of our written materials and scripts to ensure that they reflect that practice.

Third, AFS will review and attempt to renegotiate its contracts with Amerix, with particular attention to changing certain provisions: (1) The method by which payments to Amerix are calculated in favor of a transaction-based or other similar payment system. (2) The "assist rate" provision in the current contract, which is counter to AFS philosophy and practice. We also will seek to terminate the FreedomPoint and the FreedomPoint Financial contracts.

Fourth, we will again seek competitive bids for back-office services.

Fifth, we will review and revise our debt management plan form agreements as appropriate.

Sixth, we will review all applicable laws and regulations.

**9. Tax audit**

In the fall of 2002, the Tax Exempt/Governmental Entities office of the Internal Revenue Service, Pacific Coast Area, audited the credit counseling activities of the AFS division of the Foundation. The purpose of the audit was to consider, among other things, the exempt status of the Foundation or its liability for taxes, such as excise tax or unrelated business income tax. The audit concluded with a "no change" letter to the Foundation from the IRS, dated December 12, 2002, and no taxes were assessed. A copy of the IRS correspondence has been provided to the Subcommittee.

**Conclusion**

AFS is proud of its well trained counselors and the services it offers to the public. We are committed to our mission of offering personalized, high-quality, consumer credit counseling and education services at no charge to our clients. AFS, the Foundation Board and the Board's Oversight Committee are dedicated to ensuring that AFS carries out its mission appropriately and effectively and completely within the bounds of the law.

I am happy to answer any questions you may have.

# TESTIMONY FOR JAMES KROENING
## FamilyMeans CCCS

March 24, 2004

## Senate Governmental Affairs Committee
## Permanent Subcommittee on Investigations

Good morning Chairman Coleman and distinguished Members of Congress. I'm Jim Kroening, Director of Consumer Credit Counseling Service at FamilyMeans, a multi-service agency located in Stillwater, Minnesota serving the Twin Cities Metropolitan area, western Wisconsin, and southeast Minnesota.

I am here today to describe how FamilyMeans CCCS, with a department budget of approximately $1 million dollars and 12 program staff is able to provide affordable, effective, client-centered budget counseling, education and debt management programs to 10,000 people each year while adhering to stringent standards of quality.

**Community-based nonprofit**
To understand our approach, one must first look at our organizational history. FamilyMeans is a mission-based nonprofit started over forty years ago by community leaders. Because financial stability is a key to a family's well-being, FamilyMeans has always provided financial counseling, mental health counseling and supportive services to give people the tools they need to lead healthy, productive lives. Our multiple services give our clients assistance with underlying issues that may be affecting their lives.

Our 18-member volunteer board of directors provides monthly fiscal oversight, establishes policy, and raises financial support for the agency. They serve a maximum of 6 consecutive years, sign disclosure statements about potential conflicts of interest and are not related to staff members.

**Licensing, Accreditation and Evaluation**
FamilyMeans has a long history of being accredited and licensed, meeting the rigorous standards set by the National Council on Accreditation of Services for Families and Children and the National Foundation for Credit Counseling. Our credit counseling service is licensed by the states of Minnesota and Wisconsin. Each of these licensing and accrediting bodies conducts thorough reviews and audits of business practices and professional services. The agency also has an ongoing quality assurance process to help monitor and improve our programs.

**Our community roots, capable board of directors and adherence to highest standards in the nonprofit sector ensure that we provide well-run, mission-based programs that effectively meet community needs.**

**FamilyMeans CCCS** provides budget counseling, financial education and debt management plans, which I will refer to as DMP's.

**Budget Counseling** is the heart of our CCCS program. We conduct 1 ½ hour comprehensive financial counseling sessions because they are effective. A certified financial counselor and the client work together to examine income, monthly expenses and debt. Each client leaves with a workable budget and a tailored action plan. Many families learn how to manage their money from these sessions and therefore don't need a debt plan.

**A DMP** is only recommended to clients who need intervention with creditors. We put all unsecured debt on the DMP, not just major creditors or those who make creditor contributions.

**Equally important, FamilyMeans CCCS offers Consumer Education** each year to approximately 5,000 people. We conduct free classes about money management, home buying, and credit use at schools, colleges, shelters, treatment and recovery programs, community centers, correctional facilities, and other nonprofits. This work helps to prevent future financial problems.

Over the last decade, organizations have entered the credit counseling field, whose focus is on the DMP and its potential revenue generation rather than offering comprehensive counseling and education services. The practices of these companies have adversely affected the credit counseling field, harmed consumers, and tainted the nonprofit sector.

- I am appalled to know that consumers receive only a 15-minute survey instead of comprehensive counseling and education that can lead to lasting change.

- I am disappointed to hear that some of these organizations put selected debt on a DMP and charge high set-up fees, guaranteeing income to the company and almost certain failure for the consumer.

- I am saddened that many individuals *who could manage their own debt* are lured into a debt plan with promises of lowered interest rates.

- I am frustrated that current laws tie our hands when people come to us for help after they have been badly served.

- I am angry that these same businesses enrich their executives and have for-profit affiliations that taint the word nonprofit, betraying the spirit and standards we honor.

Not surprisingly creditors have responded to these practices by reducing their contributions and limiting customer concessions such as waived late fees and lowered interest rates – actions that hurt both the consumer and legitimate nonprofits like FamilyMeans.

For us, creditor contributions have decreased by 30%. Our inability to replace this revenue has forced us to close four locations and significantly reduce staff over the last four years.

Fortunately others see the value of our work. We have successfully raised charitable dollars from the United Way, foundations and individuals to support our counseling and education.

With the help of these charitable funders, and by voluntarily adhering to the standards of the COA, the NFCC and its Consumer Protection Standards, FamilyMeans will strive to maintain and restore the public's trust and continue to bring financial stability to families. We are hopeful that Congress and the Executive Branch take action to uphold the integrity of the credit counseling field in the face of questionable business practices by recent market entrants, so that FamilyMeans and nonprofits like ours can continue to serve consumers' financial needs in communities throughout the country.

Statement of Michael Malesardi
Chief Financial Officer
The Ballenger Group, LLC

U.S. Senate Committee on Governmental Affairs
Permanent Subcommittee on Investigations

March 24, 2004

Chairman Coleman and members of the Subcommittee, thank you.

My name is Michael J. Malesardi, and I am Chief Financial Officer of The Ballenger Group, LLC ("The Ballenger Group"). The Ballenger Group appreciates the opportunity to continue its ongoing cooperation with the Subcommittee and its staff. We also appreciate the Subcommittee's patience and courtesy throughout the process of numerous meetings and data requests. It remains our fervent intent to be as open and transparent as possible. After responding directly to the questions asked, we will offer some solutions for fixing a clearly troubled industry.

I graduated from Washington and Lee University in 1982 with a Bachelor of Science in Business Administration and Accounting and then spent ten years as a Certified Public Accountant with Price Waterhouse here in Washington, DC. From February 1992 until July 2002, I was Controller or CFO of three SEC registrants. In July 2002, I joined DebtWorks, Inc. ("DebtWorks") as CFO simultaneous with the hiring of several other key members of management to help the owner, Andris Pukke, prepare for and execute a sale of the company to a third party. The group that was hired has a background in providing investment-banking advice, finance, technology and other services related to this type of transaction.

The Ballenger Group is an independent, for-profit provider of customer service solutions, custom software development, payment processing services, back office functions, and marketing programs to credit counseling agencies ("CCAs") that provide consumers with debt management plan ("DMP") services. The Ballenger Group provides its services to its CCA clients on a fixed-fee basis, and does not have a direct contractual relationship with consumers. The Ballenger Group is not compensated by creditors and does not earn any float on payment processing. The Ballenger Group is committed to setting and maintaining high quality payment processing and customer representative services for CCAs and to promoting independent and accountable credit counseling practices nationwide. The business processes developed by The Ballenger Group have been certified by the International Organization for Standardization ("ISO") and are evidence of The Ballenger Group's efforts to continuously improve the quality of the services it provides to its clients.

**Response to Questions Posed by the Subcommittee**

*(1) The history of DebtWorks and the management buyout of its assets by The Ballenger Group and Ballenger Holdings, LLC ("Ballenger Holdings").*

In July of 2002 DebtWorks, a separate for-profit provider of payment processing services to CCAs, began establishing a new management team for purposes of preparing and executing a contemplated sale of DebtWorks to a third party, and hired me as DebtWorks' Chief Financial Officer. Around that time DebtWorks also added George M. "Kevin" Fortuna, Joseph Fortuna, and Philip Shen to its new management team. We brought years of previous independent experience to DebtWorks in the realms of investment banking, corporate finance, financial services, and technology. The final member of DebtWorks' new management team was Michael Kiefer, who had been employed by DebtWorks since 1999 as Operations Manager and received the title Chief Operating Officer when the new management team was formed. From the new management team's inception in the summer of 2002, the primary responsibility of each of its members was to prepare DebtWorks for a potential sale to a third party.

Throughout July and August of 2002 the management team solicited bids from numerous third parties, most of which were private equity firms, and narrowed the list of potential suitors to three firms. These firms submitted bids to acquire a majority ownership interest in DebtWorks, subject to their completion of a due diligence process. Eventually, Mr. Pukke and the management team selected one private equity firm to proceed with a more complete and extensive due diligence and negotiation process, which began in August and ended in November of 2002. Due primarily to uncertainty surrounding regulation of the credit counseling industry, the transaction was never completed. DebtWorks and the suitor mutually terminated negotiations in November 2002.

In December of 2002, DebtWorks' new management team approached Mr. Pukke with a proposal that the team form a new and independent company that would purchase substantially all of DebtWorks' operating assets. This proposal included economic terms that were functionally equivalent to the terms DebtWorks had previously negotiated with the private equity firm. After making their proposal, DebtWorks' management team retained independent counsel, began extensive negotiations with Mr. Pukke and DebtWorks, and eventually reached an agreement to purchase DebtWorks' assets.

*(2) The history and corporate structure of The Ballenger Group.*

The Ballenger Group was formed on December 27, 2002 and began doing business on January 1, 2003 upon the completion of a transaction whereby The Ballenger Group purchased certain assets of DebtWorks' CCA-servicing business. On January 1, 2003, DebtWorks exchanged certain of its assets for 100% of the membership interests in The Ballenger Group, and simultaneously sold a controlling 51% of the membership interests in The Ballenger Group to Ballenger Holdings, a holding company formed by

the management team for the sole purpose of holding membership interests in The Ballenger Group, in return for a promissory note pursuant to which The Ballenger Group made installment payments of the purchase price to DebtWorks. Ballenger Holdings currently has fourteen members. Neither DebtWorks nor Mr. Pukke has ever been a member of Ballenger Holdings.

DebtWorks' 49% interest in The Ballenger Group was severely limited by contract to preclude DebtWorks from controlling or influencing The Ballenger Group. For example, DebtWorks had no right to vote on any matter concerning The Ballenger Group, except the right to approve the issuance of membership interests that might have diluted DebtWorks' interest in the company below 25%. Additionally, DebtWorks did not have any board seats, board observation rights, or many of the customary protections normally accorded a minority owner of a business. For example, DebtWorks had no right to approve the following: The Ballenger Group's annual business plan; The Ballenger Group's entry into new lines of business; additional issuances of equity securities; fundamental transactions such as mergers, consolidations, and sales of assets; additional indebtedness or capital expenditures; and the dissolution, liquidation or bankruptcy of The Ballenger Group.

These restrictions on DebtWorks' rights, along with a non-compete agreement with Mr. Pukke, were specifically adopted to establish and preserve The Ballenger Group's independence from DebtWorks and Mr. Pukke. As a result, Ballenger Holdings was not only the majority owner, but was also clearly the holder of all important management rights of The Ballenger Group.

Moreover, Ballenger Holdings and The Ballenger Group never shared office space, advertising, or bank accounts with DebtWorks, Mr. Pukke, or with any of their clients. Neither The Ballenger Group nor Ballenger Holdings have ever been controlled in any way by any client or by DebtWorks or Mr. Pukke. At all times since the completion of the January 1, 2003 transaction: (1) The Ballenger Group and Ballenger Holdings have been legally distinct from DebtWorks and have not shared officers or directors with DebtWorks, and (2) the management teams of The Ballenger Group and Ballenger Holdings have been distinct from the management of DebtWorks and have independently made hiring, firing and promotion decisions. The tax returns to be filed by The Ballenger Group and Ballenger Holdings will be separate from tax returns filed by DebtWorks. In short, at all times since the completion of the January 1, 2003 transaction, The Ballenger Group and Ballenger Holdings essentially have operated independently from DebtWorks, Mr. Pukke and DebtWorks' former CCA clients.

On October 31, 2003, Ballenger Holdings acquired the remaining 49% of the membership interests in The Ballenger Group from DebtWorks, and became the sole owner of all of the membership interests in The Ballenger Group. This final action definitively established the complete independence of The Ballenger Group from DebtWorks and left DebtWorks without any ownership interest in The Ballenger Group. At the same time, the promissory note between Ballenger Holdings and DebtWorks made during the January 1, 2003 transaction was converted from one secured by the

membership interests of The Ballenger Group to one that is unsecured, thereby eliminating any future possibility that DebtWorks might regain control of The Ballenger Group in the unlikely event of a default on the note by Ballenger Holdings.

The following are brief biographies of The Ballenger Group's management team:

- George ("Kevin") Fortuna, President and Chief Executive Officer – Formerly headed his own venture capital group, served as Vice President of Business Development for NBC Internet, and worked in investment banking.

- Mike Kiefer, Chief Operating Officer – Has 10 years of experience in the consumer financial services industry specifically related to counseling and customer service.

- Michael Malesardi, Chief Financial Officer – Previously served as Chief Financial Officer of OmniSky and as Controller of PSINet and Watson Wyatt; also worked for 10 years as an auditor with Price Waterhouse.

- André Brunel, General Counsel and Senior Vice President of Creditor Relations and Public Affairs – Previously an equity partner with Hughes & Luce, LLP, and formerly associated with Irell & Manella, LLP; Master in Public Affairs and J.D. from University of Texas; LL.M. from University of London.

- Joseph Fortuna, Chief Information Officer – Previously served as Vice President - Internet Development and Vice President - Technology at other companies.

- Philip Shen, Vice President Corporate Development – Recently received MBA from Stanford Graduate School of Business; previously worked as a management consultant and served as a health education volunteer for the Peace Corps in Cote d'Ivoire.

- Ed Lynch, Director of Human Resources – Has over twenty years of experience working for companies such as Marriott, MCI and WorldCom.

*(3) The relationship and transactions between DebtWorks and The Ballenger Group, including any outstanding debts between DebtWorks and The Ballenger Group.*

At all times since the consummation of the management buyout transaction on January 1, 2003, The Ballenger Group and DebtWorks have been separate and distinct entities that are legally and functionally independent and have no ongoing relationship with each other. The only link between The Ballenger Group and DebtWorks is indirect: The Ballenger Group's sole owner, Ballenger Holdings, makes continuing installment payments to DebtWorks toward the purchase price for the membership interests in The Ballenger Group. These payments are made pursuant to the terms of a promissory note that was negotiated at arm's length and at market rates.

*(4) The relationship between DebtWorks and other for-profit entities, including (a) Infinity Resources Group, Inc., (b) F&M Mortgage, Inc., and (c) Fidelity and Trust Mortgage, Inc.*

I can advise the Subcommittee that I am not familiar with either F&M Mortgage, Inc. or Fidelity and Trust Mortgage, Inc. Although I am aware of the existence of Infinity Resources Group, Inc., my personal knowledge of it is limited to an understanding that it is or was a business in which Mr. Pukke is involved and that it provides or provided debt consolidation loans to consumers. To the best of my knowledge none of these entities was affiliated with DebtWorks during the time I was employed there. None of these entities is or has ever been affiliated or had a relationship with The Ballenger Group.

*(5) The circumstances surrounding the formation of the credit counseling agencies serviced by DebtWorks and The Ballenger Group and their current contractual relationships with The Ballenger Group.*

The majority of The Ballenger Group's CCA clients that were previously serviced by DebtWorks were formed prior to The Ballenger Group's existence and The Ballenger Group's knowledge of the circumstances surrounding their formation is very limited; however, The Ballenger Group does have knowledge of the activities of three of its clients in preparation for engaging in credit counseling activities. Two of these entities were not previous clients of DebtWorks and first became engaged in credit counseling activities after The Ballenger Group's formation. The third was a client of DebtWorks that had stopped actively engaging in credit counseling activities (with the exception of continuing to serve consumers who had already entered into debt management plans) prior to The Ballenger Group's formation and resumed full operations after The Ballenger Group's formation. In each of these three instances the CCA, based upon its principals' prior experiences with other clients of The Ballenger Group, approached The Ballenger Group to obtain services. The Ballenger Group's involvement in each of these CCAs' efforts to become actively engaged in credit counseling activities has been limited to gathering information and establishing banking relationships and accounts necessary for The Ballenger Group to begin providing payment processing and consumer relations services. While the CCA is the borrower and their principals have provided personal guarantees, The Ballenger Group also serves as a backup guarantor of each CCA's obligation to repay loans from the bank with which the CCA has established a relationship. These loans are essential for providing the CCAs with the initial funding necessary to provide credit counseling services to consumers. The Ballenger Group's minimal assistance to these CCAs during their formative stage is markedly less than the industry norm.

Notably, creditors were the origin of the National Foundation for Credit Counseling and its Consumer Credit Counseling Services ("CCCS") members – which are the traditional CCAs. *See* Abby Sniderman Milstein and Bruce C. Ratner, *Consumer Credit Counseling Service: A Consumer-Oriented View*, 56 N.Y.U. L. REV. 978, 980 n.17, 986-988 (1981). The creditors' involvement in the formation of CCCSs includes

direct provision of start-up funding, provision of legal services, and representation on CCCS governing boards. The pervasive influence of creditors on the activities of the NFCC and its CCCS members, who purport to be the standard bearers in the credit counseling industry, has led, in The Ballenger Group's opinion, to potential CCCS conflicts of interest and an institutional bias away from consumers and towards serving creditor interests. Since The Ballenger Group is completely independent from creditors, its limited support of certain CCAs does not present the potential for an anti-consumer conflict of interest.

## Conclusion

The Ballenger Group is committed to preserving and promoting this valuable, vital industry serving millions of American consumers. We have included as an appendix a review of the issues in the credit counseling service industry. On behalf of The Ballenger Group, I want to thank the Subcommittee and to offer The Ballenger Group's assistance in working together for a strong and consumer-oriented credit counseling industry.

Thank you again for this opportunity to submit testimony.

**Appendix I: Credit Counseling -- Needed Reforms**

It is clear that credit counseling is a troubled industry. Too often, consumers do not get good services and they do not get unbiased advice. The Ballenger Group is a leader in developing industry best practices and has actively worked toward public policy changes to protect consumers from abuse and unnecessary bankruptcy.

*(1) Industry Best Practices*

Since The Ballenger Group began doing business in January of 2003 it has developed and implemented a comprehensive set of "best practices" as part of a process of continuous self-improvement and improvement of the entire credit counseling industry. This process is grounded in The Ballenger Group's commitment to providing high quality outsourcing solutions to its clients and helping consumers alleviate their debt problems. To that end The Ballenger Group has implemented state-of-the-art technology, systems and business processes, all of which save consumers time and money and improve service levels across the board. The Ballenger Group believes that its standards for data entry, payment processing and customer support are better than any industry or regulatory guidelines and are the best in the industry.

The Ballenger Group's rigorous, intensive process of continuous improvement grew out of our commitment to our clients and is guided by the on-going feedback we solicit and receive from consumers, community leaders, regulators and legislators. We will continue reaching out in an effort to ensure that we continue to provide highest quality outsourcing solutions.

In January of 2004 The Ballenger Group presented each of its CCA clients with a "best practices amendment" to its outsourcing contract with The Ballenger Group. The Ballenger Group's goal in proposing these amendments was to provide incentives for its clients to adopt practices that ensure full disclosure of material facts, maximize consumer benefits and satisfaction, and minimize consumer confusion. The best practices amendments, when adopted by the CCAs, add a new section to The Ballenger Group's contract which permits The Ballenger Group to terminate the contract for the CCA's failure to comply with the practices described the "Client Recommendations" and "CCA Handbook" developed by The Ballenger Group.

The Ballenger Group also provides its CCA clients with a number of best practices disclosure documents. These documents are forms that are intended to provide the CCAs with the basic groundwork to establish and maintain procedures for making full and complete disclosures to consumers of all material facts related to their decision to enter into a DMP. Ultimately it is each CCA's responsibility to ensure that the disclosures it makes comply with all applicable laws, and each CCA must make necessary modifications to the form documents provided by The Ballenger Group. These documents are as follows:

1. A form "Welcome Packet" from CCAs to consumers who have enrolled in a debt management plan;

2. A form disclosure script provided to assist the CCAs in making adequate disclosures to consumers about DMPs during the counseling process;

3. A form "Consumer DMP Agreement" which explains the DMP service, any requested contributions, and the consumer's responsibilities in connection with the DMP;

4. A "Consumer Disclosure Confirmation" attachment to the DMP agreement that requires multiple signatures by the consumer whereby the consumer: (1) states whether or not he or she agrees to make voluntary contributions to the CCA, (2) acknowledges that credit reporting agencies may place a neutral mark on the consumer's credit report, (3) acknowledges that the CCA has explained that creditors may engage in a review period before accepting a proposed DMP, and (4) acknowledges that the CCA has retained a for-profit, third-party vendor to perform its processing and customer service functions; and

5. A "Counselor Disclosure Confirmation" to be signed by CCA counselors confirming that they have made required oral disclosures to consumers.

*(2) Public Policy Initiatives*

The credit counseling industry is at a crossroads. The status quo is not acceptable for consumers and not viable for the industry. There are really only two choices...the credit counseling industry must become a federally regulated business where "for profit" companies and tax exempt non-profits offer a range of service to consumers, or ONLY tax-exempt non-profits are allowed to participate in an industry that will need to be funded by mandatory levels of fair share support from all creditors.

A. Putting Consumers First: Broad Review from the Consumer's Perspective

The credit counseling industry needs reform. However, reform that puts consumers first cannot be developed in a vacuum or by a narrow gauged inspection of industry practices and government regulation that ignores how Americans are living, working and borrowing. It cannot be done piecemeal without looking at all parts of the industry, including creditor practices.

Pro-consumer changes to current legal and regulatory practices require a broad understanding of the comprehensive consumer experience in securing and managing credit. It is impossible to identify necessary and effective reforms in helping consumers without examining how and why some consumers get into credit trouble in the first place.

One cannot truly understand the credit counseling industry without understanding the integral roles played by consumers, creditors (large and small) and credit counselors.

Solutions that put consumers first must be holistic--helping protect consumers from unethical practices *and* unnecessary bankruptcy.

B. The 1990s: Booming Economy – Booming Debt

During the booming economy of the 1990s consumer debt skyrocketed. In 1990, the average household non-mortgage debt was $8,500. By 2000, it had increased sharply to $14,500. Incredibly, the portion of that related to credit card debt nearly tripled, from $2,985 to over $8,100 per household.

In his book "Credit Card Nation," author Robert Manning likens the expansion of consumer credit debt in the 1990s to personal "junk bonds." And how are consumers managing their debt load? The evidence suggests that some are not managing it well.

U.S. credit card debt today totals more than $700 billion. Late payment fees to creditors have risen from $1.7 billion in 1996 to *$7.3 billion* in 2002, making them the *third* largest source of revenue for credit card companies, trailing only interest and merchant fees.

Today, the average American family is paying about $1,100 a year in interest on its credit cards. Interest rates on bank issued cards range from 4.75% to 41% when the Federal Funds Rate is at 1%, an historic 45-year low.

Paradoxically, credit card issuers mailed *five billion* card offers in 2001, a 20% increase from 2000. Manning notes that throughout the 1990s, "aggressive marketing of consumer credit" posed serious personal and credit problems for small businesses and for college students. In fact, in 1999, the Consumer Federation of America conducted a major news conference about the terrible impact of crushing credit card debt on students, revealing that several even turned to suicide and tragically ended their own lives. Jean Braucher, author of "Options In Consumer Bankruptcy: An American Perspective" concludes that if "creditors persist in aggressive marketing to high-risk debtors, effective legal and social reforms should include better disclosure, financial education in secondary school and, perhaps, even direct regulation of risky creditor practices."

Significant and important research is being done on consumer credit. The Ballenger Group strongly recommends that the committee and staff review the important data being reported in works such as: "As We Forgive Our Debtors, Bankruptcy and Consumer Credit in America"; "The Fragile Middle Class"; and "Credit Card Nation." Especially helpful is research published by Demos Public Policy research titled: "Borrowing To Make Ends Meet: The Growth of Credit Card Debt in the '90s." This article describes numerous practices of creditors that generate increasing consumer debt, including:

- Disclosures that emphasize low introductory interest rates and fail to fully apprise consumers of the true interest and penalty structures of the credit being offered, *see id.* at 41;

- Drastically increasing fees and penalties, including late fees, over-the-limit fees, balance transfer fees and cash advance fees, which are generally borne by the consumers that are least able to handle them, *see id.* at 35-37;

- Indiscriminate and aggressive credit card marketing and solicitation, rising to the level of 5.01 billion credit card solicitations in 2001, *see id.* at 37; and,

- The reduction of minimum payment requirements to very low levels, generally around 2% to 5% of the balance owed, which creates increasing consumer debt and extends the length of time it takes consumers to pay off their credit card debts, while simultaneously generating greater interest income to the credit issuers, *see id.* at 37. As reported in the *Demos* article, it would take a consumer an astonishing 56 years to pay off a $10,000.00 credit card balance at 18% interest by making only the required minimum monthly payments of 2% of the balance, *see id.* at 13.

C. Consumers in Debt Crisis Need Choices

Consumers experiencing debt crisis have limited alternatives. Some may seek attorneys to aid them with Chapter 7 (debt discharge) or Chapter 13 (repayment plan) bankruptcy. Yet others may borrow against their future by securing a home equity loan. Some consumers are lucky enough to have a family member willing to help. A fraction simply are able to "pull themselves up by their bootstraps" but, unfortunately, most cannot. Consumers being pursued by collection agencies usually find "self help" in coping with their creditors is impossible.

Thousands of American families live better lives because they have the option of choosing to use credit counseling services -- resources that serve as many consumers' protection from collection letters and harassing phone calls. Most consumers in debt crisis simply want the phone to stop ringing. Credit counseling is an essential and valuable service. Public policy makers and the industry should work together to ensure that consumers are able to use this vital credit counseling resource.

CCAs are now assisting over 1.5 million American households a year manage their debt, save money and avoid bankruptcy. America's credit counseling industry has more than tripled in size within the past decade, and must grow another 30% just to fulfill the requirements of the proposed Federal Bankruptcy Bill.

The credit counseling industry provides services that offer real value to consumers, including debt counseling and DMPs. Agencies provide consumers with valuable expertise on what creditors are willing to accept and what benefits can be achieved. And, they offer efficient, effective ways for consumers to repay debt. The

consumer usually deals directly with the CCA and does not understand the creditors' role in the process. As a result, when something goes wrong, even when the consumers' creditor is the cause, the consumer blames the CCA.

Increasingly, consumers are demanding more "customer focus" from credit counseling agencies. Consumers expect CCAs to be as consumer friendly as other businesses and to offer such services as telephone counseling, Internet access, computerized payments and evening and weekend hours. Many traditional CCAs have been slow to meet new customer demands because they are revenue bound by declining "fair share" contributions from the largest creditors.

Non-profit, traditional CCAs frequently act as agents of banks and credit card companies and hence are creditor driven instead of consumer focused. Many have executives from creditors sitting on their board of directors. In fact, the Federal Trade Commission determined that NFCC affiliated, non-profit CCAs must disclose to consumers that these non-profit CCAs represent the very banks and credit card companies consumers may be seeking protection from. (www.ftc.gov/opa/1997/03/nfcc.htm)

It should be noted that there are literally hundreds of thousands of creditors. Very few creditors, i.e., the largest *100* creditors, account for approximately 98% of all "fair share" paid by creditors to non-profit CCAs. Significantly, though, these few large creditors refuse to pay "fair share" to for-profit CCAs *and* refuse to give debt management benefits to consumers choosing for-profit CCAs. Unsurprisingly, no for-profit CCA exists today because of this industry practice. Also troubling, many CCAs are also finding themselves taking the blame for consumer issues that are actually the faults of the consumers' creditors. (Please see the attached Appendix II entitled "Creditor and Consumer Issues with the Debt Management Plan," detailing these issues.)

In an environment of shrinking support from creditors and increasing demand, it is very likely that the non-profit business model is not long for the world.

Few dispute that credit counseling is valuable and positive. Credit counseling agencies not only help consumers manage their debt, save money and avoid bankruptcy, but a recent study indicates that CCAs also help consumers improve their budgeting skills, their ability to afford a new home and their overall financial status, as well as their credit profiles.

According to a Georgetown University study, consumers who received credit counseling reduced their total dollar amount of debt, their total dollar amount of non-mortgage debt and the number of accounts with unresolved balances. Most of them also diminished their use of bank card credit limits and experienced fewer delinquencies.

> "And, the large majority of counseled borrowers had significantly fewer accounts, lower debt and fewer delinquencies relative to other borrowers — behavior consistent with the advice provided in credit counseling."

Today, personal debt is spiraling and personal bankruptcies are following suit. Credit counseling agencies are attempting to meet the needs of American consumers. More and more consumers need unbiased credit advice and want a full range of consumer friendly counseling options that include the latest in telephone and Internet counseling.

It is crucial that we preserve credit counseling as an option to help consumers get out of debt as quickly as possible.

The future of the traditional, non-profit CCA is, frankly, dim. The traditional credit counseling agency is too dependent on creditors to give consumers unbiased advice and too revenue strapped to modernize practices and services to meet demand as a true business would to serve and retain customers. For example, most traditional CCAs have historically not even advertised their services, leaving many consumers unaware that this significant resource is available.

D. Pro-Consumer Credit Counseling: Consumer Choice, Competition, Best Practices and Federal Regulation

Traditional CCAs are losing market share to the independent agencies. Most of the growth among CCAs is among independent agencies.

Simply put, the non-profit model is no longer viable. It is being rejected by consumers and suffocated by creditors who are investing less and less. There are several crucial steps that must be taken to preserve CCAs and the benefits they bring to consumers and taxpayers:

*1. CCAs must become consumer focused and operate like true businesses.*

Competition for consumers among for-profit and non-profit CCAs would provide consumers choice and the industry with incentives to provide consumer focused--not creditor driven -- consumer credit counseling.

The traditional players in the credit counseling industry, such as the consumer credit counseling service members of the National Foundation for Consumer Credit ("NFCC") were created and remain heavily influenced by creditor organizations and are highly dependent upon "fair share" payments from creditors. *See* Stephen Gardner, *Consumer Credit Counseling Services: The Need for Reform and Some Proposals for Change*, Fall 2001/Winter 2002, at 31, 32. Because of their close relationships with creditors, the advice provided to consumers by traditional NFCC member entities is likely to be limited and may be "improper . . . [and] to the direct benefit of some creditors." *See id.* at 31, 33. For instance, organizations that are NFCC members may "not adequately disclose the[ir] collection agency role to consumers who seek and obtain counseling," and often "it is the set policy of some [of these] organizations that they never refer debtors to bankruptcy." *See id.* at 31. It has been alleged that the control of creditors over the NFCC member entities is so great that some creditors will work only

with credit counseling agencies that are members of the NFCC and that the NFCC and its member entities have engaged in anti-competitive behavior in violation of antitrust laws. *See In re: Consumer Credit Counseling Services Antitrust Litigation*, No. MDL 97MS233, 1997 U.S. Dist. LEXIS 19669, at *4 - *7, 1997 WL 755019, at *2 (D.D.C. Dec. 4, 1997).

A recent report published by the Consumer Federation of America and National Consumer Law Center highlights the need for the credit counseling industry to elevate its standard of professionalism, and embrace "best practices" that increase consumer benefits and improve customer service and satisfaction. We agree and we believe that regulators, creditors, CCAs and consumer advocates need to work together to find a funding solution that will work for everyone — especially consumers — while helping the industry continue to grow and flourish.

2. *Competition between "non-profit" and market based CCAs would benefit consumers and must be allowed.*

The "non-profit" CCA is only as viable as the level of support they receive from creditors. Without a creditor subsidy, consumers must forgo counseling or pay reasonable fees. Large banks and credit card companies created the credit counseling industry a half-century ago as an alternative way to collect debt from consumers who might otherwise file for personal bankruptcy and gain release from the obligation of repayment. These large creditors created and funded CCAs by providing a subsidy of approximately 15% – allowing CCAs to present themselves as "non-profits." In the meantime, American debt is soaring.

The large creditors are now drastically reducing or eliminating their financial "fair share" support to CCAs, reducing it, on average, to less than 4% of the amounts repaid. They make such changes suddenly, arbitrarily, and typically without any clear written policy on who qualifies. There is a vast contingency of smaller creditors who do not pay any fair share – encompassing doctors, lawyers, collection agents, loan companies, local banks, student loan companies, utility companies, credit unions, and small retail stores, just to name a few. And since most smaller creditors pay no fair share, non-profit CCAs that do not request contributions or charge fees for the services they provide are not a sustainable business model. A myriad of differing state laws are causing the cost of compliance to skyrocket while, simultaneously, fees are being "capped" by states. Without competition from market-based companies, consumers will be left on their own to negotiate against some of the largest credit card companies and banks in the world. And, with no revenues being generated by consumers who pay for the services they receive, consumers will not be able to get the key services they need.

In June of 2003, Howard Beales, Director of the Bureau of Consumer Protection at the FTC, praised the modernization of the consumer credit granting industry from the old model of in-person visits to a local banker. Likewise, modernization in the credit counseling industry is desperately needed in allowing competition among for-profit and non-profits in the best, most efficient manner of financing modern credit counseling

services. Creditors – both for-profit and non-profit – have dramatically changed over the last half century. The same cannot be said for the credit counseling industry because for-profits have been banned.

*3. Industry-wide best practices must be adopted.*

Industry trade associations should lead the industry in developing and enforcing policies, and implementing clear, dependable procedural and operating standards, including:

- Thorough, regular training and certification.
- Approved, documented standards for proposal processing and program enrollment.
- Honest, accurate advertising.
- Full disclosure of funding sources, including percentage from creditor.

*4. The industry should be Federally regulated through legislation that preempts state law.*

National rules would protect consumers across the country and provide incentives for industry investment, while overriding the confusing, inconsistent state patchwork of laws and creditor mandates.

Practical, consistent federal regulation of CCAs also would benefit creditors and counselors. National rules will protect consumers across the country with consistent standards while providing incentives for industry investment. Federal regulation would be vastly more effective and efficient by overriding the confusing, inconsistent, and unnecessarily expensive state patchwork of laws, and creditor mandates, and non-economic fee caps.

It is also extremely important that creditors make a stronger commitment to customer satisfaction. As previously noted, many consumer complaints about credit counseling are actually the fault of the creditors and beyond the control of the CCA. CCAs and creditors must work together and employ the latest business methods and technological innovations to help the industry exceed consumer expectations.

- Creditors must give full benefits of debt-management plan promptly, including waiver of late fees, within first week of program enrollment.
- CCAs must provide effective, efficient, time flexible counseling sessions.
- Creditors should discontinue collection calls within the first week of program enrollment.

- Creditors must provide timely responses to payment proposals and payment postings.
- Creditors should provide greater availability of creditor representatives.
- CCAs owe consumers unbiased counseling advice.
- Creditors should ensure that credit card statements reflect changes upon debt-management plan enrollment.

## APPENDIX II: CREDITOR AND CONSUMER ISSUES WITH THE DEBT MANAGEMENT PLAN

### *I. KEY PROBLEM AREAS*

**Execution Issues**

- Communication Difficulties. Communicating with creditors can be very difficult because direct representatives cannot always be reached. While messages are left via voicemail, there are many times when the mailboxes are full. Faxes are often submitted, but response time can be three to four days.

- Additional Paperwork Run-Around.

  - Release Letters. A creditor may require that "release" letters be faxed prior to allowing communication with a creditor representative regarding an account; and when these faxes are sent the creditors have rarely or never responded.

  - Retaining Statements. Some creditors are now requiring clients to retain their initial statements, going back as far as four years, in order to assist with accurately calculating payoff amounts. Should a client decide to simply send in payment *on their own* for the full balance owed, and not through the CCA, the client will then be denied the retroactive "credit" of finance charges that they had been working toward all along with the DMP.

- Under-Resourced Credit Counseling Departments. Because many creditors do not have a centralized CCA Department, it is difficult to find consistent and useful help.

- Limited Time to Speak with Creditors. Some creditors will limit, e.g. up to 30 minutes per day, the amount of time they will spend talking with CCAs to resolve consumer problems. For larger CCAs, this limits their ability to resolve DMP enrollment or processing problems.

- Not Providing Adequate Notification. Many creditors often fail to provide agencies and/or processing centers any or timely notification on key matters.

  - New policies. On a few occasions, for example, one large creditor has claimed to have delivered notice of new policies with regard to fair share; but none of the agencies nor the processing center ever received notice. Moreover, the creditor could not provide a copy of the letter upon request. Uninformed policy changes lead to inefficient consumer accounts.

  - Mergers/Acquisitions. The credit card industry has experienced a great deal of merger and acquisition activity in the last decade. Creditors often fail to inform agencies regarding ownership changes and the related transfer of accounts in a

- o timely manner. In addition, creditors may fail to notify the agency's processing center of benefits changes, address changes, and or electronic format changes.

- o Other. One creditor recently advised that they could not disclose information on accounts because of "liquidation." The notice, which was dated June 9, 2003, advised to cease all calls, faxes, and/or proposals on the accounts, effective as of May 25, 2003.

- Inconsistent Feedback. Creditors may provide up to three voices stating differing information to the consumer: Customer Service; CCA; and Collections. These varying messages undermine consumers' trust in agencies and the DMP. Additionally, information taken from consumers by one department is often not passed on to other departments.

- Failing to Share Information. Creditors may fail to verify balances, APRs, last payments or due dates, preferring instead to advise counseling agencies to refer to consumers' statements for such information.

- Inability to Process Electronic Payment. Some creditors use an electronic processing service that has often generated transaction errors, and have difficulty processing electronic payments.

**Anti-DMP Policies**

- No Benefits for Three Months. Some creditors will not provide benefits until the proposal has been accepted and the consumer has made three consecutive payments. This ensures that late fees and over-limit fees will be accrued during the interim.

- Aggressive Dismissal Policies:

  - o No Grace Period. Creditors will often drop consumers for not making payments without offering a grace period.

  - o Pre-payment Penalty. Once a consumer enrolls on a DMP program and the creditor has received payment from DMP, all payments must come through the DMP program. If consumers make extra payments on their own by sending a personal check for additional monies, some creditors will automatically drop them from the program.

- Delicate Billing Cycles. Many creditors have delicate billing cycles and may rescind program benefits and/or charge late fees if a payment falls one day into another billing cycle. Coincidentally, these creditors (except for direct merchants) are all sub-prime lenders or merchant cards that do not offer significant interest rate benefits.

- Proposal Denial Policies. Some creditors permanently deny proposals when they are submitted incomplete or missing the budget worksheet. For example, one large creditor was permanently denying proposals on consumer accounts in which the consumer had two accounts and the proposal had only one budget sheet to serve both accounts. The creditor required budget sheets for each account even though the budget sheets were exactly the same.

- Unnecessary Late Fees. Some creditors apply late fees after having received and cashed payments on time.

- Not Providing CCA Status at Enrollment. Consumers are moved from a delinquency status to a CCA status upon enrollment into a DMP. Some creditors do not apply the change in status until three payments have been made, which can lead to the following problems:

  - Calls from collection agencies. Collectors may call consumers for payments, leading to further consumer anxiety and frustration.

  - Not providing program benefits. Some creditors will not provide the program benefits (i.e., lower interest rates) for the interim three months until CCA status is awarded.

  - Continued Negative Credit Reporting. Some creditors continue to report customers as delinquent on their bills to credit bureaus until they make three consecutive payments on their DMP, even if the payments are made on time.

  - Not stopping late fees. Some creditors will not eliminate late fees for the interim three months until CCA status is awarded.

  - Consumer distrust. Consumers may file claims stating that program benefits are being withheld when, as a result of poor account management, creditors do not accurately list delinquency status or adjust interest rate benefits.

- Removal of CCA Status. Some creditors may remove CCA status for no obvious reason.

- Refusal to Adjust Due Dates. Creditors may refuse to adjust due dates to mitigate the effects of the negotiation period.

- Refusal to Re-age. Some creditors do not re-age accounts for as long as three months upon accepting a proposal. This means the consumer is subject to late fees in the interim. Also, some creditors will not offer lower interest rates until an account is re-aged.

- Inflexible Due Dates. Some creditors will not allow clients to adjust due dates to reflect the new payment dates in a DMP.

- Minimum Payment Requirements. Some creditors require exaggerated general payment and minimum payment requirements that drive up consumers' necessary program payments.

- Detrimental Program Benefits Formula. Creditors often have their own benefits criteria based on internal formulas, which prevent counselors from clearly articulating benefit details to the consumer.

- Irrational Policies. Some creditors require payment before receiving a proposal. This policy is illogical since, without a proposal, the amount of the payment may prove to be insufficient.

- Quotas. Some creditors allow for only a certain number of consumer inquiries.

- Creditor Misrepresentations to Consumers

  - Misrepresent Debt Management Plans. Creditors misrepresent DMPs to consumers, claiming, for example, they are the equivalent to bankruptcy.

  - Coaching Consumers. Creditors and their external collection agencies will encourage consumers, through coaching, to second-guess their decisions to donate to non-profit CCAs administering their DMP. As a result, the consumers falsely claim they have no knowledge of the voluntary nature of the money that they paid.

## *II. LATE PAYMENT ISSUES*

### A. Creditor Issues

- Creditor Execution Issues

  - Failing to Provide Transfer Notifications. Creditor may transfer delinquent accounts to different entities, which can result in confusion over payment remittance addresses and ownership to rights of collection on the account. Payment posting is then delayed due to payment forwarding from one entity to the other.

  - Bulk Check Problem. The agency's payment processing center sends large checks with vouchers detailing consumer accounts to which the payments should be applied. If there is incorrect data (i.e. if a referenced account number or name does not match the creditor's data file) on only one consumer as referenced on the voucher, some creditors reject the entire check, sending it back for correction and reissue, instead of applying the appropriate funds to accounts that reflect correct information and sending notification regarding the non-matching data.

- Consequently, the delay causes mass application of late fees and benefit denials as well as jeopardizes the enrollment status of many consumers in the program.

- Failing to Provide Address Change Notification. Creditors often do not provide notice to agencies or CCA processing centers when they merge or change payment processing center addresses. As a result, payments continue to go to the prior address and timing delays are caused due to forwarding to the correct address or returning to the processing center. Payments are either lost in the shuffle or significantly delayed in being posted to consumer accounts. Consequently, late and over-limit fees are applied and program benefits are jeopardized. Moreover, there have been instances where mergers occur and both creditors give conflicting information about payment addresses and/or data format for proposal and payment remittance.

- Failing to Notify the Change of Account Numbers. Account numbers often change when creditors merge or change data formatting for performance tracking. The creditor may no longer be able to reference the old account number and payments are lost in the shuffle, not applied, returned to the processing center, or applied late.

Creditor Not Accepting Proposal

- Considered Partial Payment. If the creditor does not accept a proposal, a payment may be considered a partial payment. The consumer then has to either accept the adjustment requested by the creditor or make a minimum payment. Moreover, the account may be subject to late fees and interest charges until the creditor receives an "accepted" amount.

Creditor System Issues

- Formatting Issues. If the creditor's payment system is incompatible with RPPS' formatting, mass rejections of proposals and/or payments can occur. Sometimes creditors provide late or inadequate notification of their data format changes to RPPS and other third parties. Consequently, the creditor may reject a proposal due to the perception of faulty or inadequate data, when the real problem is formatting inconsistencies.

- Ill-equipped Technology. RPPS program technology may prompt a transaction return due to its inability to handle certain size data fields. For example, files with long or hyphenated first and last names may be rejected even if the data matches the creditor data. Similarly, Visa Epay program technology "times out," thereby not processing requested data files, and returns all transactions as invalid which causes delays in proposal and payment processing.

- Anti-Consumer Practice

  - Re-aging. Some creditors may not re-age the account until they receive one to three payments. Meanwhile, consumers may be subject to late fees and/or original, higher interest rates.

  - Processing Payments late on Creditor Side. Creditors may post payments late to consumer accounts despite timely delivery of those payments. This has led to some creditors having been subject to class action lawsuits that claim the creditors intentionally post payments late or issue statements late to consumers and are not allowing reasonable timeframe for remittance.

  - Delaying Creditor Notification. The creditor may not provide notification that a proposal contains inaccurate data, which can result in either payments not being applied to appropriate accounts or returned from the creditors.

- Other Issues

  - Privacy Concerns and Resultant Inefficiencies. Due to new privacy regulations, creditors have denied proposals bearing unrecognizable names (perhaps due to a name change stemming from marriage or divorce). This is also a problem with proposals containing more than one applicant. Previously, many creditors processed proposals based on referenced account numbers.

**B. Consumer Issues**

- Consumer Execution Issues

  - Making Late Payments. Consumers' timely enrollment and benefits are jeopardized when the customers make late payments or skip payments to creditors.

  - Not Changing Due Date. The consumer is responsible for notifying a creditor about extending the payment due date. When a consumer fails to do so, the proposal acceptance process can take up to 60 days if the creditor doesn't accept the initial proposal (vs. 20-30 days on average).

  - Failing to Disclose Identity on Payment. When a consumer does not provide adequate reference to the account number, remits payments without specifying to apply those funds to their account, or writes illegibly, their payment is kept on an unknown payments lists and cannot be applied to their account until the consumer contacts the agency to properly identify it.

  - Failing to Provide Accurate Information at Enrollment. Consumer will often provide illegible or wrong account information at the time of enrollment. This leads to proposals with faulty information and may cause a creditor to reject the

proposal. If it is determined that the problem is a keying error, the account becomes inactive and the proposal is re-submitted. If the consumer has provided inaccurate information, they are notified that they need to produce accurate, updated account information, and that future remittance payments will be forwarded to another creditor. Otherwise, if the consumer is not responsive, the creditor remains inactive and does not receive payment.

- Sending Wrong Payment Type. Consumers may make partial payments or Payments via personal, business, starter, or third party checks, which are not allowed. In these cases a consumer's remittance is returned to them causing delays in payment posting and distribution.

- Not Providing Proper Notification. Consumers fail to provide notification of creditor mergers, changes in payment address, or other material information that is crucial to ensuring timely payments.

- Failing to Approve Increase. Consumers fail to approve required payment increases and, as a result, creditors consider future payments as partial payments.

- Failing to Change Due Dates. Enrolling in a DMP requires that consumers change their creditor due dates in order to ensure that that billing cycle allows sufficient time for the processing center to meet payment timeframe criteria. Despite being advised about making due date changes in the consumer welcome package, consumers often fail to so. This can result in the consumer incurring late fees and potentially being dropped from the program. Creditors will not allow third parties to change consumer due dates.

- Bounced Payments. In order to offset the debit, an agency may hold a consumer's payment if the previous one bounced.

- Referencing Out of Date Statements. There are times when a consumer will cite evidence of payments not being made that are, in reality, reflective of previous statements received prior to their current enrollment.

• Inadvertent Issues

- Losing Payment. Sometimes a consumer payment may become lost in the mail and, even though the consumer claims that they've sent it, there is no such record of the payment.

- Random Unavoidable Delays. Holidays may inhibit receipt of payment by the agency or creditor. Minor timing delays such as this can cause major problems with creditors due to particular creditor billing cycles.

**Opening Statement of Bernaldo Dancel**

**Before the Senate Permanent Subcommittee on Investigations**

**March 24, 2004**

**Introduction**

Thank you Mr. Chairman and members of the Subcommittee. My name is Bernie Dancel. I am the Chief Executive Officer and Chairman of Ascend One Corporation—the parent company of Amerix Corporation, 3C Incorporated ("3Ci"), FreedomPoint, and FreedomPoint Financial. I have been involved with credit counseling for nearly a dozen years. I appreciate the opportunity to appear before you today to discuss important issues in the credit counseling industry. Let me say that I think the Committee's inquiry has been a serious one and, at least in the case of our company, one that has stimulated some constructive self-examination.

Mr. Chairman, in my statement today I am going to make two principal points. First, I want to explain why I believe that the title of this hearing, which talks of "profiteering," does not appropriately apply to my company. In the course of doing that, I will discuss many aspects of the credit counseling industry and of my business. Second, recognizing that there is always room for improvement, I want to discuss with you briefly the important new initiatives we have recently undertaken, in no small part as a result of the engagement we have had with the Committee.

**Personal background and credit counseling experience**

At the outset, though, I'd like to say a word about the personal experiences that form the backdrop of my involvement in the credit counseling field. Growing up, I watched my mother—a single parent who was laid off while trying to raise two boys —struggle to keep up with her bills and end up in debt. She didn't know where to turn for help and ultimately filed for bankruptcy. Some years later, at age 23, I found myself divorced, with two children, faced with supporting two households but going deeper and deeper into debt. After two years of struggling to keep my head above water, I ended up filing for bankruptcy, which I still view as one of the worst experiences of my life. I didn't know there were any other options for someone in my situation. I wanted to break the cycle, and I wish I had known about and had ready access to credit counseling then.

I first learned how credit counseling could help people who were financially stressed when I took a job as a counselor with a nonprofit credit counseling agency in Florida. Through my work interacting directly with consumers, I realized that the agency was missing an opportunity to make these valuable services available to many more people.

I believed that there were several key obstacles preventing credit counseling agencies from meeting the growing demand for their services. The vast majority of consumers facing difficult financial situations were not even aware that credit counseling services were available or could be useful. And of the consumers who knew about credit counseling, many were

deterred by the prospect of having to sit down face-to-face with a stranger or, worse yet, a neighbor, to discuss such a personal issue as financial problems. Other consumers simply couldn't afford to take time away from their jobs to attend an appointment during regular 9 to 5 business hours. Finally, the vast majority of credit counseling agencies were relying on outdated processes that made their operations slow and inefficient. In fact, many agencies did not even use computers to process payments to creditors, and the process of initiating a plan and getting help to the consumers frequently took up to six weeks.

Those observations led me to start my own nonprofit credit counseling agency in 1992, which later became Genus Credit Management. I started small, by running an advertisement in a newspaper listing a phone number for people struggling with debt to call. By the time I started Amerix five years later, Genus had served more than two hundred fifty thousand consumers. The numbers of consumers seeking help from Genus proved my theory right: people wanted to be able to address their financial situation with more convenience and privacy over the telephone and to get immediate help.

I founded Amerix because I wanted to extend what we had done with Genus to serve other credit counseling agencies by providing state-of-the-art processing and technology to enable them to meet the growing demand for credit counseling.

**Good service at a fair price**

Now let me turn to the main points I'd like to address today. I must say, first, that the term "profiteering" has no proper application to my company. Of course I do run a for-profit business, but I assume that the Committee does not take the position that it is inherently inappropriate for a for-profit business to provide services to nonprofit organizations. It seems to me that the right questions to ask in examining whether a for-profit business is acting appropriately with regard to nonprofit credit counseling organizations are: (1) does the for-profit company offer a good service; and (2) does it offer that service at a fair and competitive price. I would submit to you that in the case of Amerix and the credit counseling agencies with which we do business, the answer to both of these questions is yes.

**Services.** Amerix offers a valuable array of services to credit counseling agencies. We achieve economies of scale by developing and improving a technology system that we offer to multiple credit counseling agencies. These services include:

- Daily direct debits, electronic disbursements and check remittances
- Automated accounting, reconciliation, and cash management services
- Electronic files for all customer-related documents
- Monthly customer statements
- Automated routing of customer calls
- Negotiating or arranging payment plans through a database of more than 60,000 credit grantors
- Providing ongoing customer service related to account processing
- Requesting and invoicing fair share payments to credit counseling agencies
- Expanding public awareness of the credit counseling agencies' services

Simply put, it is more efficient for nonprofit credit counseling agencies to purchase this bundle of services from Amerix than to invest in the technology necessary to perform these essential tasks themselves. Furthermore, this unique integration of telephony, desktop and software enables our CCA clients to efficiently conduct counseling sessions and gather information critical to assist all callers. Everyone who calls a CCA client benefits from our services regardless whether that individual enrolls in a debt management plan.

**Fair price.** There are three good indicators of the fairness of our price. First, when our largest customer, American Financial Solutions (AFS) acquired a large group of clients from Genus Credit Management, AFS put out a request for proposals to see whether it could find a better price for the set of services we offer—whether packaged together or broken up. No one stepped up with an offer. Second, as the documents we produced to this Committee show, Ascend One operates on a very low profit margin. In 2001 and 2002, our profit margin before taxes was less than 3%; and it was not substantially different in 2003. Nor would it make a material difference to those profit margins if the salaries paid to top executives were substantially reduced or even eliminated. By contrast, comparable service providers in the processing industry had a profit margin well in excess of 10% in 2003.[1/] Third, and most important, the price that we charge to credit counseling agencies allows them to offer their services to consumers for a level of contributions that are as low or lower than many credit counseling agencies that are members of the NFCC or AICCCA, and without having to pass significant up-front costs on to consumers.

**Debt Management Plans.** But what about Debt Management Plans? Is it true that we and the credit counseling agencies we serve have a fundamentally different approach to DMPs than more traditional credit counseling agencies of the kind that are members of the National Foundation for Credit Counseling? No. First, the rate of DMP enrollment for CCAs that operate under our CareOne umbrella—about 3 persons enrolled for every 10 who call—is not much different from the historical rate of enrollment among NFCC or other AICCCA members.

Second—and this is critical—we operate on a pricing model that makes it irrational for us to try to sign people onto DMPs who aren't right for that kind of service. Setting up a DMP for a consumer requires a significant upfront investment, averaging more than $300 per account, in addition to ongoing servicing expenses. We do not charge the CCAs with whom we do business any up-front fee. Our CCA clients do not charge consumers any start-up or initiation fee to enroll in a DMP. That means that we do not recoup our start-up costs until an individual has been making payments on a DMP for a year and a half. So it would be counterproductive for us to try to register people on DMPs who weren't suited for such a program.

By contrast, some CCAs charge consumers large upfront fees, keeping the consumer's entire first monthly payment, or charging a percentage of the consumer's total debt, which typically translates to a fee of $300 or more. Because they recoup their costs on day one, they have no incentive to make sure that the consumer is really suited and qualified for a DMP.

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1/ Source: Edgar Online Pro for Data Processing (SIC 7374).

Thus, where these other CCAs make money on customers even if they immediately drop out of their DMP, we actually lose money on customers who don't stick with their plans for an extended period of time. Our pricing model recognizes that it is in everyone's best interest to limit DMPs to people who can follow the program successfully. It's best for consumers who get real benefits from the plans because they are able to make the payments; it's best for the CCAs because creditors often base fair share payments on whether consumers stick with the plans; and it's best for us because we have an incentive to recoup our upfront investment. In effect, we have become invested in the consumer's success.

**Education and counseling.** But what about education and counseling? Isn't that completely lost in the shuffle in the pell mell rush to sell DMPs? No. The CCAs we serve provide valuable resources to the public, including financial literacy classes, and their websites offer myriad educational and counseling tools, including budget advice, savings exercises, financial calculators, and libraries of articles addressing everything from credit cards to taxes. In addition, we have made our own investment to provide a comprehensive on-line educational library on the CareOne website, which is available to any website visitor whether or not they are a client of a CareOne agency. The wide-ranging resources include a continuously updated database of more than 130 articles on money management and credit awareness, and interactive tools, such as a personalized budget planner and 49 calculators that give individually-tailored answers to financial questions.

I also want to underscore that DMPs themselves can be a very valuable educational tool when they are right for a particular consumer. Indeed, when a DMP is appropriate for a consumer, it is the best kind of financial education and counseling available, with the greatest capacity to actually change a person's behavior for the better. DMPs provide a framework that guides consumers to make monthly payments, exercise financial discipline, and learn by experience how to devise and follow a budget so that they can meet their financial goals. In addition, trained counselors provide ongoing support and valuable advice to consumers if their circumstances change or problems arise. Unlike some CCAs, the CCAs we service provide counseling through the entire life of the DMP and not just for the first few months. And of course, DMPs also provide other concrete benefits to consumers, such as stopping harassing creditor calls and helping consumers rebuild their credit.

**New Initiatives**

Thus, I think we have clearly been conducting our business in a fair and proper manner—offering good services at competitive prices that allow CCAs to offer their services at a very competitive rate. That said, we recognize that we can always do better, and this investigation has played a quite constructive role for our company in helping us define the best ways to do that. I think, frankly, the area where I believe there is particular room for improvement is in seeing the CCAs we serve offer good education and counseling services to *all consumers seeking assistance*, whether they are suitable for a DMP or not. In that spirit, we recently announced a number of new initiatives that should improve the experience of all those who contact an agency we serve.

First, as the owner of the CareOne℠ service mark, 3Ci has announced that it will adopt new, enhanced licensing standards to make sure that consumers working with agencies offering CareOne℠ credit counseling will have access to the highest quality personalized financial counseling and money management education, regardless of whether they choose to enroll in a debt management plan. The expanded CareOne℠ standards require licensed credit counseling agencies to:

- Provide patient personalized financial counseling and education to every client who seeks assistance, including an individualized assessment of the client's financial situation in order to identify and help implement the best alternative to address his or her needs.

- Offer each client an opportunity to receive a personalized budget worksheet, together with budgeting tips, whether or not the client qualifies for or chooses to enroll in a debt management plan.

- Devote at least 1,000 hours per year to community outreach activities that address consumer credit and money management.

- Partner with an educational institution to advance educational offerings and to promote general consumer financial awareness, education, and literacy.

- Serve all clients who seek assistance, regardless of ability to pay, creditors owed, amount owed, or enrollment in a debt management plan.

- Comply with the Code of Practice Standards established by the Association of Independent Consumer Credit Counseling Agencies or the National Foundation for Credit Counseling.

Second, Amerix will require every nonprofit agency with which it does business to adhere to these enhanced standards, even if the agency chooses not to license the CareOne℠ service mark.

Third, as of March 15, 2004, Amerix stopped providing overflow origination services to the only client that was receiving these services, and announced that it will no longer provide these services to any agency going forward. As a result, Amerix will charge no more than 67% of the revenue associated with any new caller who enrolls in a DMP.

Fourth, Amerix has undertaken to assist its credit counseling agency clients in reviewing and revising the scripts that counselors use when assisting callers seeking credit counseling so that the scripts better reflect the individually tailored counseling that all callers receive regardless whether they choose to enroll in a debt management plan.

Fifth, Amerix has undertaken to eliminate from the current service agreements with its credit counseling agency clients certain contractual provisions relating to debt management plan enrollment. These include "assist rates," which relate to enrollment of a specified proportion of

callers in debt management plans, as well as "revenue standards," which relate to average revenue level per account.

Sixth, Ascend One has made a 10-year, $5 million commitment to the Ascend One Fund for Financial Literacy, including $500,000 of immediate funding to launch the foundation's efforts to promote financial literacy, especially among teenagers and young adults who are just entering the credit market and need knowledge and skills to manage their finances responsibly.

**Conclusion**

Mr. Chairman, Ascend One is committed to playing a positive role in the field of credit counseling, so that more and more American consumers can get the help they need, delivered in a fair and straightforward manner.

Thank you, and I look forward to answering your questions.

**WRITTEN STATEMENT OF**
**COMMISSIONER OF INTERNAL REVENUE**
**MARK W. EVERSON**
**BEFORE THE**
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**
**COMMITTEE ON GOVERNMENTAL AFFAIRS**
**UNITED STATES SENATE**
**HEARING ON**
**THE ROLE AND TAX-EXEMPT STATUS OF CERTAIN NOT-FOR-PROFIT**
**CREDIT COUNSELING AGENCIES**
**MARCH 24, 2004**

***Introduction***

Thank you, Mr. Chairman and Ranking Member Levin, for the opportunity to explain the role of the Internal Revenue Service (the Service) in regulating the credit counseling industry. I am pleased you are addressing an area to which the Service is devoting increasing attention and resources. Although many credit counseling organizations continue to provide important educational and charitable services that are fully envisioned by section 501(c)(3) of the Internal Revenue Code, clearly a growing number do not. We are concerned that certain organizations are now preying on those facing financial distress.

I will review our role and the general law relating to charities, the history of tax exemption for credit counseling organizations, recent trends, and our actions to combat what we see as inappropriate activity by some organizations. As you will see, we have aggressively pursued a broad approach that includes efforts to warn consumers of issues in this area, an enhanced examination program, and stricter scrutiny in our application process, as well as partnering efforts with the state attorneys general and the Federal Trade Commission. Let me assure the Subcommittee that the Service will utilize all tools available to it, including the pursuit of criminal charges if appropriate, and the revocation of tax-exempt status.

***Background: The Requirements for Tax Exemption under section 501(c)(3)***

**The role of the Service:** The Service oversees the qualification for federal tax-exempt status of all exempt organizations, including those described in section 501(c)(3) (often referred to as "charities"). Through our compliance programs, we seek to ensure that tax-exempt organizations continue to meet the statutory requirements for exemption.

In general, an organization that wants to be recognized as tax exempt under section 501(c)(3) must apply to the Service for a determination of its status. To do this, the organization files Form 1023, "Application for Recognition of

Exemption Under Section 501(c)(3) of the Internal Revenue Code". Applications often are filed in advance of actual operations and can be based upon representations of what the organization will do in the future. We review the application to determine whether the proposed activities meet the statutory requirements for tax exemption. Those that are approved receive a determination letter that recognizes the organization as tax exempt. With certain exceptions, an exempt organization must annually file Form 990, an information return that provides information on its current activities and details its income and expenditures as well as its current financial status. Forms 1023 and 990 are publicly available documents. In fact, we make Forms 990 filed by section 501(c)(3) organizations available to various web sites to facilitate public scrutiny of charities.

We also use Form 990 as a compliance tool. Our compliance efforts generally include educational contacts, the review of filed returns and, if warranted, an examination of an organization's activities and operations.

To the extent that an organization fails to meet the criteria for exemption, its application for tax exemption will be denied or, if it already is tax exempt, the exemption is subject to revocation. Denials and revocations are based on the particular facts of each case.

**General Requirements for Section 501(c)(3) Exemption:** Section 501(c)(3) provides for the exemption from federal income tax of entities organized and operated for charitable, educational, scientific, religious, and certain other purposes. Relieving the poor and distressed is considered a charitable purpose. Providing instruction and training for the purpose of improving or developing an individual's capabilities, or educating the public on subjects useful to the individual and beneficial to the community also are considered charitable or educational activities. To qualify for section 501(c)(3) status, an organization cannot have a nonexempt purpose that is more than insubstantial.

A section 501(c)(3) organization also must meet other requirements. For today's purposes[1], chief among these are that the organization must not distribute net earnings to insiders (the prohibition against inurement) and it must operate for the benefit of public rather than private interests (the prohibition against private benefit). An organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, for-profit affiliates, or persons controlled directly or indirectly by such private interests.

[1] To date, we have not found that credit counseling organizations have a pattern of violating the section 501(c)(3) restriction against interference in political campaigns or that they have a pattern of engaging in a substantial amount of lobbying.

***History of Tax Exemption for Credit Counseling Organizations***

The Service and the courts have determined that certain credit counseling organizations meet the requirements of section 501(c)(3).[2] In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service held that an organization was charitable where the beneficiaries of its credit counseling services were low-income customers. The organization cited in the ruling had certain favorable factors: a major activity was providing educational information to the general public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications; its counseling services were limited to low-income customers; it provided individual counseling; and the board of directors was representative of the community.

A credit counseling organization may qualify for tax exemption even if it does not limit its clientele to low-income individuals where the services provided are educational. In the 1970's, the courts reversed the Service's revocation of exempt status of two organizations that provided credit counseling without limiting the services to low-income individuals. See Consumer Counseling Service of Alabama v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), and Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979). The rationale was that providing information on the sound use of consumer credit was educational because it instructs the public on subjects useful to the individual and beneficial to the community. In reaching this conclusion, the courts considered several factors. These organizations were primarily involved in educating the general public through classes and seminars. The courts considered the debt management services (payment plan and creditor intercession) an integral part of the organizations' counseling and educational function. Moreover, the debt management services were so minor that, even if not an integral part of the educational services, they were not significant enough to affect the organizations' exempt status. The boards of these organizations were representative of the general public. Finally, the fees charged were nominal and were waived where payment would create a financial hardship.

To recap, to qualify as a section 501(c)(3) credit counseling organization, existing rulings and cases indicate that an organization that provides credit counseling must limit its services to low income customers or, as its primary activity, provide education to the public on how to manage personal finances.

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[2] Credit Counseling organizations can also qualify for tax exemption under section 501(c)(4) as social welfare organizations. See Rev. Rul. 65-299, 1965-2, C.B. 165. Because contributions to section 501(c)(4) organizations are generally not tax deductible and such organizations are not exempted from consumer protection laws, few credit counseling organizations seek section 501(c)(4) status. As a result, we have not seen any significant increase in the number or activity of these organizations, and we have not addressed them in this testimony.

***Recent Trends and Profile of the Industry***

In recent years, the Service has seen an increase in applications for tax-exempt status from organizations intending to provide such services. Among the more recent applicants, we are finding credit counseling organizations that are substantially different from those described in the rulings and court opinions. We are seeing organizations whose principal activity is selling and administering debt management plans. Often the board of directors is not representative of the community and may be related by family or business ties to the for-profit entities that service and market the debt management plans. These newer organizations are supported by fees from customers and "fair share" payments from credit card companies. The fees are high in comparison to the nominal fees considered by the courts in the 1970's. Further, it does not appear that significant counseling or education is provided. As I will discuss, we have modified our application process to deal with this change in circumstances.

In 2002, as we saw an increasing number of allegations of credit counseling abuses, we contacted the Federal Trade Commission (FTC) for assistance in understanding the developments in the industry. Based on the FTC's data and our examinations, it appears that some organizations are operating solely on the internet and are providing debt management and not credit counseling. In many cases, credit counseling services have been replaced by promises to restore favorable credit ratings or to provide commercial debt consolidation services.

We also learned of the favorable treatment accorded to section 501(c)(3) consumer credit organizations under both federal and state law. Section 501(c)(3) organizations often are excluded from coverage under FTC rules, as well as state and local consumer protection laws. This exclusion appears to be one of the primary drivers for the increase in the number of these organizations. For example, the Credit Repair Organization Act of 1997 (15 U.S.C. §1679 et seq.) sought to further regulate the practice of organizations involved in "credit repair," a series of activities aimed at improving a customer's credit history. The statute exempted section 501(c)(3) organizations from the provisions of this law. Many state consumer protection laws provide similar treatment for section 501(c)(3) organizations. In 1993, for example, the California legislature imposed strict standards on credit service organizations and the credit repair industry. The California statute aims to protect the public from unfair or deceptive advertising and business practices. Most significantly, it does not apply to nonprofit organizations that have received a final determination from the Service that they are exempt under section 501(c)(3) and are not private foundations.

Two more recent developments may provide additional incentives for credit counseling organizations to seek 501(c)(3) status. The first is the provision under some proposed bankruptcy legislation requiring credit counseling before filing for bankruptcy. Although the Service takes no position on the merits of the proposal, if it becomes law we expect applications from traditional credit

counselors and the new internet-based agencies to increase. The second development relates to the "Do Not Call" list, with its exemption for charitable solicitations. Again, our purpose is not to opine on the merits of the solicitation exemption other than to note our belief that this additional benefit of exemption may also motivate organizations to seek section 501(c)(3) status. Both of these developments will require even more diligence on our part.

***Actions of the Service***

We are concerned that the potent combination of exemption from income tax and exemption from consumer protection laws may be encouraging persons to seek tax exemption who are motivated by profit rather than by charity. As a result, we have created a comprehensive and multi-faceted strategy to address possible abuses and have established a team to oversee the strategic management of our compliance efforts. Members of the team include individuals from all functions of our Exempt Organizations office, representatives from other Operating Divisions, as well as staff from the Office of Chief Counsel.

**Steps to Warn the Consumer:** We are actively pursuing avenues to warn the public about unscrupulous profiteers who prey on those in financial distress, and to set forth the characteristics of good charitable or educational programs. We have partnered with the FTC, the National Association of State Charity Officials, and other watchdog groups, who have well-established channels for disseminating information to consumers. In News Release 2003-120 and Fact Sheet 2003-117 (both released in October 2003), we informed the public that credit counseling organizations that use questionable practices may seek tax-exempt status to circumvent state and federal consumer protection laws.

We continue to look for ways to reach a broader audience with this important message. Perhaps those of you who follow "Dear Abby" saw my letter published on February 9, 2004 concerning a woman who had written to Dear Abby about her mounting credit card debt. In her response, Dear Abby said the writer should seek help from a credit counseling agency. I took this opportunity to warn the readership about possible fraudulent credit counselors. As we move forward, we will continue to publicize the problems we see to the widest available audience.

**Coordination with Regulators and Industry Representatives:** We are meeting with other regulators, industry representatives, and professional groups as well. We have contacted state enforcement officials from Maryland, California, and New York concerning the issues their states are facing in this area. We are engaged in discussions with the FTC on coordination of our efforts. We also are working with the FTC to set up meetings with banks and credit card companies to better understand the "fair share" payments they make to credit counseling organizations. In this regard, we have already had a productive meeting with one credit card company. We have also met with both of the

industry associations in this area to discuss problematic behavior in the industry and with the United States Bankruptcy Trustees Office on the proposed bankruptcy reform legislation. Other outreach efforts include speaking at credit counseling trade association conventions and the annual meeting of the American Bar Association to inform the industry and its attorneys of potential problems and to open a dialog with industry participants.

**Examinations of High-Risk Organizations:** We are aggressively searching for useful indicators of organizations that place debt management services and credit repair services above educational and charitable objectives. We have over 50 organizations that have been selected for examination. That is a substantial increase from the more than 30 I noted in my November 20, 2003 testimony before the Oversight Subcommittee of the Committee on Ways and Means. We are pursuing an overall examination strategy to ensure our efforts are rapid and have the broadest possible impact. This means we are advancing those cases first that are most important to our overall strategy in this area. We will shortly have about 50 percent of the total revenues of the known filing universe of credit counseling organizations under active examination.

As part of our strategy, we are combining the efforts of our Exempt Organizations, and Small Business/Self Employed agents in a team approach to these audits. Other parts of the Service will be involved as required. We have designated specialists to provide immediate phone or e-mail assistance to examination agents, as well as to provide on-site support when necessary. The examinations focus on specific issues, including whether the organization provides actual counseling; customer demographics; fee structure; who controls and/or contracts with the organization; the flow of money; and whether there is inurement, private benefit, or a substantial nonexempt purpose.

As I mentioned, we are pursuing these cases with vigor and with all the tools available. A typical examination may include an inquiry not only into the books and records of the credit counseling organization but also of any for-profit affiliates or other organizations that are servicing the debt management plans marketed by the nonprofit. In cases in which we see individuals or their relations operating or working for both the credit counseling and for-profit organizations, we will be pursuing the flow of money and questioning the total compensation of these individuals. In addition, we also will question the compensation of insiders of the nonprofit where compensation appears unreasonably high regardless of whether they are benefiting by reason of related for-profits. Thus, individual returns may be part of these examinations as well.

In the area of individuals involved with charities, Congress has given us a valuable tool. In general, under section 4958 of the Internal Revenue Code, persons who receive in excess of reasonable compensation from a charity are subject to a 25-percent excise tax on the excess received. If they do not "correct" this transaction (e.g., through the return of money to the charity), they

are subject to a 200-percent tax on the excess. In addition, a charity's managers may be subject to an excise tax if it is found that they knowingly participated in these transactions.

Upon completion of our examination and to the extent that a credit counseling organization fails to meet the criteria for exemption, we will revoke its tax exempt status. Revocation means that the organization will lose the benefits of exemption and will be subject to tax as a for-profit entity. Revocation will be retroactive as warranted.

We expect to see the first results in these cases this Spring and may propose revocations of tax-exempt status for some of those under examination. As I mentioned earlier, in appropriate circumstances there may be criminal referrals with respect to these organizations or individuals as well.

**Determination Program Safeguards—Stemming the Proliferation of New Organizations:** Our goal is to ensure that new credit counseling organizations meet all requirements before tax-exempt status is approved. All such cases are assigned to staff specially trained in credit counseling and who use a uniform inquiry letter to develop the facts and issues of the case fully and completely. Once the staff has completed work on the application, whether the proposed result is favorable or unfavorable, all applications are subject to special review. All credit counseling organizations are centrally tracked to enable us to determine with accuracy the number and profile of these organizations, and to better manage and ensure consistent quality treatment.

At present, we are actively considering almost 60 applications. We are in the process of finalizing proposed denials in a number of cases and are finalizing the development in several more. Under the privacy rules of the Internal Revenue Code, the public will not know the disposition of any case with respect to a particular applicant unless the application is approved or unless the applicant is denied exemption and challenges us in open court.

To move even more expeditiously, we are in the process of reviewing the current workload to group the cases for efficiency and to reassign cases as necessary. Moreover, we are revising our inquiry letter as we gain more experience in the field.

In the application process, we are seeing organizations that appear to be replicating the practices of existing organizations. A number were filed with boiler plate "fill in the blank" forms. We believe there are individuals whose names are associated with a number of applicants and who may be using these applications to promote a tax shelter or tax fraud. As a result, as we identify these individuals we will refer them to those parts of the Service that investigate tax shelter promoters.

***Conclusion***

As you can see from this discussion, the Service is committed to taking the necessary steps to ensure that organizations that hold themselves out as section 501(c)(3) credit counseling services are complying with all applicable requirements for tax exemption. That means continuing with a vigilant application process, as well as a vigorous examination program. These components, coupled with continued efforts to educate the public about the hallmarks of an acceptable credit counseling program and outreach to other oversight organizations, form a comprehensive strategy to ensure that tax exempt credit counseling organizations do not abuse their tax-exempt status. Americans deserve and will receive our protection.

# IRS Enforcement Priorities

Discourage and deter non-compliance, with emphasis on corrosive activity by corporations, high-income individual taxpayers and other contributors to the tax gap

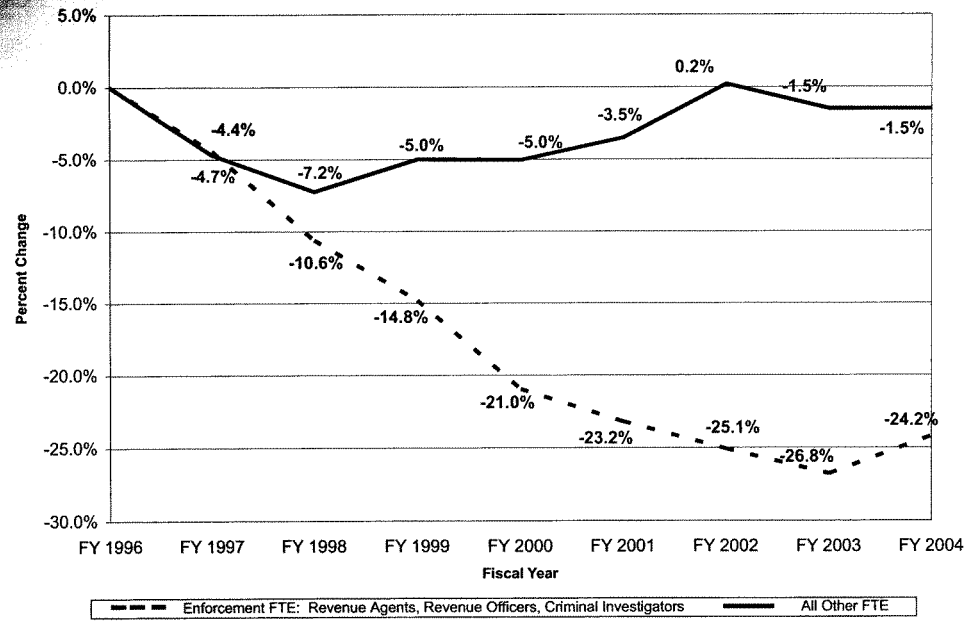
Assure that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law

Detect and deter domestic and off-shore based tax and financial criminal activity

Discourage and deter non-compliance within tax-exempt and government entities and misuse of such entities by third parties for tax avoidance or other unintended purposes

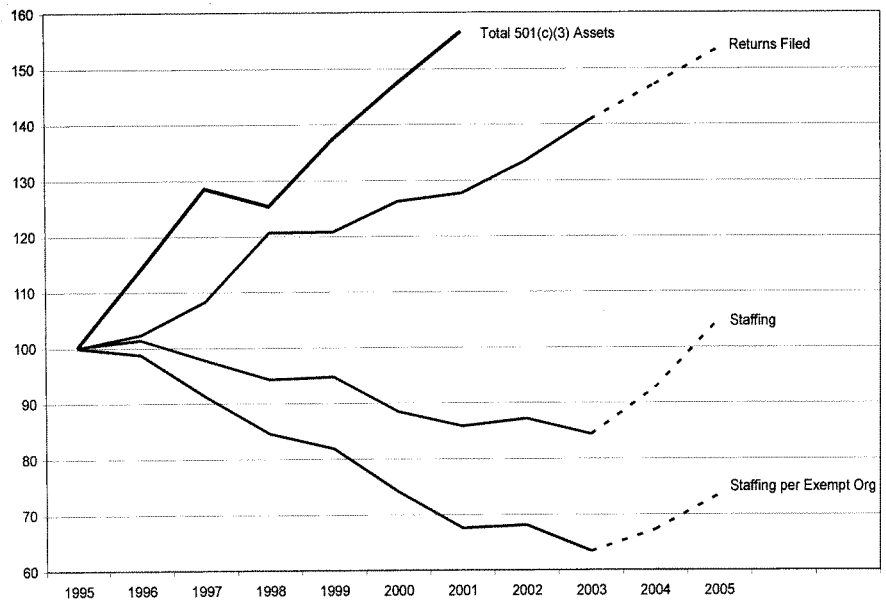
IRS

# Decline in IRS enforcement resources has been halted, but efforts remain below what is needed.



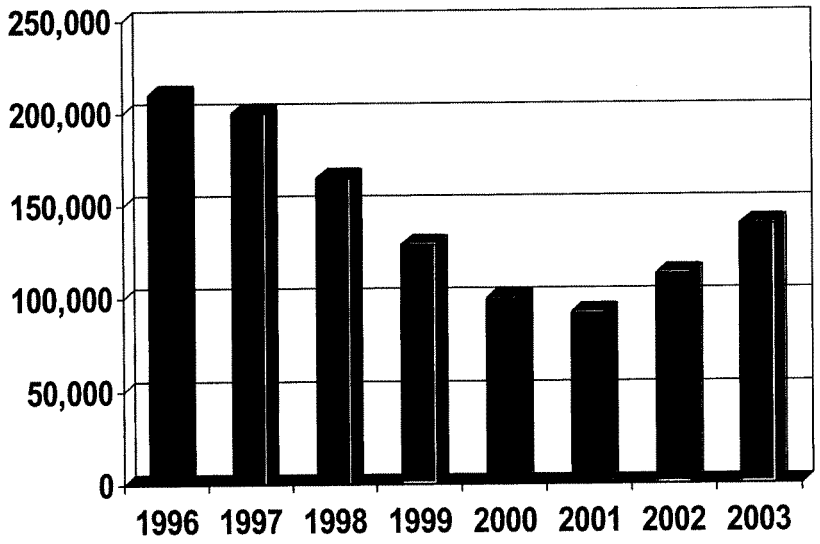

IRS

# Exempt Organizations and IRS Staffing




IRS

# AUDITS OF $100,000 TAXPAYERS ARE ON THE RISE




IRS

**PREPARED STATEMENT OF**

**THE FEDERAL TRADE COMMISSION**

**before the**

**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**
**SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS**

**on**

**Consumer Protection Issues in the Credit Counseling Industry**

**March 24, 2004**

## I. INTRODUCTION

Mister Chairman and members of the Committee: I am Thomas Leary, Commissioner at the Federal Trade Commission ("FTC" or "Commission").[1] I appreciate the opportunity to appear before you today on behalf of the Commission to discuss consumer protection issues raised in the credit counseling industry. This statement will describe the industry generally, discuss various practices by some of its members that raise consumer protection concerns, and summarize FTC law enforcement and educational efforts in this area.

As an initial matter, it is helpful to understand the Commission's role in enforcing laws that bear on the credit counseling industry. As part of its broad mandate to protect consumers, the Commission enforces the Federal Trade Commission Act ("FTC Act"), which prohibits unfair or deceptive acts or practices that are in or affect commerce.[2] The Commission also enforces a number of specific consumer protection statutes, including several relevant to credit counseling, such as the Telemarketing and Consumer Fraud and Abuse Prevention Act,[3] the Credit Repair Organizations Act,[4] and the Gramm-Leach-Bliley Act.[5]

Under its general consumer protection authority, the Commission focuses its resources on a variety of matters of importance to consumers. In addition to examining the significant consumer protection concerns raised by credit counseling services, the subject of today's hearing, the Commission's recent efforts have included:

- **Launching "Do Not Call."** In January 2003, the Commission adopted an amendment to its Telemarketing Sales Rule establishing the National Do Not Call Registry. Within 72 hours after the FTC opened the Registry, consumers had enrolled over 10 million telephone numbers. By its effective date in October 2003, the Registry contained over 53 million telephone numbers and now tops 58 million numbers. A recent Harris Poll found the Registry to be remarkably successful, with over 90 percent of participating consumers reporting a reduction in telemarketing calls.

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[1]The views expressed in this statement represent the views of the Commission. My oral statement and responses to questions you may have are my own and do not necessarily reflect the Commission's views or the views of any individual Commissioner.

[2]15 U.S.C. § 45(a).

[3]15 U.S.C. § 6101-6108.

[4]15 U.S.C. § 1679 *et seq.*

[5]15 U.S.C. § 6801 *et seq.*

- **Law Enforcement Against Fraud and Deception.** The FTC targets the most pervasive types of fraud and deception for law enforcement actions. During the past twelve months, the FTC has filed law enforcement actions targeting work-at-home schemes, Internet scams, online auction fraud, deceptive subprime lending practices, advance fee credit scams, and deceptive health, safety, and weight loss claims, among others. During fiscal year 2003, the FTC obtained multiple federal district court orders in these cases, resulting in more than $448 million in consumer redress.

- **Consumer Privacy and Identity Theft.** This year, the agency undertook aggressive enforcement actions to protect consumers' privacy and prevent identity theft and other misuses of personal information. Among other things, the agency targeted deception aimed at eliciting personal information from consumers, deceptive spam, and deceptive claims about the security provided in online transactions. In addition, the FTC is currently in the process of issuing a variety of rules to implement statutes just passed by Congress to address spam, consumer credit, and identity theft.

Among the Commission's top priorities this year in the fraud and deception area was stopping abuses within the credit counseling industry. In this area, it is important to note that the FTC Act excludes from the Commission's authority entities that are not organized to carry on business for their own profit or that of their members.[6] Therefore, the Commission does not have jurisdiction under that Act over credit counseling agencies ("CCAs") that are *bona fide* non-profit organizations.[7] The mere fact that a CCA has received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, however, does not by itself remove the CCA from Commission jurisdiction. The Commission may assert jurisdiction over a CCA with 501(c)(3) status if the CCA in fact carries on business for profit, including by operating for the purpose of distributing profits or other economic benefits to for-profit entities or individuals.[8] Thus, our cases in this area have two prongs: first, we must prove that the credit counseling company is in fact a for-profit entity within the meaning of the FTC Act; and second, we must prove that the company violated consumer protection laws. Because of these two prongs, our cases and investigations in this area are particularly fact-intensive.

In recent months, the FTC has actively used its array of law enforcement and educational tools to address its concerns about credit counseling abuses. Highlights of these efforts, discussed in more detail below, include:

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[6]15 U.S.C. §§ 44 & 45(a).

[7]Most creditors and some state laws require CCAs to be non-profit entities before they can arrange payment plans for consumers.

[8]*See, e.g., Ohio Christian Coll.*, 80 F.T.C. 815, 848-49 (1972).

- **Law Enforcement.** In November 2003, the FTC filed a lawsuit alleging a variety of deceptive practices by AmeriDebt, Inc., one of the nation's largest CCAs, its former service provider (DebtWorks, Inc.), and DebtWorks' owner, Andris Pukke. At the same time, the Commission entered into a settlement with the Ballenger Group, LLC, AmeriDebt's service provider since January 1, 2003, for its role in the deception. In related areas, the Commission has brought two lawsuits against debt negotiators, and numerous cases against credit repair organizations. The Commission is also currently conducting several non-public investigations of additional CCAs, debt negotiators, and related entities.

- **Consumer Education.** The Commission has issued a variety of consumer educational materials so that consumers can spot fraud and deception and take action to avoid it.

- **Coordination with Other Government Agencies.** The Commission is working with the Internal Revenue Service and the states to address concerns in this area. For example, the FTC, IRS, and state regulators recently issued a joint press release highlighting troubling practices within the industry and providing tips for choosing a credit counselor. The FTC has also coordinated its enforcement efforts with the state attorneys general.

As these efforts show, the FTC Act grants the agency considerable authority to pursue abuses within the credit counseling industry and engage in related educational and policy activities. Therefore, we do not have legislative recommendations at this time.

## II. THE CREDIT COUNSELING INDUSTRY

The credit counseling industry has been in existence for about 50 years, providing valuable services to innumerable financially distressed consumers. Typically, the work of CCAs on behalf of their consumer clients is both present and future directed: to help debt-strapped consumers to manage their existing financial problems and to teach them better financial management skills for the future. CCAs historically have been relatively small, community-based non-profit organizations providing consumers with individualized advice and assistance. For these services, most traditional CCAs either charge nothing or solicit modest contributions from clients to help defray their expenses. As explained below, CCAs also can be funded by creditors through so-called "Fair Share" contributions.

CCAs have a number of options to offer their financially-distressed clients, depending on the client's individual circumstances, which range from simple advice and guidance on managing finances to (in extreme cases) advising that consulting a bankruptcy attorney may be the consumer's best option. In addition, CCAs, since the industry's inception, have offered to put certain clients into a payment program commonly termed a "debt management plan" ("DMP"). DMPs allow consumers to pay off their unsecured debts, such as credit card balances, by making

a single, consolidated monthly payment to the CCA, which then disburses those funds to the creditors of debts covered by the DMP. DMPs can also benefit creditors by forestalling consumer bankruptcy. Importantly, traditional CCAs evaluate each client's individual circumstances and needs before deciding whether to enroll that person in a DMP.

When administered properly, DMPs can benefit consumers because some creditors will reduce interest rates and waive certain charges, such as late and over-the-limit fees, for consumers on a plan. Most creditors and some state laws require CCAs to be non-profit entities before they can arrange payment plans for consumers, apparently for the purpose of eliminating the incentive for CCAs to deceive consumers. However, we are concerned that some CCAs may be evading these requirements by setting up non-profit entities that funnel money to for-profit affiliates.

DMPs generate revenue for CCAs in two ways. First, some creditors voluntarily rebate to CCAs a small percentage of the funds that the organizations disburse to them. These payments are called "Fair Share" contributions.[9] Second, some CCAs solicit "contributions" or "donations" from DMP enrollees, usually consisting of up-front and monthly fees. As discussed later, some CCAs appear to have turned these ostensibly voluntary contributions into *de facto* mandatory fees by automatically deducting money from consumers' payments without adequate disclosure.

In the last decade, the credit counseling industry has experienced dramatic growth, attributable in large part to ballooning consumer debt and the resulting demand for credit counseling to prevent default on that debt. The nature of the industry has also changed. Whereas it was once composed mainly of small, local credit counselors, the last decade has seen the rise of large, high-tech organizations that aggressively market their services to consumers via telemarketing, broadcast and print advertising, and the Internet. These organizations, many of which claim non-profit status, represent a new breed in this industry. Many appear to offer little or no individualized credit counseling, but rather urge all of their clients to enroll in a DMP without consideration of their particular financial situations.

## III. CONSUMER PROTECTION ISSUES

Along with these changes in the industry have come complaints about troubling practices, including possible deception about the services offered, poor administration of DMPs, and undisclosed fees associated with DMPs.

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[9]Some creditors are reexamining their Fair Share programs and considering alternate means for providing financial support to CCAs. These alternate means include providing lump sum charitable donations to be used for counseling and education, rather than tying donations to amounts collected in DMPs.

The Commission is concerned about deceptive and other illegal practices in which some CCAs may be engaging. Our greatest concern is deception by CCAs about the nature and costs of the services they offer to consumers. The following practices have come to our attention that may violate the FTC Act or other statutes that we enforce:

- *Misrepresentations about fees or "voluntary contributions."* Some CCAs may charge substantial fees (sometimes denominated as "donations" or "voluntary contributions") that they hide from consumers. For example, some CCAs may automatically retain for themselves certain payments consumers make on their DMPs, unless the consumer affirmatively objects. These CCAs may not adequately disclose this fact.

- *Promising results that cannot be delivered.* Some CCAs appear to be marketing DMPs with promises that they will lower consumers' interest rates, monthly payments, or overall debt by an unrealistic or unattainable amount. Some organizations also appear to be exaggerating the amount of money consumers will save by signing up for a DMP, or are promising falsely to eliminate accurate negative information from consumers' credit reports.[10]

- *Abuse of non-profit status.* As noted above, some unscrupulous CCAs misrepresent that they are non-profit to comply with state laws and creditor guidelines regarding the arrangement of payment plans for consumers. In addition, some CCAs appear to use their 501(c)(3) status to convince consumers to enroll in their DMPs and pay fees or make donations. These CCAs may, for example, claim that consumers' "donations" will be used simply to defray the CCA's expenses. Instead, the bulk of the money may be passed through to individuals or for-profit entities with which the CCAs are closely affiliated. Tax-exempt status also may tend to give these fraudulent CCAs a veneer of respectability by implying that the CCA is serving a charitable or public purpose. Finally, some consumers may believe that a "non-profit" CCA will charge lower fees than a similar for-profit entity.

- *False advertising regarding credit counseling services.* Some CCAs claim to provide advice and education to consumers on handling their finances, when in fact they may merely enroll all clients indiscriminately in DMPs without any actual counseling.

- *Failure to pay creditors in a timely manner or at all.* Some CCAs may fail to pay creditors in a timely fashion or at all. This failure can result in serious consumer harm, such as from late fees that the creditors impose.

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[10]Negative but accurate information cannot be removed from a credit report until the time specified by the Fair Credit Reporting Act has lapsed (generally, seven years after the event occurred). 15 U.S.C. § 1681c.

- *Failure to abide by telemarketing laws.* To the extent CCAs are not *bona fide* non-profit organizations, they should be complying with the FTC's Telemarketing Sales Rule, including the new national Do-Not-Call registry.

- *Gramm-Leach-Bliley ("GLB") Privacy and Safeguards.* The Commission is also concerned that some CCAs may not be complying with the privacy and security requirements of the Gramm-Leach-Bliley Act, which apply to financial institutions such as credit counseling organizations or similar entities that service loans or collect overdue accounts. The GLB Act requires financial institutions to provide privacy and opt-out notices to consumers regarding the use and disclosure of their personal information, and also to implement safeguards that ensure that such information is appropriately protected from unauthorized access. Failure to comply with these requirements could put sensitive information at risk.

## IV. COMMISSION ACTIONS

The Commission has pursued a vigorous program to halt fraud and deception by those who purport to be able to solve consumers' financial difficulties. For example, in November 2003, the FTC filed a lawsuit against Maryland-based AmeriDebt, Inc., which aggressively advertises itself as a non-profit dedicated to assisting consumers with their personal finances.[11] The complaint also names AmeriDebt's former for-profit service provider, DebtWorks, and DebtWorks' owner, Andris Pukke.

According to the complaint, the defendants have engaged in a number of deceptive practices to induce consumers to enter into DMPs. For example, the FTC's complaint alleges that AmeriDebt's promotional materials have misrepresented that consumers enrolling in an AmeriDebt DMP would pay no up-front fees, when in fact the company retains the consumer's entire first payment on the plan (often totaling hundreds of dollars) as a "contribution." The complaint further alleges that the defendants have falsely claimed that AmeriDebt is a non-profit organization. The Commission charges that, despite AmeriDebt's 501(c)(3) status, it in fact operates for the profit of related parties, including Debtworks and Andris Pukke.

In addition, the complaint challenges claims made by defendants that they teach consumers about their finances and how to manage debt, when in fact they merely enroll consumers in DMPs. Finally, the complaint alleges that AmeriDebt failed to send its customers the privacy notices required by the GLB Act.

At the same time it filed its complaint against Ameridebt, the Commission entered into a settlement with the Ballenger Group, LLC, which has serviced AmeriDebt's DMPs since January

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[11] *See* FTC Press Release, *FTC Files Lawsuit Against AmeriDebt* (Nov. 19, 2003), *available at* http://www.ftc.gov/opa/2003/11/ameridebt.htm.

1, 2003.[12] The settlement resolved FTC allegations that Ballenger, which had close ties to the AmeriDebt defendants, contributed to AmeriDebt's deception by repeating some of the misrepresentations in telephone calls with consumers. The settlement contains strong injunctive relief, and requires Ballenger to pay $750,000 in consumer redress.

The Commission has also brought enforcement actions in the related industry of debt negotiation. Unlike CCAs, debt negotiation companies do not offer credit counseling or enroll consumers in DMPs. Rather, they purport to be able to negotiate settlements of consumers' unsecured debts with the creditors. Last month, the Commission filed a lawsuit against two debt negotiation companies, Innovative Systems Technology, Inc. and Debt Resolution Specialists, Inc., and their principals, alleging that the defendants misrepresented that they could "drastically" reduce consumers' debt by negotiating with creditors.[13] The complaint alleges that in fact defendants were unable to negotiate substantial reductions in the amount consumers owed. It also alleges that, as a result of purchasing defendants' debt negotiation services, consumers' credit ratings suffered, their total debt increased, and some consumers even became the target of legal action by creditors.

In addition, in September 2002, the Commission filed a lawsuit against Jubilee Financial Services, a debt negotiation company, alleging, among other things, that Jubilee falsely promised that consumers who enrolled in its program would be able to pay off their debts at a substantially reduced rate; misled consumers about the effects of the program on their credit report; and failed to tell them that, as a result of the program, negative information would likely appear on consumers' reports and stay there for seven years.[14] Instead of extricating themselves from debt, many of Jubilee's victims were left with little alternative but to file for bankruptcy.

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[12] *Id.*

[13] *See* FTC Press Release, *FTC Challenges Bogus Debt Negotiation Service* (Feb. 13, 2004), *available at* http://www.ftc.gov/opa/2004/02/briggsbaker.htm. The Commission also settled with one of the principals. *Id.* The settlement permanently bans the principal from participating in any debt reduction, negotiation, or consolidation business and from misrepresenting any fact material to a consumer's decision to purchase a good or service.

[14] *See* FTC Press Release, *FTC, States Give "No Credit" to Finance-Related Scams in Latest Joint Law Enforcement Sweep* (Sept. 5, 2002), *available at* http://www.ftc.gov/opa/2002/09/opnocredit.htm. The Commission subsequently settled with two principals of the corporate defendants. The settlement, among other things, bans those individuals from advertising, marketing, or providing debt negotiation services. *See* FTC Press Release, *Jubilee Financial Services Defendants Banned from Providing Debt Negotiation Services* (Aug. 29, 2003), *available at* http://www.ftc.gov/opa/2003/08/jubilee.htm.

Over the past several years, the Commission also has prosecuted numerous cases under the Credit Repair Organizations Act ("CROA"),[15] which prohibits fraudulent practices by organizations that promise to improve consumers' credit histories, such as falsely promising to remove accurate credit information from consumers' credit reports. The Commission has successfully conducted several sweeps of entities allegedly violating CROA, including Operation Eraser[16] and Operation New ID-Bad IDea.[17] Most recently, in August 2003, the Commission reached a settlement with one of the largest credit repair organizations in the United States, through which the defendants agreed to pay more than $1.15 million in consumer redress.[18]

The Commission also has engaged in extensive educational efforts to help consumers spot and avoid credit counseling and credit repair scams. Most recently, the Commission, in conjunction with the Internal Revenue Service and state regulators, issued a joint press release regarding CCAs, urging consumers to be cautious and providing tips for choosing a credit counseling organization.[19] The release advises consumers to pay careful attention to what fees the agency charges, the nature of the services it offers, and the terms of the contract. Consumers should also consider using agencies that offer actual counseling and education and do not simply enroll all clients in DMPs.

The IRS announced at the same time its intention to re-examine certain CCAs with 501(c)(3) status to determine whether they are operating in a manner that complies with the laws and regulations governing tax-exempt status. The IRS also stated that in the future it will examine more rigorously CCAs' 501(c)(3) applications. Specifically, the IRS noted that

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[15] 15 U.S.C. § 1679 *et seq.*

[16] *See* FTC Press Release, *Credit Repair? Buyer Beware! FTC, States Announce Crackdown On Scams That Bilk Consumers* (Mar. 5, 1998), *available at* http://www.ftc.gov/opa/1998/03/eraser.htm.

[17] *See* FTC Press Release, *Credit Identity Defendants Settle FTC Charges: Promoting False Identification Numbers to Create a "New Credit Identity" Is Illegal* (Oct. 21, 1999), *available at* http://www.ftc.gov/opa/1999/10/badidea.htm.

[18] *See* FTC Press Release, *Nationwide Credit Repair Operation to Pay More than $1.15 Million in Consumer Redress* (Aug. 11, 2003), *available at* http://www.ftc.gov/opa/2003/08/nationwide.htm.

[19] *See* FTC Press Release, *FTC, IRS, and State Regulators Urge Care When Seeking Help from Credit Counseling Organizations* (Oct. 14, 2003), *available at* http://www.ftc.gov/opa/2003/10/ftcirs.htm.

organizations that place clients on DMPs without significant education and counseling do not qualify for tax-exempt status.[20]

In addition, the Commission recently issued two consumer education brochures, *Knee Deep in Debt*[21] and *Fiscal Fitness: Choosing a Credit Counselor,*[22] which provide advice to consumers about how to handle debt and how to choose a credit counselor. We highlighted these publications when we filed the AmeriDebt case, and over 75,000 copies have been distributed in print and through the Web since that time.

## V. CONCLUSION

The Commission recognizes that credit counseling can provide financially distressed consumers with valuable assistance in managing their money and paying their debts, and that many, if not most, CCAs operate honestly and fairly. The Commission is concerned, however, that some firms may be deceiving consumers about who they are, what they do, and how much they charge. The victims of the deception may find themselves in even more dire financial straits than before. The Commission, acting with our law enforcement partners, will continue to work to protect consumers in this critical area.

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[20]*See* Press Release, *IRS Takes Steps to Ensure Credit Counseling Organizations Comply with Requirements for Tax-Exempt Status* (Oct. 17, 2003), *available at* http://www/irs.gov/newsroom/article?0,,id=114575,00.html.

[21]See http://www.ftc.gov/bcp/conline/pubs/credit/kneedeep.pdf.

[22]See http://www.ftc.gov/bcp/conline/pubs/credit/fiscal.pdf.

*United States Senate*
*PERMANENT SUBCOMMITTEE ON INVESTIGATIONS*
*Committee on Governmental Affairs*

*Norm Coleman, Chairman*
*Carl Levin, Ranking Minority Member*

# PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING

## REPORT

**PREPARED BY THE**

**MAJORITY & MINORITY STAFFS**
**OF THE**
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

**RELEASED IN CONJUNCTION WITH THE**
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS' HEARING**
**ON MARCH 24, 2004**

## TABLE OF CONTENTS


I. INTRODUCTION ..... 1

II. EXECUTIVE SUMMARY ..... 1

III. OVERVIEW OF THE CREDIT COUNSELING INDUSTRY ..... 2

A. History of the Credit Counseling Industry ..... 2
B. Current Law Governing the Credit Counseling Industry ..... 3

IV. AMERIDEBT, AMERIX, CAMBRIDGE COUNSELING: THREE CASE STUDIES ... 6

A. The DebtWorks-Ballenger Group Conglomerate ..... 6
(1) Formation of the DebtWorks-Ballenger Conglomerate ..... 7
(2) Control of the Affiliated Credit Counseling Agencies ..... 9
(3) Private Benefit to the For-Profit Corporations ..... 9
(4) Harm to the Consumers ..... 11
B. The Ascend One-Amerix Conglomerate ..... 12
(1) Formation of the Ascend One-Amerix Conglomerate ..... 12
(2) Control of the Affiliated Credit Counseling Agencies ..... 13
(3) Private Benefit to the For-Profit Corporations ..... 14
(4) Harm to the Consumers ..... 15
C. The Cambridge-Brighton Conglomerate ..... 17
(1) Formation of the Cambridge-Brighton Conglomerate ..... 17
(2) Control of the Affiliated Credit Counseling Agencies ..... 19
(3) Private Benefit to the For-Profit Corporations ..... 20
(4) Harm to the Consumers ..... 22

V. REGULATION AND ENFORCEMENT ..... 23

A. Self-Regulation ..... 23
B. Creditor Standards ..... 24
(1) History of the Creditor-Credit Counseling Agency Relationship ..... 25
(2) Three Creditor Models ..... 27
(3) Using Fair Share Payment Standards to End Abuses ..... 28
C. State Regulation and Enforcement ..... 30
D. Federal Regulation and Enforcement ..... 31
(1) The Internal Revenue Service ..... 31
(2) The Federal Trade Commission ..... 32
(3) Pending Bankruptcy Legislation ..... 33

VI. FINDINGS AND RECOMMENDATIONS ..... 34

## I. INTRODUCTION

Consumer debt has more than doubled in the past ten years.[1] The nation's credit card debt is currently $735 billion -- an average of nearly $7,000 per household.[2] Since 1996, more than one million consumers have filed for bankruptcy each year, with a record 1.66 million new filings in 2003.[3] For the past several decades, consumers in debt regularly turned to the non-profit credit counseling industry for advice and financial education. Consumers who could not afford to make all of their payments often enrolled in a debt management program, which allowed them to consolidate their debts from several credit cards, reduce their monthly payments, and lower their interest rates.

Over the past several years, however, the credit counseling industry has undergone significant changes. Some new entrants have resulted in increasing consumer complaints about excessive fees, non-existent education, poor service, and generally being left in worse debt than when they initiated their debt management program. The Internal Revenue Service has instituted a new program for reviewing the applications of credit counseling agencies for non-profit status and has initiated audits of fifty credit counseling agencies. The Federal Trade Commission and the Attorneys General of Illinois, Maryland, Minnesota, Missouri, and Texas have joined multiple private class actions in suing one aggressive actor, AmeriDebt and its related for-profit entities in venues across the country. Clearly, something is wrong with the credit counseling industry.

With this in mind, the Subcommittee initiated an investigation to determine the state of the credit counseling industry and whether solutions are available to remedy the problems that it is facing. The Subcommittee's investigation has revealed that AmeriDebt is not the only potential "bad actor" in the industry. Indeed, many of AmeriDebt's practices represent a pattern of abuse among several new entrants in the credit counseling industry.

## II. EXECUTIVE SUMMARY

Credit counseling agencies ("CCAs") traditionally relied upon contributions from creditors or small fees from consumers to cover operational costs. The new entrants, however, have developed a completely different business model, using a for-profit model designed so that their non-profit credit counseling agencies generate massive revenues for a for-profit affiliate for advertising, marketing, executive salaries, and any number of other activities other than actual credit counseling. The new model looks to the consumer to provide those revenues.

Many of the "new" non-profit and for-profit companies are organized and operated to generate profits from an otherwise non-profit industry. Evidence of the new entrants' intention to create profits is indicated in several ways by the new entrants, including (1) the manner in which the new entrant was organized, (2) the extent of control exercised by a for-profit entity

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[1] Eileen Powell, *Consumer Debt More Than Doubles in Decade*, The Washington Times, January 6, 2004.
[2] Id.
[3] The American Bankruptcy Institute, available at *http://www.abiworld.org*.

over their non-profit CCA affiliate, and (3) the revenue received by the for-profit entity from the non-profit agency.

When profit motive is injected into a non-profit industry, it should come as no surprise that harm to consumers will follow. Indeed, the primary effect of the for-profit model has been to corrupt the original purpose of the credit counseling industry -- to provide advice, counseling, and education to indebted consumers free of charge or at minimal charge, and place consumers on debt management programs only if they are otherwise unable to pay their debts. Some of the new entrants now practice the reverse -- provide no bona fide education or counseling and place every consumer onto a debt management program at unreasonable or exorbitant charge.

## III. OVERVIEW OF THE CREDIT COUNSELING INDUSTRY

### A. History of the Credit Counseling Industry

The practice known as "credit counseling" was initiated by creditor banks and credit card companies during the mid-1960's in an effort to stem the growing volume of personal bankruptcies. Most, if not all, of the original credit counseling agencies were members of the National Foundation for Credit Counseling ("NFCC").[4] NFCC member agencies were community-based, non-profit organizations that provided a full range of counseling, often in face-to-face meetings. Trained counselors would advise consumers about how to remedy their current financial problems, counsel them on budget planning, and educate them as to how to avoid falling into debt in the future.

From the outset, a popular credit counseling option was the "debt management plan" ("DMP"). In order to initiate a DMP, a consumer would authorize their credit counselor to contact each of the consumer's unsecured creditors -- primarily credit card companies. The counselor would negotiate with each creditor to lower the consumer's monthly payment amount, to lower the interest rate, and to waive any outstanding late fees. All of the consumer's lowered monthly payments were then "consolidated" into a single payment. The consumer would send a single payment to their credit counseling agency, which would then distribute payments to each of the consumer's creditors.

DMPs were prevalent because each party involved -- the consumer, the creditor, and the credit counseling agency -- received a tangible benefit. Consumers got their finances under control and received concessions from their creditors, such as reduced interest rates, waiver of late fees, and forgiveness of overdue payment status. Creditors, rather than taking a total loss from a bankruptcy, received some or all of the debts owed by the consumer. The credit counseling agency, in return for organizing the DMP, would receive "fair share" payments from the creditor to cover their expenses, salaries, and operational costs. The fair share remittance generally amounted to 12-15% of the payments received by the creditor as a result of the DMP. This mutually beneficial system operated seemingly smoothly for several decades. NFCC credit counseling agencies charged nominal fees or requested contributions from consumers in order to cover their operational costs. Such fees or contributions would be used by a credit counseling

[4] For more information on the NFCC, visit the organization's website at *http://www.NFCC.org*.

agency to defray their costs for counseling and initiating and maintaining the DMP. Such fees and contributions were small in comparison to the creditor concessions received by the consumer. Today, the fees charged by the NFCC remain minimal. The average initial fee to set up a DMP with an NFCC agency in 2002 was $23.09 and the average monthly maintenance fee was $14.00.[5]

Growth in consumer credit card debt in the 1990s brought many new and aggressive entrants into the credit counseling industry. Since 1994, 1,215 credit counseling agencies have applied to the IRS for tax exempt status under Section 501(c)(3).[6] Over 810 of these applicants applied during 2000 through 2003.[7] There are currently 872 active tax-exempt credit counseling agencies operating in the United States.[8] Many of these new entrants were not centered around community-based, face-to-face counseling, but rather upon a nationwide, Internet and telephone-based model focused primarily, if not solely, upon DMP enrollment. Many of the new entrants are set up on a for-profit model. The for-profit model is designed to provide the maximum benefit to for-profit corporations, which enter into contracts with non-profit CCAs to siphon off cash from the CCA. A common method used by for-profit entities to collect revenue from the CCA is to set itself up as a "back-office processing company," which would contract to provide data entry and DMP payment processing for the CCA in exchange for processing and other fees. The Subcommittee found that these contracts are often executed by officers or directors of a CCA who have familial ties or close business relationships with the owners of the contracting for-profit entity. The Subcommittee also found that, in many instances, multiple non-profit CCAs would send processing fees to a single for-profit company, which reaped substantial profits.

## B. Current Law Governing the Credit Counseling Industry

Because most states require corporations to be non-profit in order to perform credit counseling services, CCAs are almost exclusively organized as non-profits under 26 U.S.C. § 501(c)(3). A corporation may qualify for tax-exempt status under Section 501(c)(3) if it is organized and operated exclusively for certain aims, such as charitable, religious, scientific, or educational purposes.[9] No part of the corporation's net earnings may inure to the benefit of any individual or any private shareholder in the corporation.[10] The corporation may not be organized or operated for the benefit of any private interests, such as the interests of the creator, the creator's family, any shareholders of the corporation, or any persons controlled directly or indirectly by such private interests.[11] Organizations apply for tax-exempt status with the IRS.[12] IRS Exempt Organizations Determinations Agents review each application and grant or deny tax- exempt status.[13] Once an organization is granted tax-exempt status, they must operate under

[5] NFCC 2002 Member Activity Report, p. 30.
[6] Letter dated 12/18/03 to the Subcommittee from IRS Commissioner Mark Everson, p. 2 ("Everson letter").
[7] Everson letter, p. 2.
[8] Everson letter, p. 2.
[9] 26 U.S.C. § 501(c)(3).
[10] Id.
[11] IRS Publication 557, Tax-Exempt Status for Your Organization (Rev. May 2003), p. 17.
[12] Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) (Rev. September 1998).
[13] Everson letter, p. 6.

the requirements of § 501(c)(3) or risk losing their tax-exempt status. Each year, the tax-exempt organization must file a tax return which details their activities, revenues, and expenses.[14]

Credit counseling organizations have been recognized as proper tax-exempt entities for several decades. In 1969, the IRS affirmed that 501(c)(3) tax-exempt status was properly granted to an "organization [that] provides information to the public on budgeting, buying practices, and the sound use of consumer credit though the use of films, speakers, and publications."[15] The ruling noted that such organizations may enroll debtors in "budget plans" where the debtor makes fixed payments to the organization and the organization disburses payments to each of the debtor's creditors.[16] The budget plan services were to be "provided without charge to the debtor."[17]

In 1979, the U.S. District Court for the District of Columbia decided Consumer Credit Counseling Service of Alabama v. United States[18] which further described what activities could be performed by CCAs in conformity with their tax exempt status. The "principal activities" of the CCAs were to, without charge, "provide (a) information to the general public, through the use of speakers, films, and publications, on the subjects of budgeting, buying practices, and the sound use of consumer credit, and (b) counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families."[19] As an "adjunct" to those principal activities, agencies may enroll debtors in a "debt management program" for a "nominal" fee which "may not exceed the sum of $10.00 per month" and which is "waived ... in instances where its payment would work a financial hardship."[20] Only an "incidental" amount of revenue was realized by the agency through the debt management programs.[21]

A CCA is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.[22] Even if a CCA has many activities which further charitable purposes, exemption may be excluded if the CCA also serves a private interest.[23] The language of § 501(c)(3) specifically prohibits inurement -- no part of a CCA's net earnings may inure to the benefit of any individual or "insider" such as an officer or director. "Inurement" is simply the unjust payment of money from a CCA to an individual.[24] Such payments are unjust if they exceed fair market value or are otherwise unreasonable.[25] "Private benefit" is a much broader concept, and involves benefits to anyone other than the intended recipients of the benefits conferred by the organization's exempt activities.[26] If a CCA is operated in such a

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[14] IRS Publication 557, supra, at p. 8.
[15] Rev. Rul. 69-441, 1969-2 C.B. 115.
[16] Id. at *2-3.
[17] Id. at *3.
[18] No. 78-0081, 1978 U.S. Dist. LEXIS 15942 (D.D.C. Aug. 18, 1978); see also, Credit Counseling Centers of Oklahoma v. United States, No. 78-1958, 1979 U.S. Dist. LEXIS 11741 (D.D.C. June 13, 1979) (same).
[19] Id. at *3.
[20] Id. at *3-4.
[21] Id. at *5.
[22] Private Benefit Under IRC 501(c)(3), Topic H in the 2002 IRS Exempt Organizations Continuing Professional Education Technical Program, p. 135.
[23] Private Benefit Under IRC 501(c)(3), p. 135.
[24] Private Benefit Under IRC 501(c)(3), p. 135.
[25] Private Benefit Under IRC 501(c)(3), p. 138.
[26] Private Benefit Under IRC 501(c)(3), p. 139.

manner that an individual or other entity benefits to a substantial degree, then the CCA is deemed to be operating for a private purpose. That holds true even where the benefit conferred upon the private interest is reasonable and for fair market value.[27] Examples of private benefit include payments to outsiders for goods or services, "steering business to a for-profit company," and excessive compensation paid to employees (not officers or directors, which would be inurement).[28]

Tax-exempt CCAs face harsh penalties from the IRS if they fail to confine their activities exclusively to educational and charitable purposes. If a CCA is held to have conferred private benefits or to have violated the prohibition on inurement, its tax-exempt status is subject to revocation. In lieu of having its exemption revoked, the IRS may instead choose to impose "intermediate sanctions" against the CCA. Intermediate sanctions may also be imposed upon certain individuals who are not employed by the CCA that have engaged in an "excess benefit transaction" with the CCA. An excess benefit transaction is any transaction where a CCA provides an economic benefit to a "disqualified person" that has a greater value than the value of goods or services that the CCA receives from the disqualified person.[29] Therefore, where an individual outside the CCA has substantial influence over the affairs of the CCA and engages in an excess benefit transaction with that CCA, the individual is subject to sanctions. The sanction imposed upon such an individual is an excise tax equal to 25% of the excess benefit.[30] Further, if the individual fails to correct the harm caused by the excess benefit transaction within the taxable period, a tax equal to 200% of the excess benefit will be assessed against the individual.[31]

In addition to the serious tax consequences that could be assessed against CCAs and their affiliated for-profit entities, consumer protection laws provide additional protection against improper conduct in the credit counseling industry. The Federal Trade Commission ("FTC") is charged with enforcing Section 5(a) of the FTC Act, which prohibits unfair and deceptive acts or practices in or affecting commerce.[32] Although the FTC generally lacks jurisdiction to enforce consumer protection laws against bona fide non-profits, they may assert jurisdiction over a CCA if it demonstrates that the CCA is "organized to carry on business for its own profit or that of its members," where it is a "mere instrumentality" of a for-profit entity, or if it operates through a "common enterprise" with one or more for-profit entities.[33]

The Subcommittee has uncovered alarming abuses by three CCAs and their affiliates, as described in the following section.

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[27] est of Hawaii v. Commissioner, 71 T.C. 1067 (1979) ("Nor can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, International and EST, Inc., benefited substantially from the operation of petitioner."); Church by Mail v. Commissioner, 765 F. 2d 1387 (9th Cir. 1985).

[28] Private Benefit Under IRC 501(c)(3), p. 139.

[29] 26 U.S.C. § 4958(c)(1)(A). A "disqualified person" is someone who, at any time during the five years preceding an excess benefit transaction, was "in a position to exercise substantial influence over the affairs of the organization."

[30] 26 U.S.C. § 4958(a)(1).

[31] 26 U.S.C. § 4958(b).

[32] 15 U.S.C. § 45(a).

[33] 15 U.S.C. § 44; Sunshine Art Studios, Inc. v. FTC, 481 F.2d 1171 (1st Cir. 1973); Delaware Watch Co. v. FTC, 332 F.2d 745 (2d Cir. 1964).

## IV. AMERIDEBT, AMERIX, CAMBRIDGE COUNSELING: THREE CASE STUDIES

As noted above, the "traditional" CCA model has been in operation for several decades. This model was generally a community-based, modest operation with minimal overhead and expenses. There were no large fees, no large executive salaries, high-priced advertising blitzes, or expensive marketing campaigns. Their day-to-day operations were characterized by face-to-face meetings between consumers and credit counselors that last in some cases for several hours. If a consumer enrolled in a DMP, the employees of the CCA would negotiate with the consumer's various creditors, set up the plan, and distribute payments to the creditors until the consumer's debts were paid in full. The traditional CCA did not "outsource" any of its essential functions to for-profit companies, and millions of dollars did not flow through the CCA to for-profit companies.

The characteristics of the "new" CCA model has modified or even reversed the practices of the traditional CCA. The new model is characterized by high consumer fees and lucrative contracts that benefit related for-profit companies. The revenue generated through DMPs is seldom spent on improving or expanding education or counseling, but rather on advertising, marketing, and other activities unrelated to assisting consumers with their financial problems. This Staff Report focuses on the following three major debt management groups: (1) the DebtWorks-Ballenger Group conglomerate, (2) the Ascend One-Amerix conglomerate, and (3) the Cambridge-Brighton conglomerate.

### A. The DebtWorks-Ballenger Group Conglomerate

The first case study examines DebtWorks, Inc. ("DebtWorks"), now known as The Ballenger Group, LLC ("Ballenger"), which provides DMP processing services to eleven non-profit CCAs, including (1) AmeriDebt, Inc., (2) A Better Way Credit Counseling, Inc., (3) CrediCure, (4) Debticated Consumer Counseling, Inc., (5) Debtscape, Inc., (6) DebtServe, Inc., (7) Fairstream, Inc., (8) Mason Credit Counseling, (9) Nexum Credit Counseling, Inc., (10) The Credit Network, Inc., and (11) Visual Credit Counseling. The aggregate consumer debt managed by those

eleven CCAs exceeds $2.5 billion.[34]

### (1) Formation of the DebtWorks-Ballenger Conglomerate

The DebtWorks-Ballenger conglomerate is organized and directed primarily by Andris Pukke and his wife Pamela Pukke. Andris Pukke entered the credit counseling industry by organizing and operating a for-profit CCA in Gaithersburg, Maryland, called Consumer Debt Resources.[35] In 1996, after the State of Maryland ordered Consumer Debt Resources to cease operations because it was a for-profit company, it began to wind down its affairs. At that same time, however, Pamela Pukke was organizing another non-profit CCA -- AmeriDebt, Inc. Pamela Pukke acted as vice president, secretary, and director of the new CCA.[36] Although not listed as an officer or director, Mr. Pukke regularly held himself out to be the president of AmeriDebt.[37]

After operating as a non-profit CCA for approximately three years, AmeriDebt decided to "spin off" its DMP processing function and turn it into a for-profit entity called DebtWorks, Inc., which was wholly owned and controlled by Mr. Pukke.[38] DebtWorks was incorporated on July 21, 1999, purchased the assets of AmeriDebt on September 1, 1999, and signed its first contract with AmeriDebt to provide DMP processing on the same day.[39] AmeriDebt simply moved its DMP enrollment employees to the building next door while the DMP processing function (DebtWorks) remained in AmeriDebt's original office space.[40] AmeriDebt then also opened "branch" DMP enrollment locations in New York and Florida. AmeriDebt was DebtWorks's sole client, but that was soon to change as AmeriDebt officers, directors, and employees fanned out to form multiple CCAs, each of which subsequently contracted with DebtWorks for DMP processing services.

Most or all of the eleven non-profit CCAs in the DebtWorks-Ballenger conglomerate were organized by insiders of AmeriDebt or by friends of Mr. Pukke, including: (1) Edward Catsos, the managing director of AmeriDebt's Florida office, organized DebtServe;[41] (2) Edward's brother, James Catsos, who had served as AmeriDebt's secretary, formed Debticated Consumer Counseling with Mr. Pukke's brother, Eriks;[42] (3) Andrew Smith, who served as interim president for AmeriDebt, formed Fairstream; (4) William Sergeant, an AmeriDebt counseling manager, formed Debtscape;[43] (5) Jeffrey Formulak and Richard Brennan,

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[34] Letter from Ballenger to Subcommittee, dated 11/26/03, at Ex. A.
[35] Subcommittee interview of Ballenger representatives (03/12/04).
[36] Articles of Incorporation dated 12/23/96 (originally named Consumer Counseling Services, Inc.); AmeriDebt Form 1023 dated 03/19/97.
[37] Subcommittee interview of Ballenger representatives (03/12/04).
[38] Articles of Incorporation of DebtWorks, Inc., Bates DWS 001538-1541.
[39] Articles of Incorporation of DebtWorks, Inc., Bates DWS 001538-1541; Asset Purchase Agreement between AmeriDebt and DebtWorks dated 09/01/99, Bates DWS 001526-1535; Fulfillment Agreement between AmeriDebt and DebtWorks dated 09/01/99, Bates DWS ******. AmeriDebt has made a dubious assertion that a "disinterested board" at AmeriDebt chose DebtWorks to be AmeriDebt's DMP processor after reviewing several bids from other entities. Subcommittee interview of AmeriDebt representative (02/27/04).
[40] Subcommittee interview of AmeriDebt representative (02/27/04).
[41] Subcommittee interview of AmeriDebt representative (02/27/04).
[42] Subcommittee interview of AmeriDebt representative (02/27/04).
[43] Subcommittee interview of AmeriDebt representative (02/27/04); AmeriDebt 1998 Form 990, p. 7.

respectively vice president and general counsel of AmeriDebt, formed CrediCure, and;[44] (6) Harold Patrie, an AmeriDebt counseling manager, formed The Credit Network.[45] Matthew Case, the current chief operating officer of AmeriDebt and long time family friend of Mr. Pukke, acted as president of The Credit Network prior to his employment with AmeriDebt.[46] This proliferation of CCAs served both the interests of DebtWorks and the various former AmeriDebt employees. DebtWorks was affiliated with a larger number of CCAs that could capture a larger market share of the DMP enrollment business, while the former AmeriDebt employees apparently paid themselves higher salaries from their CCAs than they received at AmeriDebt.[47]

The Subcommittee investigation uncovered significant evidence that these CCAs formed a common enterprise. Spirer & Goldberg, P.C., a law firm with a long-time relationship with Mr. Pukke, filed the 501(c)(3) applications for almost every CCA in the current conglomerate, including AmeriDebt, A Better Way, Mason, Nexum, Visual, Credit Network, and Debticated. Moreover, in its Form 1023 application to the IRS, Mason listed its billing address at 12850 Middle Brook Road in Germantown, Maryland -- the address of DebtWorks. In addition, some of these CCAs, such as Debticated, signed a contract with DebtWorks before it was even granted non-profit status.[48] At least two CCAs – A Better Way and Visual Credit Counseling – received "start-up" loans from Infinity Resources Group, Inc. ("Infinity Resources"), a private lending institution wholly owned and operated by Mr. Pukke.[49] None of the Form 1023 applications filed with the IRS by the new CCAs mentioned the fact that the applicant CCA intended to contract with DebtWorks for processing services, although each such CCA did.

At the end of 2002, Mr. Pukke formed Ballenger for the purpose of purchasing the DMP accounts and other business assets of DebtWorks.[50] The DebtWorks managers and Pukke executed a management buyout for over $43 million, financed with cash and a promissory note. Ballenger still owes Mr. Pukke and DebtWorks more than $37 million on the promissory note.[51] Since the DebtWorks-Ballenger transaction, Ballenger has continued the practice of assisting with the organization of CCAs. For example, both Debtserve and Fairstream received start-up capital of $250,000 by way of a loan, which Ballenger signed onto as a secondary guarantor.[52] In addition, both Debtserve and Fairstream were extended a functional line of credit by Ballenger for remittance of initial payments that otherwise would have been due to Ballenger.[53]

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[44] Subcommittee interviews of AmeriDebt representative (02/27/04) and Ballenger representatives (03/12/04).
[45] AmeriDebt 1998 Form 990, p. 7.
[46] Deed of Lease Agreement for The Credit Network, dated 05/13/99.
[47] For example, Eriks Pukke made approximately $51,000 as an AmeriDebt counseling manager, but makes $85,000 as president of Debticated. AmeriDebt 1997 Form 990, p. 7; Debticated 2002 Form 990, p. 4,
[48] Fulfillment Agreement between Debticated and DebtWorks (08/01/00); Letter from IRS granting 501(c)(3) status to Debticated (08/16/00).
[49] A Better Way 2000 Form 990, indicating loan of $150,000 from Infinity Resources.
[50] Subcommittee interviews of Ballenger representatives (01/15/04, 03/12/04).
[51] Subcommittee interviews of Ballenger representatives (01/15/04, 03/12/04).
[52] Subcommittee interview of Ballenger representatives (03/12/04).
[53] Subcommittee interview of Ballenger representatives (03/12/04).

### (2) Control of the Affiliated Credit Counseling Agencies

DebtWorks exercised control of its affiliated CCAs through certain contracts, termed "Fulfillment Agreements," with each CCA. Basically, the Fulfillment Agreements contracted all functions of the CCAs to DebtWorks except for the actual enrollment of consumers into DMPs: "Debtworks shall perform all fulfillment, back-office, and customer relations services for budget plan clients of [the CCA], with the exception of intake and counseling services."[54] The CCA therefore served as a mere "call center" from which consumers could be enrolled into DMPs. All operations from that point forward were contractually turned over to DebtWorks.

After Mr. Pukke sold the DMP portfolio of DebtWorks to Ballenger, Ballenger added a new term to the Fulfillment Agreements that conferred additional control over the CCAs. Specifically, Ballenger added a term that charged each CCA a standard fee for a new DMP enrollment of $50, and an additional $25 per month for each active DMP.[55] However, if the CCA could not for some reason obtain the standard fee from the consumer, Ballenger required a minimum $20 start-up fee and a minimum $10 monthly fee for each DMP. As a result, each CCA was contractually required to pay Ballenger for each DMP that it initiated and maintained. Each CCA was therefore required to generate income from its consumers or be considered in breach, regardless of the fact that all income generated from consumers are supposedly "voluntary" contributions. In sum, Ballenger is dictating to a non-profit CCA that the CCA must pay it for DMP enrollment and maintenance, even if the new DMP is generating no revenue for the CCA.

### (3) Private Benefit to the For-Profit Corporations

DebtWorks reported gross revenues of $2,160,100 in 1999, $15,411,072 in 2000, $38,066,044 in 2001, and $53,117,661 in 2002.[56] These figures document a 2359% increase in gross revenues during this time period. In all, between 1999 and 2002, DebtWorks obtained nearly $109 million in gross revenues from their "non-profit" CCA affiliates. Even if those revenues were realized by DebtWorks through arms-length transactions at fair market value, the evidence suggests that the DebtWorks CCAs are not operating exclusively for exempt purposes, and therefore, may be in violation of tax regulations because they are providing excess benefits to Ballenger.[57] If the revenues received by DebtWorks from their affiliated CCAs were the result of excess benefit transactions, then intermediate sanctions should be considered.[58]

The DebtWorks-Ballenger conglomerate has continued to be lucrative for Ballenger since their acquisition of the DebtWorks DMP portfolio. In 2003, Ballenger realized gross receipts of $37,390,906.[59] Ballenger is owed an additional $10.7 million from affiliated CCAs, most of

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[54] See, e.g., Fulfillment Agreement between DebtWorks and Mason, Inc., 09/06/01.
[55] See, e.g., Fulfillment Agreement between Ballenger and A Better Way dated May 1, 2003, ¶ 4.1.
[56] DebtWorks 1999-2002 Form 1120S, Bates DWS 005411-5510. DebtWorks was unable to provide the Subcommittee with executed tax returns. This data was therefore taken from their draft returns.
[57] Treas. Reg. § 1.501(c)(3)-1(a), see also, Private Benefit Under IRC 501(c)(3), p. 135.
[58] 26 U.S.C. § 4958.
[59] Ballenger Accounts Receivable, Bates 01241.

which are in arrears. All of the revenue received by Ballenger comes from consumers who enroll in DMPs through the "non-profit" CCAs.

Mr. Pukke also continues to profit from Ballenger's CCAs by offering consumers debt consolidation loans through his company Infinity Resources. Several of the current Ballenger CCAs operate a program where they refer consumers to Infinity Resources, which charges a fee to process a consumer's loan application and then profits from the interest earned on the loan itself. For example, Eriks Pukke's CCA -- Debticated -- promotes the Infinity Resources debt consolidation loan as a key component of Debticated's program:

> **Debticated, Inc.** is the **ONLY** company in the country that offers such a unique and beneficial debt consolidation program.
>
> Our "**six month**" program has revolutionized the debt consolidation industry by providing clients with the **benefits associated with working with a non-profit credit counseling company, combined with the opportunity for a complete debt consolidation loan.**
>
> If you successfully complete the [six month] program we will attempt to secure a debt consolidation loan for you. ... **This is the ultimate goal of the program.**[60]

This advertisement indicates that the stated goal of Debticated is not to provide credit counseling, education, or debt management, but rather to refer consumers to a for-profit entity for a loan consolidation. Additionally, Debticated is hardly the "only" CCA that offers debt consolidation loans with Infinity Resources: A Better Way, Credit Network, and AmeriDebt all offer the same service.[61] Mr. Pukke and Infinity have had legal troubles for its treatment of consumers referred to it by AmeriDebt. In addition to several civil lawsuits brought against Infinity Resources, Mr. Pukke pleaded guilty in 1996 to a federal charge of defrauding consumers by falsely promising to broker debt-consolidation loans while pocketing excessive application fees.[62] Nevertheless, between 1999 and 2002, Infinity Resources reported gross revenues of $8,364,488.[63] Referrals by a non-profit CCA to a for-profit entity for debt consolidation loans may not serve any educational or charitable purpose. Such referral activities, if more than insubstantial, will constitute a private benefit to Infinity Resources that is prohibited under the tax code and could lead to the revocation of the 501(c)(3) status of any Ballenger CCA that makes such referrals. If the revenues received by Infinity Resources between 1999 and 2002 were the result of excess benefit transactions, then intermediate sanctions should be considered.[64]

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[60] Debticated promotional materials faxed to a consumer (name withheld) on February 28, 2001 (emphasis in original).

[61] A Better Way Form 1023, Tab D, dated January 20, 2000; Credit Network Form 1023, Tab D, dated September 23, 1999; Caroline E. Mayer, *Easing the Credit Crunch?*, Washington Post, November 4, 2001.

[62] Caroline E. Mayer, *Easing the Credit Crunch?*, Washington Post, November 4, 2001.

[63] Infinity Resources 1999-2002 Form 1120S, Bates DWS 005289-5410. Infinity Resources was unable to provide the Subcommittee with executed tax returns. This data was therefore taken from their draft returns.

[64] 26 U.S.C. § 4958.

### (4) Harm to the Consumers

An example of how the DebtWorks-Ballenger conglomerate treated its clients is illuminating. The Subcommittee interviewed Jolanta Troy, who was a 46-year-old mother of two children, ages eleven and sixteen, when she heard an AmeriDebt radio commercial.[65] Ms. Troy had recently been divorced and began accumulating debt soon thereafter. Her job as a behavior specialist consultant working with mentally ill and behaviorally challenged children did not provide her with enough income to pay her $30,000 in credit card debt and support her children. Ms. Troy contacted AmeriDebt in 2001 and was informed by Vicky, an AmeriDebt "counselor," about the benefits of enrolling in a DMP. Ms. Troy told Vicky that she wanted to think about whether to sign up on a DMP, but soon thereafter received 3 to 4 additional calls from AmeriDebt, pressuring her to enroll.

Ms. Troy agreed to enroll and was told that her first payment would be $783. She was told to rush the payment by Western Union "so that her bills would be paid on time." Vicky told her that she could make a voluntary contribution at a later date when she was more financially stable. Ms. Troy mailed in her $783 payment, but continued to receive calls from creditors. She then called AmeriDebt to inquire about her account and was informed that AmeriDebt had kept her first payment and had sent nothing to her creditors. Ms. Troy requested a refund and was denied, even after complaining to the Better Business Bureau. Ms. Troy then believed her only option was to declare bankruptcy, which she did later that year. Needless to say, she received no counseling or education from AmeriDebt during any of their telephone conversations.

Ms. Troy's experience with AmeriDebt is, unfortunately, all too common. In addition, even if she had remained on AmeriDebt's DMP, the fee she was charged bears no relation to the value of the services that would have been provided to her by AmeriDebt. The initial DMP start-up fee charged by AmeriDebt and the other ten CCAs in the DebtWorks-Ballenger conglomerate is based upon the consumer's aggregate debt, rather than the actual expense of initiating a DMP. Specifically, the consumer is generally asked to make a contribution equaling 3% of their aggregate debt. For example, if a consumer owes a total of $25,000 their initial fee would be $750 (3% of $25,000). In contrast, the start-up fee at the average NFCC member agency for a consumer who owes $25,000 would be $23.09.[66] Furthermore, as in the case of Ms. Troy, consumers are often left with the impression that this initial fee amount will be sent to their creditors, when in fact it is retained by the CCA. Aside from the initial start-up fee, the monthly DMP maintenance fees charged by Ballenger CCAs are based not upon AmeriDebt's actual costs or the value of the service to the consumer, but upon the number of credit cards on the plan -- generally $7 per credit card with a minimum of $20 per month and a maximum of $70 per month.

The profit motive of AmeriDebt is illustrated by the fact that their employees were given incentive bonuses for enrolling consumers in DMPs. The amount of the employee's bonus was based upon the number of consumers the employee enrolled in a DMP, as well as the amount of money collected from initiating the DMP.[67] Such an arrangement creates a clear conflict of

[65] Subcommittee interview with Jolanta Troy (03/15/04).
[66] NFCC 2002 Member Activity Report, p. 30.
[67] Subcommittee interview with former AmeriDebt employee (02/21/04).

interest since the AmeriDebt employee had a direct financial incentive to enroll consumers in DMPs, rather than give advice and counseling to a consumer who is not planning on enrolling in a DMP.

## B. The Ascend One-Amerix Conglomerate

The second case study examines the Ascend One-Amerix conglomerate. Amerix Corporation ("Amerix") provides DMP processing services for five non-profit CCAs: (1) American Financial Solutions ("AFS"); (2) Genesis Financial Management, Inc. ("Genesis"); (3) Consumer Education Services, Inc.; (4) Clarion Credit Management, and; (5) Debt Management Group. The combined consumer debt under the management of these five CCAs exceeds $4.1 billion.[68]

### (1) Formation of the Ascend One-Amerix Conglomerate

Amerix is one of four for-profit companies wholly owned by a holding company called Ascend One Corporation ("Ascend One"), 87% of which is owned by Bernaldo Dancel, the President and CEO of Ascend One.[69] An organizational chart of Ascend One and its affiliates is shown below:

In November 1992, Bernaldo Dancel founded a non-profit CCA called Genus Credit Management ("Genus"). In October 1996, Mr. Dancel split Genus into two parts, dividing the counseling function and DMP portfolio from the processing function. On October 3, 1996, Mr. Dancel incorporated Amerix as a for-profit business to provide DMP processing services for the Genus DMP portfolio. Mr. Dancel severed his management ties to Genus around that same time in order to run Amerix.

Over the next several years, Amerix facilitated the establishment of several CCAs to serve as sources of revenue for Amerix. Amerix approached community colleges and

[68] Amerix Active Clients and Total Debt as of October 2003, Bates AMX 000001.
[69] Stockholders of Ascend One Corporation, Bates AMX 000008.

universities with the express purpose of proposing a "start-up" CCA.[70] In all, between 1998 and 2003, Amerix made presentations to almost thirty colleges and universities.[71] Under normal circumstances, a new CCA is required to apply to the IRS for 501(c)(3) status. The IRS then has the opportunity to review the application of each new CCA and determine whether the applicant qualifies for non-profit status. However, by finding existing 501(c)(3) organizations that could be used to establish CCAs, Amerix facilitated the establishment of new CCAs while bypassing the scrutiny of the IRS associated with applying for new 501(c)(3) status. In this manner, American Financial Solutions ("AFS") was organized under the 501(c)(3) status of the North Seattle Community College Foundation.[72] Other Amerix CCAs such as Clarion Credit Management and Debt Management Group were similarly organized through a pre-existing 501(c)(3) entity that did not perform credit counseling services prior to their relationship with Amerix.[73] This practice effectively side-stepped the IRS's review of these new entrants into the credit counseling industry.

By facilitating the establishment of CCAs, Amerix's actions may demonstrate an intention to privately benefit by generating profits for itself. Ascend One also created additional for-profit corporations, including FreedomPoint, 3C Inc., and FreedomPoint Financial. FreedomPoint markets various specialized products such as "prepaid" credit cards and tax settlement products to consumers carrying significant debt.[74] 3C Inc. owns the "CareOne" service mark under which Amerix's CCAs are marketed to the public. FreedomPoint Financial serves as a mortgage broker and markets mortgage-related products to highly indebted consumers.

Some of the five CCAs in the Ascend One conglomerate refer consumers to FreedomPoint and FreedomPoint Financial. As noted above, a CCA will not be regarded as tax-exempt "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."[75] Referrals by a non-profit CCA to a for-profit entity selling mortgage brokerage services and other products are questionable because a non-profit must serve an educational or charitable purpose. Such referral activities, if more than insubstantial, will constitute a private benefit to Ascend One that is prohibited under the tax code and could lead to the revocation of the 501(c)(3) status of each CCA that makes such referrals.

### (2) Control of the Affiliated Credit Counseling Agencies

Although Amerix does not formally own any of the five CCAs it helped to establish, Amerix exerts control over its associated CCAs through its Service Agreements. The Service Agreements are generally entered into by Amerix and a new CCA as part of the CCA's "start-up" arrangement. One key term in Amerix's Service Agreement is the requirement that the CCA enroll 30% of their callers onto a DMP: "During the Term, [the CCA] agrees to maintain an Assist Rate of not less than 30%" where "Assist Rate" is defined as "the ratio of Client

[70] Subcommittee interview of Amerix representative (01/30/04).
[71] List of colleges, universities, and non-profits presented with start-up opportunity, Bates AMX 001732.
[72] Letter from American Financial Solutions to Subcommittee, dated 11/19/03.
[73] Telephone interview of Clarion Credit Management representative (03/09/04).
[74] Subcommittee interview of Amerix representative (01/30/04).
[75] Treas. Reg. § 1.501(c)(3)-1(c), see also, Private Benefit Under IRC 501(c)(3), p. 135-39.

Commitments to First Time Calls per Counselor per month."[76] That means for every ten calls received by a CCA, at least three must be placed onto a DMP or the CCA is considered in breach of contract. Indeed, Amerix has taken legal action against one of their CCAs -- Genesis Financial Management, Inc. -- for its failure to maintain a 30% "assist rate."[77] Such contractual requirements essentially remove the discretion and judgment of a credit counselor as to which consumers they should enroll on DMPs.

In addition to the "assist rate" requirement, there are additional provisions in the Service Agreements that require each DMP to generate a minimum of $30 each month per DMP, termed the "revenue standard."[78] This requirement means that each CCA is contractually required to find money from some source for each DMP to meet the "revenue standard" in their Service Agreement. Each CCA is therefore required to generate income from the consumers or be considered in breach, regardless of the fact that all income generated from consumers is supposedly "voluntary."

The control granted to Amerix through the "assist rate" and "revenue standard" provisions shows that Amerix's CCAs may be operating for a private, rather than public, purpose. Control of a non-profit by a for-profit is not permitted under the Internal Revenue Code due to the potential for abuse of the non-profit agency by the for-profit corporation. If a CCA "is closely controlled ... by ... a for-profit management company that operates with a great amount of autonomy" then the CCA must establish that the CCA is not organized or operated for the benefit of private interests.[79] This analysis is called the "organizational test" and is usually conducted during the 501(c)(3) application process. Amerix's practice of organizing CCAs through existing 501(c)(3) entities, however, deprived the IRS of the opportunity to determine the extent of control that Amerix will possess over their associated CCAs, when first established.

### (3) Private Benefit to the For-Profit Corporations

On November 1, 2001, Mr. Dancel sold Genus's DMP portfolio to AFS for $17 million. The sale price of the Genus portfolio was based upon what future revenues would be generated by the portfolio from fees and fair share payments over a period of several years.[80] AFS, however, was already under contract to pay Amerix for processing services on all of AFS's DMP accounts. Therefore, AFS paid $17 million to Amerix for the DMP portfolio itself, and since that time has paid Amerix out of the revenues generated by the same portfolio. For example, in fiscal year 2001, AFS paid Amerix more than $70 million in processing fees for servicing their DMP portfolio *and* paid back over $7.4 million of the outstanding loan.[81] Such "double payment" by AFS to Amerix for the same goods and services may constitute an excess benefit

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[76] Service Agreement between Amerix and Genesis Financial Management, Inc. dated 09/09/02, ¶ 14. Amerix's other CCAs are also required to carry an Assist Rate of 30%.

[77] Amerix Corporation v. Genesis Financial Management, Inc., No. 16 Y 181 00463 03, Before the American Arbitration Association, filed on 09/02/03.

[78] See, e.g., Service Agreement between Amerix and AFS dated 10/18/02, ¶ 15.

[79] Private Benefit Under IRC 501(c)(3), p. 136.

[80] Subcommittee interview of AFS representative (01/22/04).

[81] AFS 2001 Form 990.

transaction under the Internal Revenue Code, and could subject Amerix to excise taxes on any excess benefit.[82]

Amerix and Ascend One enjoy great financial benefits under their contracts with the CCAs. Under the terms of Amerix's "Fee Schedule," Amerix is to receive between 50-85% of every dollar that is received from the CCA. If a consumer contacts an Amerix CCA directly and enrolls in a DMP, then Amerix is to receive 50% of all the non-profit's revenue -- enrollment fees, monthly fees, voluntary contributions, and creditor fair share payments -- generated by that DMP in exchange for Amerix's processing services.[83] If the consumer contacts and enrolls with the CCA as a result of a referral from Amerix, Amerix is then entitled to 68% of all revenue generated by the DMP.[84] Finally, if a consumer enrolls in a DMP entirely through the "CareOne" website, then Amerix is entitled to *85%* of all revenue generated by the DMP.[85] Such pricing levels are based not upon the cost of the processing services provided by Amerix, but rather upon the results of lead generation and marketing activities.

The Service Agreements have certainly been lucrative for Amerix. Amerix reported gross revenues of $43,292,677 in 1998, $79,805,084 in 1999, $91,686,853 in 2000, $76,382,167 in 2001, and $95,286,442 in 2002.[86] These figures represent an increase of 120% in gross revenues during this time period. In all, between 1998 and 2002, Amerix received $386,453,223 in gross revenues -- all of which was generated by the "non-profit" credit counseling industry. Even if the amounts above were realized by Amerix through arms-length transactions at fair market value, the evidence suggests that the Amerix CCAs are not operating exclusively for exempt purposes and therefore may be in violation of tax regulations.[87] If the revenues received by Amerix between 1998 and 2002 were the result of excess benefit transactions, then intermediate sanctions may be appropriately assessed against Amerix.[88]

### (4) Harm to the Consumers

Some Amerix CCAs charge excessive DMP fees, as described earlier. On the other hand, at least two Amerix CCAs – AFS and Debt Management Group – have capped their fees as a result of their membership in the Association of Independent Consumer Credit Counseling Agencies. As such, the harm caused to consumers from unreasonable DMP fees is greatly mitigated. Even these Amerix CCAs, however, fail the consumer by neglecting to provide adequate counseling and education.

Through Ascend One's "CareOne" website and through links from each of the Amerix CCA websites, a consumer is permitted to enroll in a DMP without a single contact with a counselor at any of the five CCAs in the Amerix conglomerate. Since a CCA's charitable status

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[82] 26 U.S.C. § 4958.
[83] See, e.g., Service Agreement between Amerix and AFS dated 10/18/02, Schedule B, p. 20.
[84] Id.
[85] Subcommittee interview of Genesis representative (02/24/04). The questionable practice of enrolling on a DMP entirely through the Internet is discussed below.
[86] Amerix/Ascend One 1998-2002 Form 1120S, Bates AMX 001452-1730.
[87] Treas. Reg. § 1.501(c)(3)-1(a); see also, Private Benefit Under IRC 501(c)(3), p. 135.
[88] 26 U.S.C. § 4958.

is largely dependent upon its providing educational services, there is no reasonable reading of IRS regulations or case law that would permit a CCA to enroll a consumer into a DMP without even interacting with a credit counselor.[89] Amerix employs between 30-40 "credit counselors" at its location in Columbia, Maryland. These "counselors" can provide DMP enrollment for Amerix's affiliated CCAs who cannot at that moment provide services to a consumer. For instance, if a consumer on the East Coast telephones AFS (located in Seattle) during the morning hours (before AFS is open for business) the caller is routed to Amerix in Maryland. From there, an Amerix "credit counselor" enrolls the consumer in a DMP. Any CCA that knowingly allows such services to be transferred to a for-profit company may be placing itself in jeopardy of losing their license in states that allow only non-profit agencies to provide credit counseling services. Currently, of Amerix's CCA affiliates, only AFS allows that call transfer to occur. Clarion Credit Management and Consumer Education Services, Inc. have done so in the past, while Debt Management Group and Genesis Financial Management, Inc. have allegedly never allowed such transfers.[90]

Amerix stated that the reason why it approached colleges and universities to pitch CCA "start-up" opportunities was because those organizations could educate consumers about their finances.[91] It does not appear, however, that any Amerix CCAs provide classes to consumers on credit practices or budgeting. Genesis told the Subcommittee that it would like to provide counseling and education, but it is unable to do so due to a lack of funds after making the payments required under their Service Agreement with Amerix.[92]

Consumers who actually enroll in a DMP with AFS are allowed access to a website that has some form of interactive program regarding spending and budgeting.[93] However, AFS does not permit consumers who do not enroll in a DMP to have access to that website even though AFS's non-profit mission is to provide counseling and education to all consumers in need of such help.

AFS told the Subcommittee that, originally, it had high hopes of raising funds for grants and scholarships for students enrolled at North Seattle Community College. On March 18, 2002, shortly after AFS acquired the DMP portfolio of Genus, the CEO of AFS stated that "we're generating more revenue than the foundation ever did. We anticipate giving (North Seattle Community College) in the multimillions of dollars over the next few years" and expected that their next donation would perhaps be in the million-dollar range.[94] Although AFS received gross revenues of $75,165,312 during the following fiscal year, however, it managed to donate only 0.8% of that amount ($581,766) for the college's grants and scholarships.[95] Ironically, two years

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[89] See, e.g., Consumer Credit Counseling Service of Alabama v. United States, No. 78-0081, 1978 U.S. Dist. LEXIS 15942 (D.D.C. Aug. 18, 1978).

[90] Subcommittee interview of Amerix representative (01/30/04). On March 15, 2004, AFS discontinued the "overflow origination" option of its Service Agreement with Amerix.

[91] Subcommittee interview of Amerix representative (01/30/04).

[92] Subcommittee interview of Genesis representative (02/24/04).

[93] Subcommittee interview of AFS representative (01/22/04).

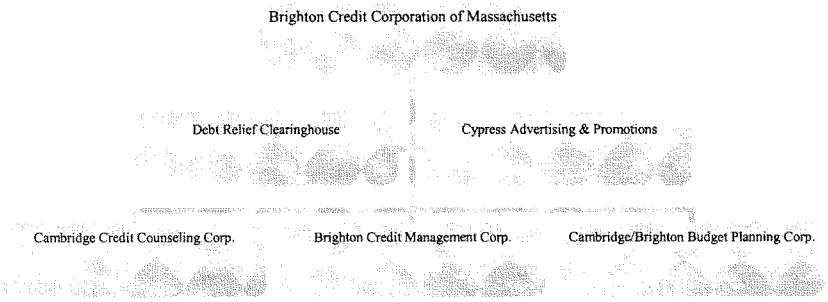
[94] Jeanne Lang Jones, *A strong foundation: $17M purchase makes college's nonprofit arm the largest U.S. credit counseling firm*, Puget Sound Business Journal, March 18, 2002.

[95] AFS 2002 Form 990, pp. 1-2, Bates AFS 01849-01882.

prior to the AFS-Genus transaction, when AFS had total revenues of just $4,180,059, it donated 16% of that amount ($673,306) in grants and scholarships.[96]

## C. The Cambridge-Brighton Conglomerate

The third case study examines the Cambridge-Brighton conglomerate, a complex web of interrelated non-profit and for-profit entities with overlapping directorates and ownership. The operations of the Cambridge-Brighton conglomerate are completely integrated and controlled by brothers John and Richard Puccio. Brighton Debt Management Services, Ltd. ("Brighton DMS") provides DMP processing services to three CCAs: (1) Cambridge Credit Counseling Corp., a non-profit CCA based in Massachusetts; (2) Brighton Credit Management Corp., a for-profit CCA based in Florida; and (3) Cambridge/Brighton Budget Planning Corp., a CCA based in New York with 501(c)(3) status pending. Debt Relief Clearinghouse Ltd. is the for-profit marketing arm for the conglomerate, and Cypress Advertising & Promotions, Inc. provides advertising services.[97] Brighton DMS processes DMP accounts amounting to approximately $900 million of consumer debt.




### (1) Formation of the Cambridge-Brighton Conglomerate

The Cambridge-Brighton conglomerate was originally organized by John and Richard Puccio as a for-profit enterprise. Two entities -- Cambridge Credit Corporation ("Cambridge Credit") and Brighton Credit Corporation ("Brighton Credit") -- were incorporated on April 20, 1993 and October 28, 1993, respectively, as for-profit corporations in New York.[98] The two entities operated out of the same location.[99] Cambridge Credit performed the DMP enrollment function while Brighton Credit performed the DMP processing services.[100] In 1996, after

[96] AFS 2000 Form 990, pp. 1-2.
[97] Subcommittee interview of Cambridge and Brighton DMS representatives (01/20/04).
[98] Cambridge Credit Corporation 1998 Form 1120S, Bates 00297-312; Brighton Credit Corporation 1998 1120S, Bates 00230-243.
[99] Id.
[100] Subcommittee interview of Cambridge and Brighton DMS representatives (01/20/04).

operating for approximately three years, the New York Banking Department served a cease and desist order prohibiting the two entities from performing credit counseling services in New York because they were for-profit organizations.[101]

The Puccio brothers moved their principal operations to Massachusetts where they formed several corporations, including Cambridge Credit Counseling Corp. ("Cambridge") and Brighton Credit Corporation of Massachusetts ("Brighton Mass.").[102] As was the case in New York, one entity -- Cambridge -- was organized to perform the DMP enrollment function while a for-profit entity -- Brighton Mass. -- was organized to perform the DMP processing and to lease equipment, personnel, software, and provide "other services" to Cambridge.[103] Cambridge applied for 501(c)(3) status, which was granted by the IRS on February 12, 1998.[104] In terms of aggregate debt, Cambridge is currently the largest CCA in the Cambridge-Brighton conglomerate. The Puccio brothers, however, have recently organized two additional CCAs.

Despite the cease and desist order from the New York Banking Department, John and Richard Puccio incorporated another New York entity – Cambridge/Brighton Budget Planning Corporation ("Cambridge/Brighton") – on December 6, 1996.[105] Cambridge/Brighton currently operates in the same space previously occupied by Cambridge Credit and Brighton Credit.[106] Like Cambridge, Cambridge/Brighton is under contract with Brighton DMS for all processing services associated with their DMP portfolio. A third CCA was organized as a for-profit corporation in Florida -- Brighton Credit Management Corp. ("Brighton Credit Management"). Like Cambridge and Cambridge/Brighton, Brighton Credit Management outsources all of its DMP processing services to Brighton DMS.

In addition, the Puccio brothers created two other wholly-owned and controlled, for-profit entities that conduct business with the three Cambridge-Brighton CCAs. On July 17, 1996, Cypress Advertising & Promotions, Inc. was created by the Puccios to "procure advertising space/time" for the Cambridge-Brighton CCAs. On January 27, 2000, another for-profit company named Debt Relief Clearinghouse, Ltd. ("Debt Relief") was created by the Puccios to "produce television infomercials" and operate a call center to screen calls for the Cambridge-Brighton CCAs.[107] Both Cypress and Debt Relief operate from the same location as Cambridge/Brighton. Each of the Cambridge-Brighton CCAs pays Debt Relief and Cypress for their services. Therefore, although credit counseling is supposedly a "non-profit" industry, only two entities within the Cambridge-Brighton conglomerate have been organized as non-profits. All of the revenue realized by these entities is generated by consumers who enroll in DMPs.

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[101] Subcommittee interview of Cambridge and Brighton DMS representatives (01/20/04).

[102] Brighton Mass. 1998 Form 1120S, Bates 00423-435 (Brighton DMS, incorporated on March 21, 2003, was originally incorporated and did business as "Brighton Credit Corporation of Massachusetts").

[103] Cambridge 1997 Form 990, p. 16, Bates 00175; Subcommittee interview of Cambridge and Brighton DMS representatives (01/20/04). Brighton DMS was incorporated on March 21, 2003 to perform DMP processing for all Cambridge-Brighton CCAs.

[104] Letter from IRS to Cambridge dated 02/12/98, Bates 00002-4.

[105] Cambridge/Brighton Attachment to Form 1023, Bates 20698.

[106] Cambridge/Brighton 2002 Form 990, Bates 20643-20665.

[107] Debt Relief 2000 Form 1120S, Bates 00333-340; Cambridge/Brighton Attachment to Form 1023, Bates 20701.

### (2) Control of the Affiliated Credit Counseling Agencies

Unlike the Amerix and Ballenger conglomerates that exercise control over their CCAs through the terms of complex service contracts, the principals of Brighton DMS actually own or control each of their three CCAs, Cambridge, Cambridge/Brighton, and Brighton Credit Management, as well as all of the affiliated for-profits entities, Brighton DMS, Debt Relief, Cypress, Cambridge Credit, and Brighton Credit. The Cambridge-Brighton non-profit CCAs (Cambridge and Cambridge/Brighton) are controlled by John and Richard Puccio through their positions as directors, officers, and "key employees." John and Richard Puccio have served as directors of Cambridge since its inception.[108] John Puccio serves as president and director of Cambridge/Brighton, and Richard Puccio serves as "strategic planner."[109] Additionally, the for-profit entities in the Cambridge-Brighton conglomerate are wholly or collectively owned by John and Richard Puccio:

| CAMBRIDGE-BRIGHTON FOR-PROFIT ENTITIES | JOHN PUCCIO (% Ownership) | RICHARD PUCCIO (% Ownership) |
|---|---|---|
| Brighton Credit Management[110] | 100% | 0% |
| Brighton Mass.[111] | 50% | 50% |
| Brighton DMS | 50% | 50% |
| Debt Relief[112] | 100% | 0% |
| Cypress[113] | 100% | 0% |
| Cambridge Credit[114] | 50% | 50% |
| Brighton Credit[115] | 50% | 50% |

Through their joint ownership and control of each entity in the Cambridge-Brighton conglomerate, John and Richard Puccio direct all operations and execute all contracts. Almost every possible operation of Cambridge is contracted out to a related for-profit entity. Cambridge pays Brighton DMS to provide processing for Cambridge's DMP portfolio.[116] Cambridge pays Brighton Mass. to lease its equipment, personnel, and software.[117] Cambridge pays Debt Relief for referrals of consumers[118] and pays Cypress to place advertising.[119] The level of control over the Cambridge-Brighton entities by John and Richard Puccio is illustrated by the fact that some of the entities within the conglomerate conduct millions of dollars of business with one another without any written contract. For example, Brighton Credit Management (the CCA based in

[108] Cambridge Schedule of Officers Directors, Bates 01120-01125.
[109] Cambridge/Brighton 2002 Form 990, p. 4, Bates 20646.
[110] Brighton Credit Management 2002 Form 1120S, Schedule K-1.
[111] Subcommittee interview of Cambridge and Brighton DMS representatives (01/20/04); Brighton Mass. 1998 Form 1120S, Bates 00432.
[112] Debt Relief 2000 Form 1120S, Bates 00339.
[113] Cypress 2000 Form 1120S, Bates 00364.
[114] Cambridge Credit 1998 Form 1120S, Bates 00309.
[115] Brighton Credit 1998 Form 1120S, Bates 00240.
[116] Administrative Services Agreement between Cambridge and Brighton DMS dated 06/0103.
[117] Cambridge 2001 Form 990, p. 19, Bates 00085.
[118] Client Subscription Services Agreement between Cambridge and Debt Relief dated 01/01/03.
[119] Advertising Services Agreement between Cambridge and Cypress dated 04/01/99.

Florida) has no contract with Brighton DMS or Debt Relief, but they have conducted business with one another for almost three years. Such control of CCAs by for-profit organizations, whether under contract or not, may violate the "private benefit" prohibitions of the tax code.[120]

### (3) Private Benefit to the For-Profit Corporations

The for-profit entities in the Cambridge-Brighton conglomerate have realized great private benefits from the Cambridge-Brighton CCAs. These benefits have been realized in two principal ways: (1) the two original New York for-profit entities (Cambridge Credit and Brighton Credit) created and executed a windfall transaction by selling their "intangible assets" to Cambridge, and; (2) the for-profit entities in the current structure (Brighton Credit Corporation of Massachusetts, Debt Relief, Cambridge Credit, Brighton Credit, and Cypress) obtain large amounts of money from Cambridge and Cambridge/Brighton through various service contracts.

When Cambridge was organized in Massachusetts, John and Richard Puccio executed a transaction between Cambridge and their two original New York corporations (Cambridge Credit and Brighton Credit) in which the New York corporations "sold" their "intangible assets" to Cambridge for $14.1 million. These "intangible assets" included "trademarks and goodwill in the marks utilizing 'Cambridge' and 'Brighton' ... copyrights, general business goodwill, business plans, creditor contacts and relationships, referral source contacts and relationships, business 'know-how,' trade secrets and proprietary information."[121] Since Cambridge had no money (being a newly-formed, non-profit organization), the two New York entities "loaned" Cambridge the necessary $14.1 million. John and Richard Puccio created an artificial, "paper" debt that Cambridge would be obligated to pay back to them for the "intangible assets" of Cambridge Credit and Brighton Credit. In effect, John and Richard Puccio sold their "business goodwill" and "know-how" to John and Richard Puccio.

As a result, a non-profit agency (Cambridge) must pay two for-profit corporations (Cambridge Credit and Brighton Credit) $14.1 million plus interest instead of spending that money on improving education, expanding community outreach programs, or any other activity for which it was granted tax-exempt status. Cambridge Credit and Brighton Credit have received repayments on that "loan" over the past several years from revenue realized by Cambridge from DMP fees paid by consumers. Although Cambridge has 50 years under the terms of the "loan" to repay the two New York entities, over $11.5 million has been paid back over the past five years alone. This $14.1 million transfer may constitute an "excess benefit transaction" prohibited by the tax code.[122] Indeed, since Cambridge was arguably created in part for the purpose of generating $14.1 million for two related for-profit corporations, it may be said that it was not organized exclusively for non-profit purposes.[123]

Beyond the revenues generated by the "intangible assets" sale, Cambridge generates substantial additional revenues for the other for-profit entities in the Cambridge-Brighton

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[120] Private Benefit Under IRC 501(c)(3), p. 135-39.
[121] Intangible Assets Sale Agreement between Cambridge, Cambridge Credit, and Brighton Credit dated 11/27/96, Bates 00038-46.
[122] 26 U.S.C. § 4958(c)(1)(A), (f)(1)(A).
[123] Treas. Reg. § 1.501(c)(3)-1(a).

conglomerate. In the Ascend One-Amerix and DebtWorks-Ballenger conglomerates discussed previously, all revenues generated by the CCAs streamed to a single entity. Specifically, in the Ascend One-Amerix conglomerate, all of the revenue from the CCAs streamed to for-profit Amerix, while in the DebtWorks-Ballenger conglomerate all revenues streamed to for-profit DebtWorks/Ballenger. In contrast, the revenue streams are more diversified in the Cambridge-Brighton model. The three CCAs (Cambridge, Cambridge/Brighton, and Brighton Credit Management) distribute their revenues to three or four for-profit entities, all owned and controlled by the Puccio brothers. The bulk of the funds generated by the three CCAs are allocated to Brighton DMS (formerly Brighton Mass.), Debt Relief, and Cypress.

The primary function of for-profit Brighton DMS/Brighton Mass. is to provide DMP processing services, as well as to lease equipment, personnel, software and other goods and services to the Cambridge-Brighton CCAs. While it is not unusual in the credit counseling industry for a CCA to lease equipment, pay for potential leads, or pay for advertising, such payments are usually made as a result of arms-length transactions between unrelated parties at market rates. In the Cambridge-Brighton model, however, the revenues are transferred among related entities.

Since 1998, Brighton Mass./Brighton DMS has realized gross receipts in excess of $40.5 million.[124] Since 2000, for-profit Debt Relief has produced television "infomercials" and operated a call center to screen calls for the Cambridge-Brighton CCAs. Debt Relief is paid $750 for each consumer it transfers to a CCA that enrolls in a DMP.[125] Through 2002, Debt Relief's referrals resulted in gross receipts of over $25 million.[126] Cypress has served as an advertising agency for the Cambridge-Brighton conglomerate since 1999, and has realized gross receipts in excess of $6.5 million.[127]

While purportedly operating non-profit, educational entities, the individuals that own and operate the Cambridge-Brighton conglomerate have grown extremely wealthy from their activities. The IRS Form 990s submitted by Cambridge state that the founders of Cambridge – Richard and John Puccio – had combined salaries in 2001 from Cambridge alone of $1,248,000. That means they each received a salary in 2001 of $624,000 for running a non-profit entity. In addition they received compensation from related organizations of more than $600,000 in that same year. As noted above, IRS rules say that organizations should not qualify as non-profit corporations if they are organized or operated for the benefit of individuals associated with the corporation and if they are not operated exclusively to accomplish charitable or educational purposes.

The IRS has initiated an audit of Cambridge.[128] As part of that audit, the IRS should determine whether the revenues received by Cambridge Credit and Brighton Credit from the sale of their "intangible assets" amount to an excess benefit transaction and to what extent, if any,

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[124] Brighton Mass. 1998-2002 Form 1120S, Bates 00423, 00412, 00400, 00388, 00375.
[125] See, e.g., Client Subscription Services Agreement between Cambridge and Debt Relief dated 01/01/02, at ¶ 4(b).
[126] Debt Relief 2000-2002 Form 1120S, Bates 00333, 00324, 00313.
[127] Cypress 1999-2002 Form 1120S, Bates 00369, 00359, 00350, 00341.
[128] Subcommittee interview of Cambridge and Brighton DMS representatives (01/20/04).

excise taxes should assessed.[129] Additionally, the IRS should determine whether Cambridge was organized or now operates for the a private benefit and whether, if so, its 501(c)(3) status should be revoked.[130] Finally, the IRS should examine the organization and operation of Cambridge/Brighton, whose 501(c)(3) status is currently pending. Since Cambridge/Brighton was designed along the same lines as Cambridge, the IRS should fully scrutinize their application in order to determine whether it is organized and operated for the public benefit and that its assets do not inure to the benefit of any private individual.[131]

### (4) Harm to the Consumers

The Subcommittee interviewed a former client of Cambridge, Mr. Raymond Schuck, to evaluate their services. Mr. Schuck told the Subcommittee that, in the summer of 2001, he was $90,000 in debt distributed among nine credit cards.[132] After hearing about Cambridge on the radio, he called them and spoke with a counselor. The counselor suggested a debt management plan, and promised a reduction in interest rates. After answering a list of questions about his various credit cards, the counselor told Mr. Schuck that his monthly payment would be $1,949 and that Cambridge would charge him 10% of his monthly payment for their services, or $194 a month. Mr. Schuck thought that $194 was high, but knew very little about the industry and assumed that, because Cambridge was a non-profit, he could trust them.

The counselor told Mr. Schuck to hurry and send the first monthly payment to Cambridge to get the program started. He immediately sent in a cashier's check. Although he had already sent in the check to Cambridge, Mr. Schuck started getting calls from some of his creditors asking why he had not made any payments. The creditors told him that they were unaware that he was on a DMP with Cambridge and stated that no payments had been received.

Mr. Schuck called Cambridge to find out what was going on. He found it very difficult to contact someone in customer service who could tell him about his account. When Mr. Schuck did speak with Cambridge, he was informed that the first payment he had sent was a fee for initiating his DMP. He was shocked by this information, and told the Subcommittee that had he known of that in advance, he would have searched for a different credit counseling agency. Mr Schuck said he would never have agreed to give Cambridge almost $2,000 when that money could have gone to his creditors. Ultimately, Mr. Schuck declared bankruptcy. Mr. Schuck felt that if Cambridge had done a reasonable analysis of his financial circumstances, the proper recommendation would have been to seek legal assistance and declare bankruptcy.

The fee structure of the Cambridge-Brighton CCAs is the highest of any CCA that the Subcommittee investigated.[133] The fees are clearly excessive and bear no relation to the actual expense of initiating and maintaining a DMP. The initial start-up fee charged to a consumer --

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[129] 26 U.S.C. § 4958.

[130] Treas. Reg. § 1.501(c)(3)-1(a) ("[A]n organization must be both organized and operated exclusively for [tax exempt] purposes" or "it is not exempt."

[131] Treas. Reg. § 1.501(c)(3)-1(c)(2).

[132] Subcommittee interview with Raymond Schuck (02/24/04).

[133] Unfortunately, Cambridge's fee schedule is not unique in the industry. The Subcommittee's investigation identified several other CCAs who charged an initial fee equal to one month's payment, including Express Consolidation, Inc. of Delray Beach, Florida, and CreditCare Credit Counseling, Inc. of Boca Raton, Florida.

the "Payment Design Fee" -- is typically set in an amount equal to the consumer's monthly payment. The vast majority of monthly payments are several hundred dollars and many are in excess of $1000 or even close to $2000. As such, the Cambridge-Brighton CCAs routinely charge a consumer $500 or $1000 for merely setting up a DMP. Like AmeriDebt and other Ballenger CCAs, the Cambridge-Brighton CCAs retain this fee instead of sending it to creditors. Also like AmeriDebt, the Cambridge-Brighton CCAs often fail to adequately disclose that fact. Like many other consumers who dealt with Cambridge, Mr. Schuck was not informed that his "Payment Design Fee" of $1,949 would not go to his creditors, but would in fact be kept by Cambridge.

The monthly DMP "Program Service Fee" charged by Cambridge-Brighton CCAs was also high. The amount had no relation to Cambridge's actual expenses but was instead set at 10% of the monthly DMP payment. Therefore, a consumer who is already paying an $800 monthly payment would also be required to pay an $80 maintenance fee each and every month. By contrast, the average NFCC agency's monthly DMP maintenance fee in 2002 was $14.00.[134]

The "credit counselors" in the Cambridge-Brighton CCAs are given bonuses for enrolling consumers in DMPs. The amount of the bonus is a function of the amount of start-up fees that the counselor generates each month.[135]

Like the counselors at many other new entrants, Cambridge-Brighton "credit counselors" provide minimal credit counseling. Mr. Schuck told the Subcommittee that he was on the phone with his "counselor" for a mere 20 minutes before he was convinced to mail a cashier's check for $1,949 to initiate his DMP.

## V. REGULATION AND ENFORCEMENT

The credit counseling industry is currently governed by a patchwork of professional, state and federal standards, some of which are mandatory and others which are voluntary. They include standards issued by credit counseling professional associations, guidelines issued by creditors, state statutes, and federal tax and fair trade laws.

### A. Self-Regulation

The credit counseling industry has two major associations, the NFCC and the Association of Independent Consumer Credit Counseling Agencies ("AICCCA"), each of which has issued mandatory membership standards for their members. The NFCC standards, adopted through the Counsel on Accreditation for Children and Family Services ("COA"), are the more restrictive of the two. If applied throughout the industry, the Subcommittee staff believes these professionals standards would go a long way toward addressing the abusive practices identified in this Report. For example, each NFCC member must demonstrate that it:

[134] NFCC 2002 Member Activity Report, p. 30.
[135] Subcommittee interview of former Cambridge employee (02/02/04).

- Allocates a reasonable percentage of operating expenses, to a variety of consumer educational programs on money management, budgeting and the intelligent use of credit.[136]

- Ensures that certified counselors provide a comprehensive one-on-one money management counseling interview with each client.[137]

- Keeps fees as low as possible. Agencies are specifically forbidden from charging excessively large or unconscionable fees. At no time can a person be refused service due to an inability to pay the fee.[138]

AICCCA maintains similar standards as part of the code of practice its members must adhere to. For instance, AICCCA sets a maximum initial fee of $75 for setting up a DMP and a maximum $50 fee for monthly maintenance.

Several CCAs have pointed to their adherence to a standard named ISO 9000 as ensuring that they also adhere to high standards. It is therefore important to understand the difference between these claims and the NFCC and AICCCA requirements. ISO 9000 is a generic set of quality assurance standards that are followed by many large businesses. It is not specific to the credit counseling industry. Pursuit of ISO 900 standards has been helpful as a first step toward improving performance because it requires careful documentation of business procedures. But ISO 9000 does not affect business products or services. For instance, nothing in ISO presumes to tell an entity how much it can charge, who it can do business with, or even what quality of service it should provide.

Self-regulation also has certain limitations. First, although the standards are mandatory on an association's membership, joining the association itself is voluntary. CCAs that wish to operate pursuant to lower business standards or no standards can simply refuse to join. By not having to comply with strict standards, these CCAs may even obtain a competitive advantage over those who adhere to more ethical conduct. Second, it is unclear whether the associations have the resources and mechanisms needed to monitor and consistently enforce compliance with their standards. Weak enforcement reduces the efficacy of even strong standards.

### B. Creditor Standards

A second source of credit counseling standards lies not with the credit counseling agencies themselves, but with the large creditors, such as banks and credit card operating companies, which interact with CCAs on a regular basis. Large creditors often support credit counseling agencies by providing them with a percentage of the payments made by the debtors that the agencies counsel. Often referred to as "fair share payments," these payments are intended to reimburse some CCA costs in exchange for the agencies' positive work in helping debtors repay their debts. Many of the largest creditors have developed standards to determine

[136] NFCC Member Quality Standard #03.00.
[137] NFCC Member Quality Standard #04.00.
[138] NFCC Member Quality Standard #09.00.

which CCAs are eligible to receive fair share payments. If well developed and carefully enforced, the Subcommittee staff believes these standards could also play a major role in reducing abuses and encouraging best practices within the credit counseling industry.

### (1) History of the Creditor-Credit Counseling Agency Relationship

In the late 1950s, credit card issuers played a key role in developing what we refer to today as the credit counseling industry. Originally, they helped establish local offices, known as Consumer Credit Counseling Services ("CCCSs"), that offered face-to-face counseling related to an individual's finances. These counseling sessions were viewed as comparable to other social services available at the time such as substance abuse or family counseling.[139] These CCCSs took a comprehensive approach to treating a consumer's financial instability. Through tools such as debt management plans, referrals to other social agencies (to address other problems associated with the symptoms of the financial stress), and adequate financial education and counseling, these CCCSs nursed debt-ridden consumers back to financial health.

The National Foundation for Credit Counseling ("NFCC")[140] is the parent organization of the CCCSs and historically has worked with creditors to operate and fund these non-profit credit counseling agencies through fair share payments.[141] The purpose of these fair share payments was to provide funding for the non-profit agencies to establish educational programs, implement debt management programs, and assist with operating expenses.[142] This funding afforded CCAs the financial freedom to offer their services to customers without charge or to make payment of a modest fee voluntary. The consumers' voluntary contributions were relatively small amounts and were waived when necessary for hardship cases.[143]

Fair share payments are typically paid by creditors on a monthly basis on the aggregate debtor payments managed by a CCA. Until the mid to late 1990s, this payment was typically 12-15 percent of the aggregated debtor payments. In recent years, as the expense associated with fair share payments increased, at times taking up 25-30 percent of the budgets of the collections departments at major creditors,[144] some creditors have reduced their fair share payments to a lower percentage. In addition, to improve the debt management plans they receive, some creditors have moved to performance-based fair share models. These models link the percentage

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[139] These counseling sessions were traditionally one-on-one meetings in which an educated counselor performed a detailed analysis of an individual's income, expenses, debts, and all other budget requirements. A consumer would often meet with a counselor more than once and for significant lengths of time (over an hour). After a budget analysis, the counselor would make a recommendation for the consumer to readjust their budget, utilize a debt management plan, and seek legal assistance (possibly to declare bankruptcy).

[140] For more information on the NFCC, visit the organization's website at *http://www.NFCC.org*.

[141] The creditors interviewed by the Subcommittee typically viewed fair share payments as a form of voluntary contribution to the non-profit agency, rather than as payment for a contracted service. However, most creditors apparently treat these payments as ordinary business expenses rather than take charitable deductions for them on their tax returns.

[142] Historically, 60% of NFCC funding came from creditors and 40%came from charities. Subcommittee interview of NFCC representatives (01/12/04).

[143] In 2002, the average fee among NFCC members for establishing a debt management plan was $23.09. The average monthly fee was $14.00. Many NFCC members still do not charge the consumer any fee for their services.

[144] Subcommittee interview with Citigroup representatives (03/09/04); Bank One operating expenses spreadsheet, Bates BO 253-254.

of fair share payments each credit counseling agency receives to the success rates of the DMPs that the creditor receives from each CCA.[145]

In addition to their historic funding relationship with non-profit credit counseling agencies, major creditors had traditionally acted in an advisory role for the NFCC through membership on the NFCC's board of directors. The close ties between creditors and NFCC members, however, led to the filing of two legal actions. In 1994, a number of independent CCAs filed an antitrust suit against the NFCC, its member agencies, and the Discover Card. The plaintiffs alleged that the NFCC members and the creditors were operating to prevent new agencies from offering certain credit counseling services. The parties eventually entered into a settlement agreement which, in part, removed the creditors from the NFCC's national board of directors.[146] In 1996, the NFCC entered into an agreement with the FTC to require its members to disclose the fact that they receive payments from the creditors. It is noteworthy that non-NFCC members are not required to disclose this information, even though they receive the same payments.

In the mid-1990s, a new breed of CCA began to enter the market. These credit counseling agencies used more technologically advanced practices to implement their DMPs through innovative software. They also launched heavily funded advertising and marketing campaigns using late night television ads and the Internet. Through these practices, these new entrants to the credit counseling market were able to reach hundreds of thousands of potential clients. The ability to reach and serve a national market changed the industry from a local, storefront, client-specific operation to a nationwide, mass-marketed sale of a product -- the DMP.

As consumer debt reached new heights during the late 1990s and early 2000s, the debt management plan became the method of choice recommended to consumers by many of the new CCAs to resolve their unsecured debt problems. These CCAs used DMPs to generate two streams of revenue, one from creditors providing them with fair share payments, and the second from consumers charged DMP start-up and monthly fees.

Even without agencies aggressively pushing them, the rapid increase in consumer debt over the last decade would likely have produced a sharp increase in the use of DMPs. As fair share payments increased, it should not surprise anyone that creditors began to examine the merits of this growing expense. These inquiries indicated the wrong consumers were being placed on DMPs. For example, consumers who could afford to pay their debts but were looking for a break in interest rates and fees were unnecessarily and incorrectly placed on DMPs. As a result, the creditors heightened the level of scrutiny of the CCAs and their proposed debt management plans. Creditors began issuing more detailed CCA and DMP standards, in effect becoming a regulator of credit counseling practices.

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[145] Common ways to measure success rates are (1) retention rate (the length of time a consumer stays on the DMP), (2) declination rate (the number of proposed DMPs declined by the creditor), and (3) a combination of those two measures as well as other factors.

[146] Individual NFCC members may still have representatives from the local banking community on their board of trustees.

### (2) Three Creditor Models

The Subcommittee interviewed three major creditors to gain an understanding of the competing interests of the industry as well as actions taken by the creditors towards CCAs. These creditors are Bank One Delaware, N.A. ("Bank One"), MBNA America, N.A. ("MBNA"), and Citigroup, Inc. ("Citigroup"). The Subcommittee found that all three issue standards for CCAs seeking fair share payments and that all three have recently revised and tightened their standards to eliminate abusive practices.

#### (a) Bank One

Bank One utilizes a combination of a minimum standards model[147] and a performance-based model. Before Bank One will even consider making fair share payments, an agency must make debtor payments and submit debtor proposals electronically and not be involved in any pending litigation. The agency's business eligibility is then assessed. The following minimum standards must be met:

- Accreditation of the agency[148]
- Certification of counselors
- Fees meet Bank One guidelines
- Marketing budget and content are approved by the CCA's board

Once these criteria are met, Bank One will make a maximum of 9 percent fair share payments to an agency. This maximum is broken into two components. If a CCA meets the business eligibility requirements it will receive 2 percent. The CCA may receive up to an additional 7 percent depending upon the performance of the portfolio.[149] This measures the average fixed payment and the default rate of the agency, both equally weighted to provide a maximum of 3.5 percent in additional fair share payments for each criteria. In addition, the agency must also meet a New Inventory Criteria. This criteria measures whether the agency is continuing to sign up new Bank One card members or just administering old Bank One accounts. New Inventory Criteria requires a growth rate of 0.25 percent.

#### (b) MBNA

MBNA also utilizes a minimum standard model coupled with a performance-based model.[150] MBNA has set minimum requirements that must be met before an agency qualifies for any fair share payments:

- Agency must be accredited.

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[147] A minimum standards model requires that certain minimum criteria be met before any fair share payments will be made to a credit counseling agency.

[148] Industry-accepted accreditation organizations include COA, BSI, BVQI, and ISO 9000 with an accepted "Code of Practice." NFCC and AICCCA have developed a code of best practices for their members which address their operations.

[149] Subcommittee interview of Bank One representatives (02/10/04). New model implemented July 2003.

[150] Subcommittee interview of MBNA representatives on (02/17/03). New model implemented in February 2004.

- Agency must be a non-profit under IRC § 501(c)(3).
- Agency may not be affiliated with any entity that is not a 501(c)(3) agency.[151]
- All debtor payments and proposals must be transmitted electronically.
- A full-budget disclosure must be attached to all proposals.
- No start up fee may exceed $75, no monthly fee may exceed $50, and there can be no termination fees.
- At least 90 percent of the CCA's consumers must have completed a full budget disclosure.
- At least 85 percent of the DMP proposals submitted by the agency must meet MBNA's criteria for establishing a DMP.

Upon meeting these criteria, an agency's portfolio is measured by its payment volume and portfolio vintage. Thus, the older the account, the larger the percentage of fair share available, starting with 2 percent for brand new accounts and rising to 15 percent for accounts that last thirty-six months.

#### (c) Citigroup

Citigroup has recently introduced a form of fair share payments new to the credit counseling industry.[152] Citigroup refers to this method of disbursing fair share payments as a "Grant Program." Under this program, Citigroup will pay CCAs according to their "perception of the agency's needs and the benefits they provide to the customer and the community."[153] With the Citigroup grant program, payments will be made in quarterly advances in a lump sum contribution.[154] The amount of payment will reflect Citigroup's judgment of the value that the CCA is delivering to consumers, based on a twenty-nine question application. The questions in the Citigroup application address many of the same issues utilized by other industry leaders to assess CCAs.

### (3) Using Fair Share Payment Standards to End Abuses

The collective impact on the credit counseling industry of the minimum and performance-based standards issued by major creditors such as Bank One, MBNA and Citigroup could be substantial. Since CCAs depend on fair share payments as a major source of revenue, they are obligated to comply with creditor standards, which means creditors can play a major role in eliminating some of the abusive practices examined in this Report. Standards setting limits on fees, for example, directly attack the problem of CCAs' charging excessive fees unrelated to costs. Standards prohibiting CCAs from affiliating with for-profit entities addresses the core of the profiteering problem. Some of the performance-based requirements encourage debt management plans that set realistic goals for debtors.

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[151] MBNA allows outsourcing only for payment processing.
[152] Subcommittee interview with representatives of Citigroup (02/20/04). New model implemented on January 1, 2004.
[153] Citigroup model letter to CCA dated November 4, 2003, Bates CC 00073-74.
[154] Id.

As with the professional standards set by credit counseling associations, however, the effectiveness of the creditor standards will depend in large part upon the extent to which the creditors monitor compliance and discontinue fair share payments to CCAs that do not comply with the requirements. Creditors informed the Subcommittee that they feel limited in their ability to police the industry, and some expressed a reluctance to condition the concessions they provide to a debtor upon the debtor's choice of a particular agency. Some creditors also worry about appearing to favor some agencies over others, although choosing to do business with some entities and not others is a routine business decision encountered every day in the marketplace.

CCAs are less sanguine about the creditor standards. A common CCA complaint is the absence of uniformity among creditor standards which can translate into higher costs and administrative burdens for agencies.[155] Creditors respond that, while uniformity in criteria for fair share payments may be desirable, current antitrust laws may inhibit creditors from collectively agreeing on common standards. Another common CCA complaint is that creditors retain the right to change their criteria without notice and may apply changes retroactively. CCAs also contend that sudden changes to creditor criteria leave them with little time to respond. This complaint applies not only to the amount of fair share payments the creditor will pay, but also the terms a creditor will offer debtors under a DMP.

CCAs also assert that the ambiguous tone of some policies and an inability to obtain creditor clarification complicates the job of administering plans. For example, Citigroup announced its new Grant Program on November 4, 2003.[156] Some CCAs have complained that the criteria for determining fair share payments under this program are subjective, leaving agencies unsure of how to operate their practices in order to maximize their Citigroup fair share payments. Citigroup also required the CCAs to respond by November 24, 2003, within twenty days of receiving a notice of the change in policy,[157] which CCAs complain left them with little understanding of what to expect from the creditor and an inability to plan for their operating budgets.[158]

At the same time, CCAs concede that creditors have no obligation to make any fair share payments to them. Many smaller creditors, in fact, do not typically provide fair share payments to CCAs. Thus, they recognize that creditors have the right to condition these payments as they see fit. Since having debtors pay their debts is in the best interests of the creditors, and many CCAs provide worthwhile counseling and debt management services that assist debtors in meeting their financial responsibilities, major creditors indicate they are likely to continue making fair share payments. Thus, creditor standards related to fair share payments continue to provide a valuable mechanism for ending abusive practices in the credit counseling industry.

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[155] Subcommittee interviews with NFCC and AICCCA representatives (10/16/03, 10/09/03).
[156] Citigroup model letter to CCA dated November 4, 2003, Bates CC 00073-74.
[157] Id. at Bates CC 00073–74.
[158] A CCA may make a request of Citigroup in advance for their quarterly payment, however it is unknown the weight Citigroup affords any request. Citigroup will pay the CCA according to their perception of its needs and the benefits it provides to its customers and the community. Subcommittee interview of Citigroup representatives (02/20/04).

## C. State Regulation and Enforcement

Although many states have statutes concerning the credit counseling industry, effective regulation at the state level is hampered due to the wide variety of differing state requirements. In addition, many states still lack legislation directly applicable to the credit counseling industry. In these states, general laws against false advertising and fraud provide the only protection for consumers. Other states do have laws that at least partially relate to the credit counseling agency. Many of these, however, were written when the industry generated few complaints, and therefore, most of these laws either limit credit counseling to non-profit agencies or provide non-profits with an exemption from mandatory requirements. This exemption is the primary reason why many of the agencies discussed in this Report applied for 501(c)(3) status. In recent years, a few states, such as Maryland, have passed more comprehensive laws dealing specifically with the debt management industry.

The widespread use of the telephone and Internet for contacting and servicing consumers also inhibits effective state enforcement. Many counseling agencies assert that they do not need to be licensed in a state unless they maintain a physical presence in that state. Under this interpretation, a company located in Maryland could contact and serve consumers in every other state without obtaining separate state licenses or being bound by laws of the states in which its consumers reside. Agencies that attempt to comply with the laws of each state in which they serve consumers are burdened by a mix of different regulations and bonding requirements.

There are currently two attempts to draft model legislation for states to adopt. In February 2004, the National Consumer Law Center and the Consumer Federation of America jointly issued a Model Consumer Debt Management Services Act.[159] In March 2004, the National Conference of Commissioners on Uniform State Laws discussed a draft of the Consumer Debt Counseling Act.[160] Both laws would impose much tighter licensing and business practices on all credit counseling agencies.

In many states, the most significant regulatory action has come from suits filed by the attorneys general of various states. In addition to an earlier action brought by the District of Columbia,[161] the Attorneys General in Illinois,[162] Minnesota,[163] Missouri,[164] and Texas[165] have all filed lawsuits against AmeriDebt in the past few years. These suits have typically charged AmeriDebt with consumer fraud and deceptive business practices such as false advertising, misrepresentation, non-disclosure of fees, and failure to obtain the proper licenses.

The Subcommittee believes that these suits have convinced AmeriDebt to stop enrolling new consumers into DMPs. Nevertheless, they do not necessarily prevent the same business model from operating between Ballenger and their other affiliated CCAs such as DebtServe, to

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[159] Available at *http://www.law.upenn.edu/bll/ulc/UCDC/Feb2004modelbill.pdf.*
[160] Available at *http://www.law.upenn.edu/bll/ulc/UCDC/Mar2004mtgdraft.htm.*
[161] District of Columbia v. AmeriDebt, Inc. and Andris Pukke, Superior Court of the District of Columbia.
[162] State of Illinois v. AmeriDebt, Inc., Circuit Court of the Seventh Judicial Circuit, Sangamon County.
[163] State of Minnesota v. AmeriDebt, Inc., District Court, Fourth Judicial District.
[164] State of Missouri v. AmeriDebt, Inc., Circuit Court of St. Louis City.
[165] State of Texas v. AmeriDebt, Inc., et al., District Court of Travis County, Texas.

whom AmeriDebt now refers all potential DMP enrollees. Nor have the suits impacted the questionable business practices within the Cambridge and Amerix credit counseling conglomerates.

In addition to state enforcement action, AmeriDebt is also facing a number of private lawsuits. Consumers have filed class action lawsuits in Illinois,[166] Alabama,[167] California,[168] and Massachusetts.[169] With the exception of the Massachusetts case, each is limited to the AmeriDebt family of corporations.

### D. Federal Regulation and Enforcement

The Internal Revenue Service and the Federal Trade Commission are aware of the major problems in the credit counseling industry, and have taken steps to enforce the tax code and the Federal Trade Commission Act, respectively.

#### (1) The Internal Revenue Service

As noted above in Section III(B), CCAs typically apply for non-profit status under Section 501(c)(3) of the Internal Revenue Code. The IRS has recognized more than 850 credit counseling organizations as tax exempt under 501(c)(3).[170] The non-profit status of CCAs arose mainly by historical pattern, rather than any specific decision by Congress. When creditors established the first credit counseling agencies, they set them up as non-profits, presumably because of the tax savings and because this status harmonized with their original purpose of providing debtors with general financial education in exchange for little or no fee. State laws often made non-profit status a legal requirement to conduct activities within their borders.

The rapid evolution of the credit counseling industry caught the Internal Revenue Service by surprise. In most areas, Congress has indicated that federal scrutiny of non-profits should be fairly lax: regulators should not deter agencies from fulfilling charitable purposes by imposing standards that are more suitable to the for-profit sector. In most cases this policy preference is appropriate because non-profits are seeking to make a positive contribution to society. In the case of the bad actors in the credit counseling industry, however, certain individuals used this lower standard to enter the industry with an explicit profit motive.

Since the recent problems of the credit counseling industry have surfaced, the IRS has taken several steps to address the issue both retroactively and prospectively. Retroactively, the IRS has initiated audits of fifty CCAs, including nine of the fifteen largest CCAs in terms of gross receipts.[171] The IRS Commissioner has informed the Subcommittee that the Service will

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[166] Cass v. AmeriDebt, Inc., et al., Circuit Court of Cook County, Illinois.
[167] Crawford v. AmeriDebt, Inc., et al., U.S. District Court for the Northern District of Alabama.
[168] Polacsek v. Debticated Consumer Counseling, Inc., et al., U.S. District Court, Central District of California.
[169] Zimmerman v. Cambridge Credit Counseling Corp., et al., U.S. District Court for the District of Massachusetts.
[170] Testimony of Commissioner Mark Everson before the House Ways and Means Committee, Subcommittee on Oversight (11/20/03).
[171] Everson letter, p. 1. Section 6103 of the Internal Revenue Code prevents the IRS from publicly revealing the identities of the CCAs currently under audit.

not hesitate to revoke the 501(c)(3) designation of any CCA that has abused its non-profit status.[172] The process for revoking non-profit status is fairly lengthy. The IRS must conduct a full audit of the agency's finances and make a formal finding that it does not qualify as a 501(c)(3) organization under the statute. The non-profit can appeal this decision both within the IRS and in the courts. In addition, the IRS is considering giving more explicit guidance on what the law requires of non-profits, which would put CCAs on formal notice of the standards they should follow.

Prospectively, the IRS has taken measures to subject new CCA applications for 501(c)(3) status to greater scrutiny. It has formed a specialized group within the IRS called the Consumer Credit Service Compliance Team to develop and pursue strategies to address (1) inurement and private benefit issues, and (2) issues related to CCAs that operate as commercial businesses.[173] The Compliance Team currently has twelve staff members, including technical specialists, examination agents, and attorneys from the Office of Chief Counsel.[174] These individuals review the applications, including budgets and outsourcing contracts, of new CCAs to ensure that they plan to operate as true non-profits.

### (2) The Federal Trade Commission

The FTC is charged with enforcing Section 5(a) of the FTC Act, which prohibits unfair and deceptive acts or practices in or affecting commerce.[175] The FTC, however, lacks jurisdiction to enforce consumer protection laws against bona fide non-profits. Nevertheless, the FTC may assert jurisdiction over a CCA if it demonstrates that the CCA is "organized to carry on business for its own profit or that of its members."[176] Alternatively, the FTC may assert jurisdiction over a non-profit CCA if it is a "mere instrumentality" of a for-profit entity, or if it operates through a "common enterprise" with one or more for-profit entities.[177] Even with these jurisdictional issues to contend with, the FTC has made inroads in enforcing the Federal Trade Commission Act against CCAs who may be abusing their non-profit status.

On November 19, 2003, the FTC filed a complaint against AmeriDebt, DebtWorks, Andris Pukke, and Pamela Pukke, and a second complaint against the Ballenger Group.[178] The complaint seeks to enjoin AmeriDebt, DebtWorks, and Mr. Pukke from making false and deceptive claims about the nature and costs of the services provided by AmeriDebt. The FTC has settled its case against Ballenger, which was based on the same basic premises, but the case against the remaining defendants is still at an early stage. A ruling on the remaining defendants' respective motions to dismiss is expected on May 3, 2004.

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[172] Everson letter, p. 7.
[173] Everson letter, p. 4.
[174] Everson letter, p. 4.
[175] 15 U.S.C. § 45(a).
[176] 15 U.S.C. § 44.
[177] See Sunshine Art Studios, Inc. v. FTC, 481 F.2d 1171 (1st Cir. 1973); Delaware Watch Co. v. FTC, 332 F.2d 745 (2d Cir. 1964).
[178] FTC v. AmeriDebt, Inc., et al., Case No. PJM 03cv3317, United States District Court for the District of Maryland; FTC v. Ballenger Group, LLC, et al., United States District Court for the District of Maryland.

The FTC is currently investigating several CCAs as well as their relationships with various for-profit entities. These investigations have not yet been made public.[179]

### (3) Pending Bankruptcy Legislation

Another factor necessitating a more immediate remedy to the problems facing the credit counseling industry is the possibility that Congress will enact the bankruptcy reform bill. The credit counseling provisions in Section 106 of the current bankruptcy bill (H.R. 975) would amend the bankruptcy act to require that all consumers receive "an individual or group briefing ... that outlined the opportunities for available credit counseling and assisted that individual in performing a related budget analysis." The briefing would have to come from an approved non-profit budget and credit counseling agency within 180 days prior to filing a petition for bankruptcy. The bill also requires that after filing for bankruptcy under either Chapter 7 or Chapter 13, the debtor complete "an instructional course concerning personal financial management."

The bill requires the clerk of each district to maintain a public list of credit counseling agencies and instructional courses approved by the United States Bankruptcy Trustee or the bankruptcy administrator for each bankruptcy district. Agencies and instructional courses would have to meet the following criteria:

- Provide qualified counselors;
- Maintain adequate provision for the safekeeping and payment of client funds;
- Provide adequate counseling with respect to client credit problems; and
- Deal responsibly and effectively with other matters as they relate to the quality, effectiveness, and financial security of counseling programs.

Although the bill leaves these requirements to the Bankruptcy Trustee or the bankruptcy administrator for the individual districts to define, it does spell out certain minimum criteria. To be approved, a credit counseling agency must, among other requirements:

- Be a non-profit agency;
- Have a board of directors, the majority of which are not employed by the agency, and will not directly or indirectly benefit financially from the outcome of a credit counseling session;
- Charge a "reasonable" fee and provide services without regard to the debtor's ability to pay the fee;
- Provide full disclosure to clients regarding funding sources, counselor qualifications, possible impact on credit reports, any costs that will be paid for by the debtor, and how such costs will be paid;
- Provide adequate counseling that includes an analysis of the debtor's current situation, what brought them to that financial status, and how they can develop a plan to handle the problem without incurring negative amortization of their debts; and
- Provide trained counselors who receive no commissions or bonuses based on the counseling session outcome and who have adequate experience and training.

[179] Subcommittee briefing by FTC representatives (03/15/04).

The bill also spells out minimum requirements for instructional courses concerning personal financial management. These courses must, among other requirements:

- Provide experienced and trained personnel;
- Provide relevant learning materials and teaching methodologies;
- Provide adequate facilities: instruction may occur over the telephone or the Internet if it is effective; and
- Demonstrate after the probationary period that it has been or is likely to be effective in assisting "a substantial number of debtors" to understand personal financial management.

Agencies and courses are initially approved for a six-month probationary period and for one-year terms thereafter. "Interested parties" may periodically seek judicial review of these approvals. A district court may also investigate any credit counseling agency and remove it from the list.

## VI. FINDINGS AND RECOMMENDATIONS

Based upon the Subcommittee's investigation, the Subcommittee staff recommends that the Subcommittee make the following findings and recommendations.

(1) **Abusive Practices.** Some credit counseling agencies are engaged in abusive practices that hurt debtors, including by charging excessive fees, putting marketing before counseling, and providing debtors with inadequate educational, counseling, and debt management services.

(2) **Profiteering.** Some non-profit credit counseling agencies are funneling millions of dollars each year from cash-strapped debtors to insiders and affiliated for-profit businesses, in apparent violation of tax laws prohibiting tax-exempt charities from benefiting private interests.

(3) **Creditor Standards.** As part of ongoing efforts to halt abusive practices in the credit counseling industry, major creditors should review and strengthen their standards for credit counseling agencies with whom they do business, as well as their methods for monitoring and enforcing compliance. These standards should include requiring credit counseling agency to join an association such as NFCC or AICCCA and to comply with their membership requirements.

(4) **Stronger Enforcement.** The IRS and FTC should accelerate their enforcement efforts to review suspect credit counseling agencies and take appropriate action against agencies and others who are violating restrictions on tax exempt entities or engaging in deceptive or unfair trade practices. Federal enforcement personnel should also consider coordinating their actions with state enforcement agencies to make efficient use of government resources.

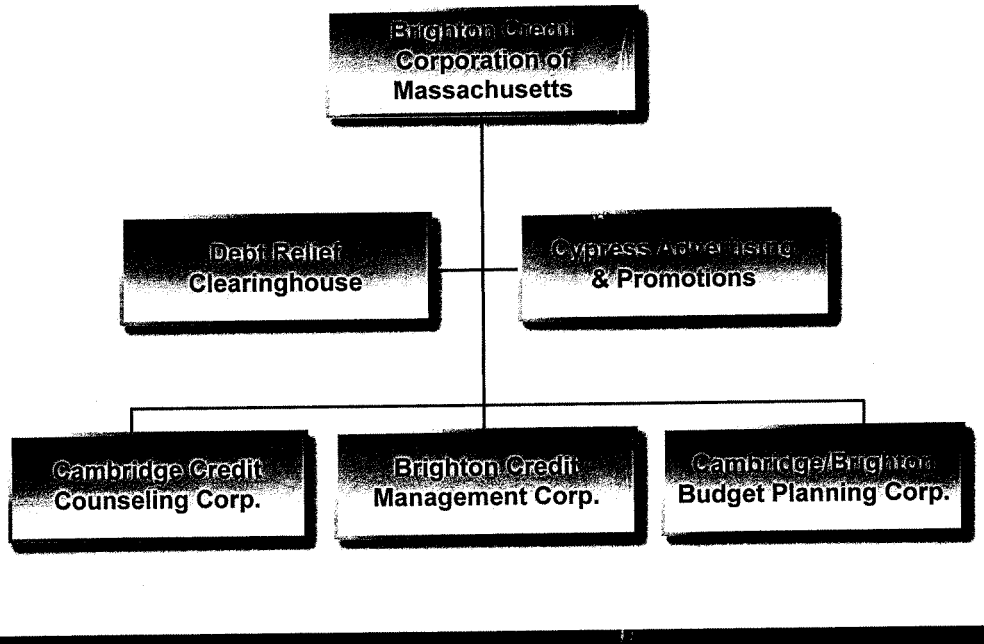
(5) **Improved Bankruptcy Bill.** The Senate should consider modifying credit counseling provisions in the pending bankruptcy legislation to strengthen protections against abusive

practices, including determining whether a single authority, the U.S. bankruptcy trustee, should issue a central list of qualifying credit counseling agencies to provide counseling to bankruptcy petitioners and whether credit counseling fee limits would be appropriate.

(6) **New Legislation.** The Senate should consider introducing federal legislation, either modeled on the Debt Repair Organizations Act of 1996 or expanding that law's application to reach non-profit entities, to strengthen protections against abusive practices in the credit counseling industry.

Permanent Subcommittee on Investigations
EXHIBIT #1

# The Cambridge-Brighton Conglomerate

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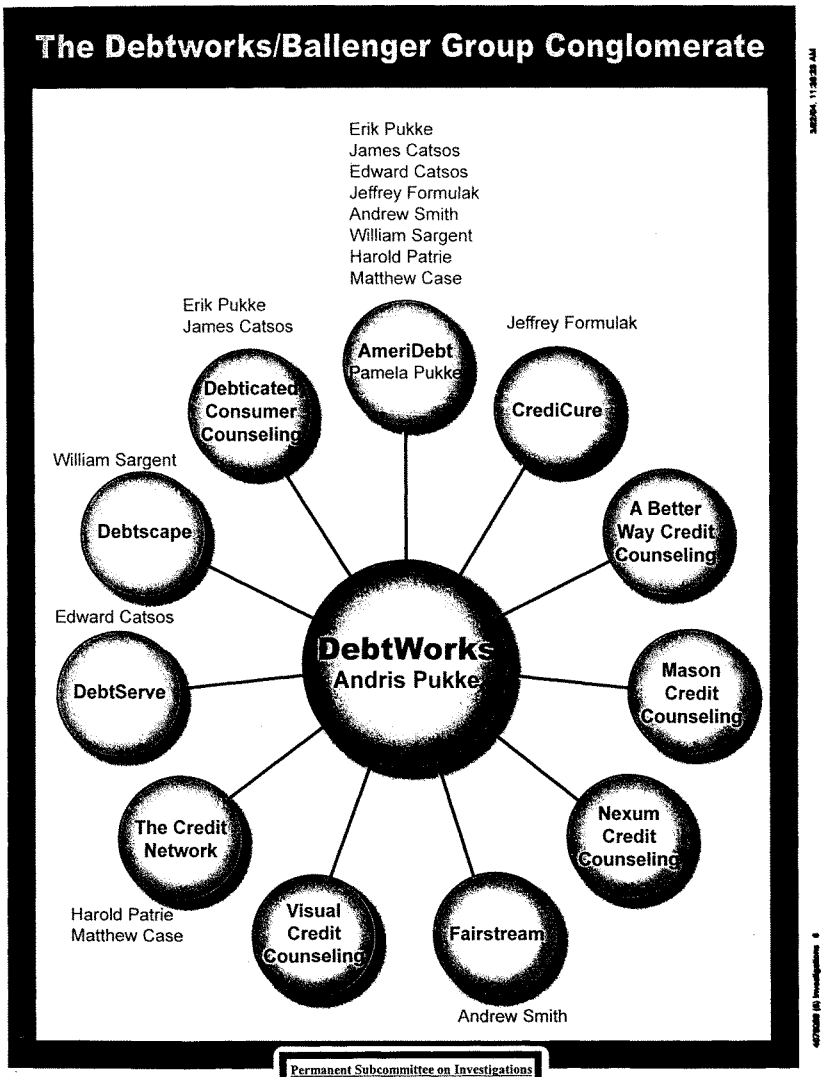
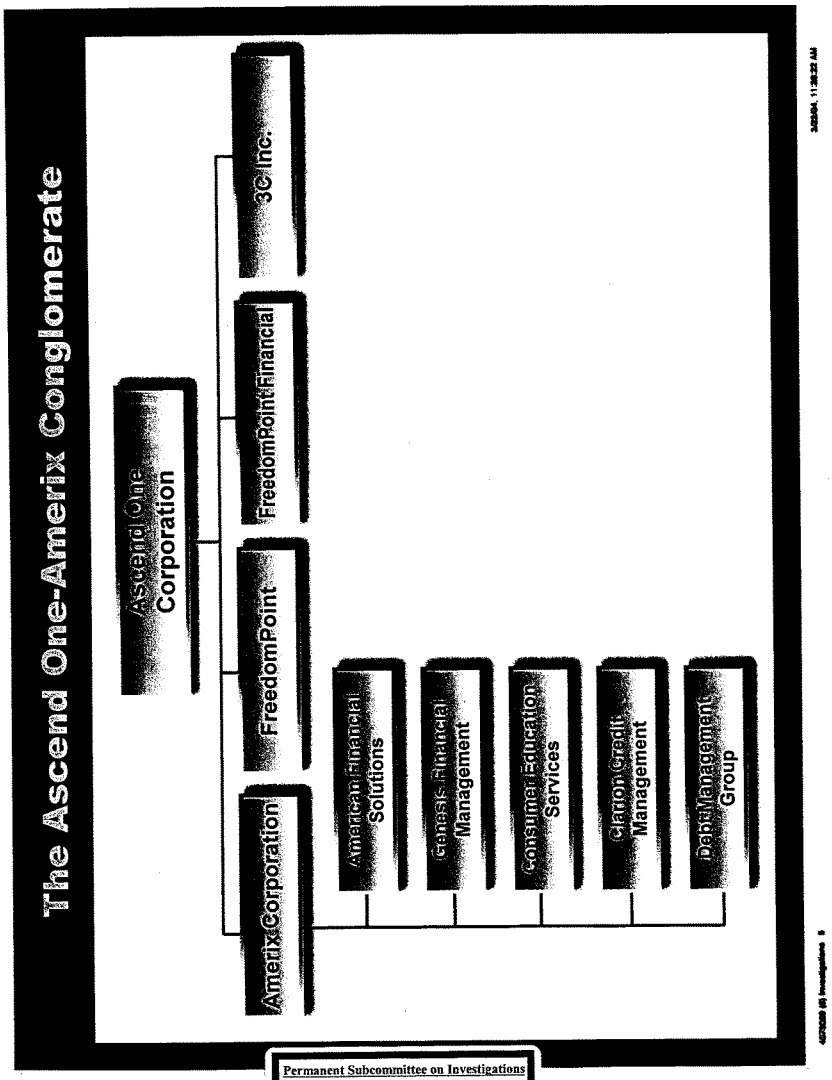



Permanent Subcommittee on Investigations
EXHIBIT #2




Permanent Subcommittee on Investigations
EXHIBIT #3

A 501(c)(3) NOT-FOR-PROFIT ORGANIZATION

Page 1

**CAMBRIDGE**
**CREDIT COUNSELING CORP.**

67 Hunt Street
Agawam, MA 01001

Tel: (413) 821-8900
Fax: (413) 821-0925
Cust.Service: (413) 821-6901

# SERVICE AGREEMENT

M00119228

*BONDED*

AGREEMENT, entered into as of the 29 day of JUNE, 20 01, by and between

Name(s): RAYMOND SCHUCK (Client)

Address: 5610 1/2 EAST BUTLICK RD Phone(H): 419-228-

City: UMA State: OH Zip: 45801 Phone (W): 419-772- [Redacted by Permanent Subcommittee on Investigations]

S.S. #: [Redacted by Permanent Subcommittee on Investigations] S.S.# (Spouse): N/A

You are referred to in this Agreement as the "CLIENT" or "you" or "your" and CAMBRIDGE CREDIT COUNSELING CORP. is referred to in this Agreement as "CAMBRIDGE."

**Reason For The Agreement**

You would like to consolidate into one convenient monthly payment all your monthly payments to creditors such as your credit card companies and/or other consumer lenders. In addition, if possible, you would like to reduce the size of your total monthly payment to these creditors to a more manageable level and reduce the interest rate you are currently paying. CAMBRIDGE has offered to:

1. Consolidate your payments into one convenient monthly payment (CLIENT understands that accounts included in the debt management plan will be closed),
2. Use its best efforts to reduce the amount of your monthly payments,
3. Use its best efforts to reduce the interest rate you are currently paying to your creditors (Although many major creditors will reduce the interest rate of a consumer like yourself at CAMBRIDGE's request, there is no guarantee that your particular creditors will extend this benefit in your case. Some creditors will not extend this benefit to anyone. Other creditors will not extend this benefit where the client has recently used the credit card to make purchases or cash advances, or if the client is current on his or her payments.) and
4. Pay to you as a bonus, fifty (50%) percent of any creditor contributions that CAMBRIDGE is able to obtain from your creditors in accordance with the Good Payer Program described below.

ACCORDINGLY, YOU, THE CLIENT, AND CAMBRIDGE AGREE AS FOLLOWS:

I. CAMBRIDGE'S SERVICES, FEES AND SIGN UP INSTRUCTIONS

**Monthly Payment Design Services and Fee**

Upon receipt of a copy of a signed Service Agreement and Creditor Listing Sheet, CAMBRIDGE will do the following: using the credit card and other debt information provided by the CLIENT, CAMBRIDGE will analyze the CLIENT's debt structure, research creditor practices and calculate a proposed monthly payment amount acceptable to the CLIENT ("Monthly Payment"). It is extremely important that the debt information that you provide to CAMBRIDGE is correct and does not underestimate the amount owed by you. CAMBRIDGE will use its best efforts to create a Monthly Payment based upon this debt information that reduces the CLIENT's monthly payment amount. CAMBRIDGE's Monthly Payment Design Fee for creating an acceptable proposed Monthly Payment will be equivalent to one proposed Monthly Payment and will be payable upon the CLIENT's acceptance of the proposed Monthly Payment. This Agreement will be executed upon CAMBRIDGE's receipt of CLIENT's signed Service Agreement and Monthly Payment Design Fee in accordance with Massachusetts' law.

29/6/01
Date

Client (Primary)

Client (Secondary)

CAI Ver 010701 16

Permanent Subcommittee on Investigations
EXHIBIT #4

*PREMIER* A 501 (C)(3) NOT-FOR-PROFIT ORGANIZATION *BONDED* Page 2

CAMBRIDGE
CREDIT COUNSELING CORP.
67 HUNT STREET
AGAWAM, MA 01001

Tel: (413) 821-8900
Fax: (413) 821-0925
Cust.Service: (413) 821-6901

This proposed Monthly Payment will not increase by more than fifteen (15%) percent without your consent when the Payment Program is put into effect as explained below, unless the debt actually owed to any of your creditors is greater than the amount reported by you to CAMBRIDGE. The proposed Monthly Payment will include the ten (10%) percent Payment Processing Fee described below.

**Cambridge's Creditor Cooperation and Payment Services and Payment Program Fee**

Upon receipt of a signed Agreement and Monthly Payment Design Fee, CAMBRIDGE will do the following: CAMBRIDGE will set up a creditors payment account in its computerized system. It will use its best efforts to obtain your creditors' cooperation in the acceptance of their respective shares of the proposed Monthly Payment or of an amount that will increase the amount you must pay monthly to no more than fifteen (15%) percent higher than the original proposed Monthly Payment without your consent ("Modified Monthly Payment"). However, the Monthly Payment Design Fee is earned for the services rendered based upon the information you originally provide to CAMBRIDGE. CAMBRIDGE will request a reduction or waiver of the Client's interest rate and any late charges and seek rebates for the Client Good Payer Program and Account Pay-Off Services described below. Each month thereafter, you will pay the Monthly Payment, or Modified Monthly Payment if there is any modification, to CAMBRIDGE and CAMBRIDGE will pay your creditors. CAMBRIDGE is a not-for-profit corporation. CAMBRIDGE is not a loan company. It may, however, at its own discretion, advance its own money to pay your creditors. CLIENT agrees to repay any such advance within thirty (30) days from the date CAMBRIDGE makes the advance on your behalf. In the event any of your payments is less than the amount required above, CAMBRIDGE shall have the right to return such payment to you, or to, after deducting its Payment Program Fee, disburse the remainder of the money to your creditors in the manner that CAMBRIDGE determines would be most beneficial to you. If any of your payments is more than the amount required above, CAMBRIDGE shall have the right to disburse the additional amount, after deducting its Payment Program Fee, to your creditors in the manner that CAMBRIDGE determines would be most beneficial to you. In addition, if any of the information identifying your account with any of your creditors is incorrect and prevents CAMBRIDGE from making payment on your behalf to that creditor, CAMBRIDGE will hold the funds allocated to that account in trust for you until CAMBRIDGE is able to obtain sufficient information to make the payment on your behalf. CLIENT understands that in the event that the CLIENT removes an account that was originally included on the program, the CLIENT will not be entitled to a partial refund of the Monthly Payment Design Fee. CLIENT also understands that any interest rate reductions that CAMBRIDGE is able to obtain on the CLIENTS behalf may not occur immediately. Some creditors require that they receive a certain number of consecutive payments before they make any interest rate adjustments.

CAMBRIDGE's Payment Program Fee for setting up the creditor accounts, obtaining the cooperation of your creditors to any interest rate or other reductions that may be obtained, and receiving and paying out your monthly payments to your creditors will be ten (10%) percent of the amount you pay to CAMBRIDGE each month or twenty-five ($25) dollars, whichever is greater. This Payment Program Fee shall be included in and deducted from each payment received from the CLIENT. If you desire to add additional creditor accounts at a later date, an additional monthly service charge will be due for those additional accounts.

**Summary of Cambridge's Fees**

Monthly Payment Design Fee = proposed Monthly Payment - one time only.

Payment Program Fee = ten (10%) percent of each payment made to CAMBRIDGE or twenty-five ($25) dollars, whichever is greater.

29/6/01
Date

Client (Primary)

Client (Secondary)

*PREMIER* A 501 (C)(3) NOT-FOR-PROFIT ORGANIZATION *BONDED*

Page 3

CAMBRIDGE
CREDIT COUNSELING CORP.
67 HUNT STREET
AGAWAM, MA 01001

Tel: (413) 821-8900
Fax: (413) 821-0925
Cust.Service: (413) 821-6901

**Cambridge Program Sign up Instructions**

When you are satisfied with the proposed Monthly Payment amount and understand and agree to the rest of the terms of this Agreement, you simply mail your first payment installment in the amount equal to the proposed Monthly Payment. This is our design services fee. Note that all payments must be in the form of a CERTIFIED CHECK, POSTAL MONEY ORDER, OR ELECTRONIC BANK PAYMENT payable to CAMBRIDGE. IMPORTANT! If you are current on your creditor payments, you must make this month's payment to avoid your creditors reporting to credit reporting agencies that you were thirty (30) days late. CAMBRIDGE's payments to creditors will not start until after it receives your second payment which is due thirty (30) days after you pay the Monthly Payment Design Fee.

**II. CANCELLATION AND REFUNDS**

CLIENT may cancel this Agreement and receive a full refund of the Monthly Payment Design Fee by giving CAMBRIDGE written notice of cancellation by certified mail, return receipt requested, within three (3) days (not including Sundays and U.S. Postal Service holidays) after you send this Agreement and the Monthly Payment Design Fee to CAMBRIDGE. Your money will be refunded within ten (10) days after receipt of notice of cancellation. At any time, you may discontinue making any further monthly payments to CAMBRIDGE without further obligation to CAMBRIDGE. However, the CLIENT will remain liable to pay the balance of the debts owed to the creditors in accordance with your agreement with your creditors. Failure to make payment to CAMBRIDGE for any ninety (90) day period will, at CAMBRIDGE'S option, cause termination of this Agreement.

**III. GOOD PAYER PROGRAM**

CAMBRIDGE has instituted a program to try to obtain contributions from your Creditors for CAMBRIDGE's prompt and professional efforts, which we feel are the best in the debt management business. In appreciation for your loyal and continuing participation in our program, for every six (6) month period that you complete by making all your payments on time and in the required amount, we will pay to you a bonus of fifty (50%) percent of any such creditor contributions that we receive from your creditors. For example, if CAMBRIDGE receives contributions totaling one hundred fifty ($150) dollars from your creditors during the first six (6) months that you are on the program, we would pay a seventy-five ($75) dollar bonus to you. If you continue to make timely and appropriate payments for a second six (6) month period, we will again pay to you fifty (50%) percent of any creditor contributions received by us during that second six (6) month period. While there is no guarantee that we will be able to achieve creditor contributions for the Good Payer Program, we will do our best. Many creditors will pay such contributions. If we are successful, at your request, we will mail you a bonus check after the completion of each six (6) month period. Otherwise, any monies collected on your behalf will remain in your client trust account.

**IV. DEBT SETTLEMENT SERVICES**

If at any time you would like us to negotiate a full settlement of your debts with your creditors, our fee will be fifty (50%) percent of any SAVINGS we negotiate for you not to exceed ten (10%) percent of the total amount you owe to all of your creditors that we negotiate with. CAMBRIDGE does not guarantee that any debt settlement will result in savings. Certain creditors require that an account be in a delinquent status in order for a debt settlement to be negotiated. Some creditors will report to the IRS some or all of any savings we negotiate on your behalf as income, which could result in tax liability on the amount saved. Consult with your own tax advisor about this. Such reporting is beyond the control of CAMBRIDGE.

**V. RE-EVALUATION**

If the CLIENT makes at least six (6) months of payments on time and in the appropriate amounts, at the request of the CLIENT, CAMBRIDGE will use its best efforts to reduce the CLIENT's regular monthly payment amount. Re-Evaluation can be attempted after each six (6) month period of on time payments. If successful, each Re-Evaluation will extend the CLIENT's debt repayment over a longer period of time.

29/6/01
Date

Client (Primary)

Client (Secondary)

CAMBRIDGE
CREDIT COUNSELING CORP.
67 HUNT STREET
AGAWAM, MA 01001

Tel: (413) 821-8900
Fax: (413) 821-0925
Cust.Service: (413) 821-6901

VI. ACCOUNT PAY-OFF SERVICES

In the event you would like to pay-off any or all of your accounts on our program, we will refund you twenty-five (25%) percent of any creditor contributions we collect on your behalf. For example, if CAMBRIDGE receives contributions totaling five hundred ($500) dollars from your creditors, we would refund you one hundred twenty five ($125) dollars. This refund will be forwarded to you within ninety (90) days after you make the pay-off through CAMBRIDGE.

VII. PROTECTION OF CAMBRIDGE

The CLIENT agrees to take full responsibility for and protect CAMBRIDGE, its employees, personnel, or agents from any claim, suit or demand of creditors ("Claim") arising out of this Agreement and any credit application containing information supplied or approved by you that we submit at your request. The CLIENT will reimburse CAMBRIDGE for any legal fees, expenses or monies paid relating to any such claim. The CLIENT agrees that CAMBRIDGE is not liable for any damages to the CLIENT, including garnishments, levies, late fees, negative credit history or repossessions, caused by anyone else including your creditors, the postal or other widely used parcel or mail delivery. CAMBRIDGE's liability for any breach of this Agreement shall be limited to payment of late fees and additional interest charges incurred, if any, or refund of all fees collected for Payment Program Implementation, at CAMBRIDGE's option. You shall immediately give CAMBRIDGE written notice of any problems with payment that you become aware of. CAMBRIDGE shall not be liable for any damages that occurred after you could have given notice to CAMBRIDGE if such damages could have been avoided had you given such notice.

VIII. DEBTOR'S CREDIT RATING AND ACCOUNTS

The CLIENT understands that CAMBRIDGE makes no representation about any aspect of the CLIENT's credit rating. Creditors will sometimes report participation in CAMBRIDGE's program as a "consumer credit counseling" item on your credit report. Persons with perfect credit histories may have their credit record adversely affected. CAMBRIDGE has no control over reporting or interpretation, as it is strictly a creditor and lender decision. The CLIENT's credit rating is outside of the scope of this Agreement, however, at the CLIENT's request, CAMBRIDGE will provide CLIENT with credit references based upon CLIENT's payment history with CAMBRIDGE. For such credit references to be helpful, it is extremely important that the CLIENT's payments are made on time and in the appropriate amount to CAMBRIDGE.

IX. NO OTHER REPRESENTATIONS

CAMBRIDGE has not authorized any person or other company to make any representations on its behalf concerning fees, credit, any services to be performed by CAMBRIDGE or any other matter. In the event you were referred to CAMBRIDGE by another company, you understand that the other company was not authorized to make any representations about CAMBRIDGE or its services. You agree that all the representations concerning fees, credit, refinancing or any services to be performed by CAMBRIDGE that were made by CAMBRIDGE or relied upon by you when you signed this Service Agreement are set forth in this Agreement. No fees paid to any other company shall be considered fees paid to CAMBRIDGE. Except as provided herein, CAMBRIDGE will not divulge any CLIENT information to third parties unless requested by CLIENT and approved by CAMBRIDGE. All the obligations of CAMBRIDGE are set forth in this Agreement.

I have reviewed the terms of this Agreement, agree to all terms, and acknowledge receipt of a copy of this Agreement.

2/1/6/01
Date

Client (Primary)

BY: J. Puccio
John Puccio, President
CAMBRIDGE CREDIT COUNSELING CORP.

Client (Secondary)

*PREMIER* A 501 (C)(3) NOT-FOR-PROFIT ORGANIZATION *BONDED*

CAMBRIDGE
CREDIT COUNSELING CORP.
67 HUNT STREET
AGAWAM, MA 01001

Tel: (413) 821-8900
Fax: (413) 821-0925
Cust Service: (413) 821-6901



# AUTHORIZATION TO RELEASE FINANCIAL DATA

DATE: 29/6/01

CLIENT: RAYMOND SCHUCK

To Whom It May Concern:

You are hereby authorized to release to my agent, CAMBRIDGE CREDIT COUNSELING CORP., all financial records and other data pertaining to my above referenced account.

Further, my agent is authorized to negotiate all matters pertaining to my account.

Please be further advised that all future monthly payments will emanate from my agent, CAMBRIDGE CREDIT COUNSELING CORP.

I understand that my account with your organization may be current. I have employed the services of CAMBRIDGE CREDIT COUNSELING CORP. to restructure my debt in order to assist me with my present budget.

Thank you for your attention to and cooperation in this matter.

Very truly yours,

RAY SCHUCK
Client (Primary)

Client (Secondary)

Permanent Subcommittee on Investigations
EXHIBIT #5

FOR YOUR PROTECTION SAVE THIS COPY

OFFICIAL CHECK

214768504

BANK ONE.
BANK ONE, NA

Remitter RAYMOND SCHUCK

7-13-01

⑈ 1946⑈00⑆

Pay To The Order Of CAMBRIDGE CREDIT COUNSELING CORP.

$ *1,946.00*

Drawer: BANK ONE, NA

NON-NEGOTIABLE

CUSTOMER COPY

TERMS

KEEP THIS COPY FOR YOUR RECORD OF THE TRANSACTION. TO REPORT A LOSS OR FOR ANY OTHER INFORMATION ABOUT THE INSTRUMENT, CONTACT THE INSTITUTION FROM WHICH YOU RECEIVED THE INSTRUMENT.

**Initial payment by Raymond Schuck to Cambridge**

4078088 (6) Investigations 11

3/22/04 11:38:29 AM

**CAMBRIDGE**
**CREDIT COUNSELING CORP.**
67 Hunt Street
Agawam, MA 01001

A 501(C)(3) NOT-FOR-PROFIT ORGANIZATION
www.cambridgecredit.org

Tel: 413-821-8900
Fax: 413-821-9448
Cust. Service: 413-821-6901

# CLIENT FINANCIAL DISCLOSURE

**Client Name:** RAYMOND SCHUCK **Next Payment Due:** _____

**SS#:** Redacted by Permanent Subcommittee on Investigations **Cust. #** ~~**Other SS#:**~~ M0119228

**Employer:** OHIO NORTHERN UNIVER. **Other:** RETIRED

**Monthly (Gross) Income:** 4310.00

**Total Household Income:** 4310.00

***MONTHLY EXPENSES:***

| | | |
|---|---|---|
| **Mortgage/Rent:** | 250.00 | |
| **Debt Management Payment:** | 1824.00 | |
| **Auto Payment(s) / Insurance:** | 150.00 | |
| **Health / Life Insurance:** | 100.00 | |
| **Phone Bill:** | 80.00 | |
| **Utilities:** | 75.00 | |
| **Groceries:** | 200.00 | |
| **Bank / Personal Loan:** | 455.00 | |
| **Other:** | 800.00 | SPOUSAL SUPPORT |
| | 350.00 | OUTSTANDING CREDIT CARD DEBT |
| | 50.00 | PROFESSIONAL DUES, BOOKS, TRAVEL, ETC. |
| ***TOTAL:*** | 4334.00 | |

**Reason for Hardship:** CASH FLOW BASED ON AVAILABLE INCOME.

**Date:** 10/12/01

**Representative:** _____

CS-9 050599.3

Permanent Subcommittee on Investigations
**EXHIBIT #6**

December 26, 2002

MAILED
MT 12-26-02

Ms. Ester Hardesty
Trade Practice Consultant
Better Business Bureau
Washington DC Branch
1411 K Street, NW 10th Floor
Washington, DC 20005-3404

RE: Jolanta Troy

Dear Ms. Hardesty:

Upon receiving your inquiry, we have investigated Ms. Troy's concerns.

According to our records, Jolanta Troy, enrolled in our program on December 2, 1999. She signed an agreement with AmeriDebt on October 31, 1999, acknowledging that she would be contributing to our program and was willing to accept the terms presented to her. Moreover, Ms. Troy has acknowledged being informed of the contribution. The consumer requested a refund of her contribution, stating that we did not provide the service she was promised.

Our records indicate that AmeriDebt did enroll Ms. Troy in its debt management program. Proposals were sent to creditors on December 14, 1999. Many of Ms. Troy's creditors responded. AmeriDebt did perform as required in the agreement entered into by both Ms. Troy and AmeriDebt. The lack of responsiveness from some creditors is not due to AmeriDebt not fulfilling its obligation to Ms. Troy.

At this time, AmeriDebt considers this matter closed. I await confirmation from your office as to the satisfactory conclusion of this matter. Please contact me at (301) 515-1500 extension 2255 if you have any questions regarding this or any other matter.

Cordially,

Zynda C. Sellers
Associate General Counsel

cc: Jolanta Troy
kc

12800 Middlebrook Road, 3rd Floor, Germantown, Maryland 20874
Phone: 301-515-1500 Fax: 301-515-1600 Web Site: www.Ameridebt.org

**AmeriDebt letter to Washington D.C. Better Business Bureau regarding Jolanta Troy (12/26/02)**

Permanent Subcommittee on Investigations
**EXHIBIT #7**

AmeriDebt and I agree to all of the terms and conditions of this Agreement and each of us has received a copy. There are no other agreements, promises, or representations, unless executed in writing between AmeriDebt and me, other than those contained in this Agreement. This Agreement shall be considered for all purposes, including interpretation, Court jurisdiction, and consumer rights, as a contract made wholly in the State of Maryland.

PLEASE read the following and initial only ONE choice:

My counselor explained to me and I understand that Ameridebt asks that I voluntarily contribute my first payment to assist AmeriDebt in covering the initial costs of setting up my debt management plan, as well as a monthly contribution to defray the costs of managing my program. I acknowledge AmeriDebt's need for my support and:

I agree to make these contributions to Ameridebt._____(initials)

I do not agree to make these contributions to Ameridebt._____(initials)

*Please print below and sign:

Name:_____ SS#: _____-_____-_____

Spouse/Co-App:_____ SS#: _____-_____-_____

Address: _____City:_____State:____Zip:_____

Home Phone#:(_____)_____ Work Phone#:(_____)_____

Mother's Maiden Name: (For Security Purposes Only) _____

X_____ X_____

Customer Signature Date Spouse/Co-Applicant Signature Date

Email Address: _____@_____ Email Address: _____@_____

X «Counselor»
Authorized Corporate Signature
«Counselor»

**IMPORTANT**
Please indicate when you will be able to send your first payment.

_____/_____/_____Best

*Please make sure you provide current statements of your credit card bills, to ensure accuracy on your account. It is important to fax this agreement back to your counselor. You can mail your statements to the address provided on the contract or fax them along with your paperwork.

BEST TIME & PLACE TO REACH YOU:

Time: _____ Best place (phone)_____

«Counselor» 5

Revised 3-17-02

Permanent Subcommittee on Investigations
EXHIBIT #8

# Flow Chart

- Consumer calls in, fill out carbon fully.
- Go over first half of script with consumer.
- Get a list of creditors and approximate balances to quote new payment amount and interest rates.
- Go over 2nd half of script.
- Fill out fax cover sheet and fax out agreement or turn carbon into AA's (highlighted) so they can fax it out.
- Follow-up (use no fax back message handout)
- Once fax has been received - Set Payment (read setting a payment script) ONLY when you have full and complete information.
- Turn in "AmeriDebt 1st payment request form" for AA's to send the confirmation letter. Push to get the letter faxed out.
- Write down consumer's first and last name and amount due on calendar and payment log.
- Approx. 1 week prior to payment follow-up with consumer
  Make sure consumer...

✓ Received letter (use your reminder call message)
✓ No problems with creditors
✓ Still sending payments on time

Permanent Subcommittee on Investigations
**EXHIBIT #9**

❖ Check payment list for payment. Including the unknown lists.

❖ When payment is here...

- Contact consumer client to go through "AmeriDebt Orientation" with them, and transfer to extension 2525.
  - Do package Doc: (fill out consumer client information sheet and top half of file tracking form)

You should have papers in the following order...
Consumer Client information sheet
page 5
page 6
page(s) 7
page 8
statements, consumer notes form, and file tracking form last (facing outward so that it looks like you have a front and back cover)

* Make 1 copy to keep for yourself (must keep for 6 months)
  Original gets turned into the package Doc Bin for Dick Wahlberg at consumer client services.
* Copy the front cover (or client information sheet) & attach to lead, put it in the lead source bin.

4167

Debt Relief Clearinghouse
America's Leading Debt Solutions Provider
www.debtreliefonline.com

**Second Letter**
We have no record of receiving a response from you.Please review this offer before it expires!

## "Having Trouble Paying Down Your Credit Card Debt? Get Money Back While You Become Debt Free!"

Dear

A few months ago, I wrote to you about a simple way of becoming debt free. I hope you're not one of those people who think that they can pay off all their credit cards and still have enough money to spare.

If you are, **think again**! Allow me to let you in on a little secret. The banks have a clever system for making sure you continue to pay on their credit card for years and years to come.

### "Here's What They Do …"

If your balance is **near your credit limit**, or if you have **multiple credit cards** (yes, they know if you do), or if you're even a little bit **late on your payments**, the banks start to raise your interest rate, sometimes without you even realizing it!

Eventually, your interest rate is so high that your **entire payment** goes toward your **interest** and **VERY LITTLE** or even **NONE** goes toward paying off your bill. You end up never being able to pay off your credit card debt!

### "It's a Vicious Cycle!"

Once you're caught in this brutal trap, you're stuck making **huge payments** with absolutely **no end in sight**. Gone are the dreams of enjoying a relaxing retirement, putting your children through school, or even taking the vacation you've always wanted.

What's worse is that you become a **slave to your debt**. You can't even stop by the local fast food restaurant without worrying if you have enough money to pay for your meal. It's time to **stop the insanity**!

### "Stop Being a Prisoner to Your Debt and Start Taking Charge of Your Financial Future."

Turn this page and I'll show you how to start today.



**Letter from Chris Viale to consumer**

Permanent Subcommittee on Investigations
**EXHIBIT #10**

## Fidelity & Trust Loan Officer's Extensions

Instead of transfer directly to the extension, please dial this number:

1 800 955 0031

And then refer to any of these extensions:

| | |
|---|---|
| Mark Landers | x 229 |
| Mike Wendorf | x 237 |
| Erin Berry | x 232 |
| Frank Owusu | x 230 |

12800 Middlebrook Road, 3rd Floor, Germantown, Maryland 20874
Phone: 301-515-1500 Fax: 301-515-1600 Web Site: www.Ameridebt.org

Permanent Subcommittee on Investigations
EXHIBIT #11

# Fidelity & Trust Mortgage, Inc

Toll Free: (800) 955-0031 Local: (301) 528-3340 Fax: (301) 528-3362

## Provides home equity loans for:

- Debt consolidation
  *Secured or unsecured debts*
- Home improvements
- Cash advance

## Benefits of home equity loans:

- Cut monthly payments in half
- Low fixed interest rates
- Tax deductibility
- All closing costs are financed into the loan. No out of pocket expense.

## Qualifications:

| | |
|---|---|
| Must be a homeowner | NO trailers or double-wides |
| Must be current on their bills | NO more than four consumer 30-day late payments on all Installment or revolving accounts permitted in the last 2 years (Includes credit cards, cars, student loans, etc.) |
| Must be current on mortgage(s) | NO more than one 30-day late payment in the last year |

Minimum loan amount $15,000

**If the consumer meets the qualifications transfer lead to:**
**301-528-3340**

**Please be sure the consumer knows your name and extension.**

**Remember**
This is your lead, pitch your program before transferring. Follow up with the consumer, and please call us f or any updates. All leads are logged in by the counselor's name. They are tracked and the results are returned by fax to the counselor.

**Compensation**
If F & T can close a loan from your lead, you will receive:

- A $150.00 check
- Credit for two special accounts
- Credit for a $600.00 special first pay

**If we cannot qualify the lead,** we will refer the consumer back to you selling the benefits of Ameridebt's programs.

**If we can qualify the lead,** we will send the consumer the necessary loan documents. If the consumer accepts the loan offer, it will take about 3 to 4 weeks to close the loan. Counselors will receive credit the same month the loan closes.

**-ALL STAES EXCEPT VERMONT & TEXAES**

# FACT SHEET FOR EMERGENCY HOME RESCUE:

## How we help the Client:

1) When someone is 60 days late on their home payment, this is the most important issue for them to deal with.
   a) Once a mortgage falls 60+ days behind, the Mortgage Company will not accept a payment, because it will stall the foreclosure process. In order to foreclose on the property the Lender must follow a step by step process.
   b) Lenders will require full payment to stop the foreclosure process.

2) Once they go into foreclosure, your lead will be lost forever because:
   a) Attorneys will call them and convince them to file a Chapter 13 bankruptcy.
   b) All debt, including unsecured debt, will be included in the bankruptcy pay back plan.
   c) **But, if we can save their home with a repayment plan instead of a bankruptcy, they can then become <u>your</u> client once the mortgage is restored.**

3) We negotiate with the lender to work out a reasonable repayment plan so the client can catch up with the late payments and get their mortgage reinstated, avoiding foreclosure or Bankruptcy.

## WHAT'S IN IT FOR YOU:

## <u>IF YOUR LEAD BECOMES OUR CLIENT</u>:

1) YOU GET PAID:
   a) **1 Bonus Account Credit for Sale**
   b) **$25 Bonus paid from Full Service Program**
   c) **$5 for Owner-Assisted Guided Options Program**
   d) **1 Account Credit when Client completes the EHR plan and signs on with you.**

**To save you time and effort, please do not attempt to put the Client in your program until we have assessed their financials.**

1) We direct our clients to call you once the mortgage situation is worked out. This could take a few weeks or a few months. Each case is different.
   a) Once you are notified that a Client is working with EHR, you may keep in touch with our office for an update.
   b) We instruct the Client to call the referring Rep. once their mortgage is stabilized.
4) We are NOT LENDERS and do not lend money. Send that Client to F&M Mortgage.

**IF YOUR LEAD DOES NOT QUALIFY (check weekly update sheet) PUT THEM IN YOUR PROGRAM ASAP!**

# GET EXCITED

If you can't get excited about your own service, don't expect anyone else to get excited about it!

If you assume a position of authority, you will find that people give it over to you without resistance.

If you give the consumer ideas, it creates excitement and creative energy inside. When a consumer feels that excitement, it is linked to you as a marketer and your sales skills will be more successful.

Use the consumer's first name and "you" often.

Perceive value - Don't only market their "hot button", add in extras

Create mental pictures- 10 times faster, 3-6 years as opposed to 20 or more years.

Create a sense of urgency- "Your creditors want you to get started as soon as possible, the quicker you get started the faster you'll be out of debt"

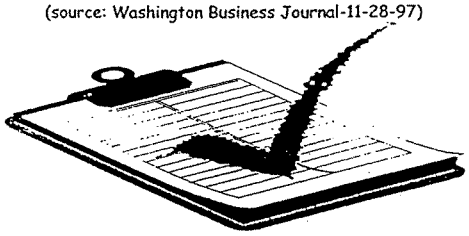
**Page from AmeriDebt credit counselor training manual**

Permanent Subcommittee on Investigations
EXHIBIT #12

## Some tips on improving your telephone sales skills

- ✓ Talking too long. There is somewhat of a gray area between building rapport and being too long-winded. There is also a fine line between follow up and closing the sale.
- ✓ Not getting to the point fast enough. Its okay to get to the point right away without "sugar coating" it with questions and insincere words.
- ✓ Making personal calls. Yes, it can be tempting but it can really set you back. You will loose your train of thought and become unfocused. Avoid them at all costs.
- ✓ **Be prepared! If you can't answer questions or make the right point, it can be the difference of a sale or no sale.**
- ✓ Making or taking too few calls. There are no excuses. "Well done is better than well said!"
- ✓ Not making clear communications. Get a firm commitment from your consumer on every call.
- ✓ Your success or failure is totally up to you. Don't blame others; take responsibility for your own actions.
- ✓ Smile, smile, smile it will come across on the phone if you don't sound up beat, enthusiastic, and willing to help the client. Make them feel good.

(source: Washington Business Journal-11-28-97)



**Page from AmeriDebt credit counselor training manual**

Permanent Subcommittee on Investigations
EXHIBIT #13

Permanent Subcommittee on Investigations
EXHIBIT #14

**Do I have to cancel my insurance or Internet service that is attached to my account?**

Yes, you need to cancel the service, because they will automatically cancel any services when you start the program.

**Why do I have to change my due date?**

It is important that you call on your own to change your due date directly with the creditors because if your payment comes to us later than your due date with that creditor they will assess a late fee because they have not received a proposal yet. Also, the creditors want you to take an active part in re-paying your bills through a CCCS program so they want you to take the initiative to call on your own to change your due date.

**I cannot afford a contribution right now, but maybe I can afford to contribute later.**

If you can afford to make a monthly payment, you can afford to make a contribution because of the 30-day negotiation period. As long as the creditor receives a proposal, they will know of your intent to get out of debt, and they will not expect a payment until the negotiation period is complete. You will not fall any further behind by supporting this program as long as you make all your payments on time. That contribution is not going into our pocket, it is going to cover the costs of setting you up on the program. If you do not agree to contribute, that payment will still be held for 30 days, so by the time the creditors receive any money, they will receive a double payment. Would you rather have that payment go to us, to help people like you get out of debt or would you like it to go into the creditors pocket as extra interest, because most creditors will not re-age until 3 months. Without the contributions from our consumers, we could not stay in business. Would you rather support a non-profit company, or help a bank get richer? Remember through our program, you will be out of debt in 3-6 years, where as, if you paid on your own, it could take 20-50 years, and the amount of money you would pay in interest would make the contribution look like nothing.

**If I go on this program now, will my derogatory marks on my credit be eliminated?**

No, these marks will stay on your credit report for 7-10 years. The main benefit that you will receive by going on this program is that it should show up on your credit report that you have taken an active measure to pay all your balances in full and this will help you obtain credit in the future.

**Is bankruptcy an option for me?**

Bankruptcy is your last resort if we can't work out an agreeable repayment plan based on the bills that you owe. We do not advise people file bankruptcy because this ruins their credit for at least 7-10 years and should be used only as a last resort.

**My creditors are not calling me now because my bills are so old, should I still pay my bills?**

You should pay back your unpaid bills as soon as you can afford to because of the legal ramifications of garnishment. Also, the sooner you pay back your bills, the better your credit is.

**Why are the creditors harassing me to make a payment during the negotiation period?**

**Pages from AmeriDebt credit counselor training manual**

# September 2001 Company Notes

Jeff Leader Get groups fired up!!!
Erin Cover last month totals. We helped 9025 clients and we achieved $2,837,033 in contributions. Our goal last month was 7500 clients and $2,600,000 in contributions WE MET OUR GOAL and we had our best month ever! We will meet our goal for September won't we??
Stella Education updates
Ted new goal for September is to achieve $3,050,000 in contributions and help 9150 clients.
Rich Bonus Structure No Bonus for 50 accts. 60 acct. =$250, 50 SP &15K = $300, 55SP acts & 20K=$750, 60SP acts & 25K = $1000, & 60SP accts & 30K = $1500, 60SP & 35K = $2000, & 60SP & 40K = $3000, 100 or more accts =$1500. Leads are still plentiful so keep rolling Make sure you notify Manager if you have too many leads!!
Kim referral bonuses
Kelly discuss new hires for prior month
Eddie introduce new trainees make sure counselors using the training manual
Kamah remind people to check the unknown list claim & unclaim payments on the appropriate list Daily It is important to keep phone ready after 6pm (Notify Manager)
Colleen reminder we have two days to have files complete and turned in to Compliance
Melanie counselors to follow script and disclose contribution (voluntary and 1st pay)
David the 60 account lunch will be on Friday the 14th meet in the lobby at 12:15pm
We had 32 people and they are Steve W, Mike L.,Lacey, Stacy,Nikki, Joe G., Stephanie, Ron L,Tonyia, Maria S., Amber, Maria M., Rene, Elsa, Anthony, Vonrae, Erin, Jason A., Jamal, Malik, Schwanna, Minassie, Judy, Jamai R., Ellen, Michael D., George, Dan G., Alex, Charise, Kendall, & Matt M Call PW by this Wednesday the 12th if you are attending
Monica intro Ellen recognize group members
Roxanne intro Mike H. Recognize group members
Pw intro Ryan H. recognize group members
Travis intro Tenilla recognize group members
Amber intro Charles F. recognize group members
Bobby intro Maria recognize group members
Jesse intro Eric A. recognize group members
Kristy recognize Brandon group members
Lacey cover lead audits, make sure all leads are called 3X, the importance of not going into work mode, and ACD calls are very important do not get Name & Number
Lead A.A.'s intro Alfia recognize new group members
Mike L. remind people if they stay extra and call leads bonus will be achieved for Sept.
Counselor of the Month Steve Woodring as & Employee of the Month as Zeek Weeks
Jeff Director Comments 1) Expanding Target date? 2) Leads plenty 3) New Contest winner is Steve Woodring 4) Promotions
Finish the meeting by asking are we going to meet out goal!!!

Permanent Subcommittee on Investigations
**EXHIBIT #15**

Permanent Subcommittee on Investigations
EXHIBIT #16

# HOW DO YOU RESPOND WHEN EXPLAINING QUESTIONS REGARDING THE CONTRIBUTION

DO YOU FEEL .....

SCARED ??

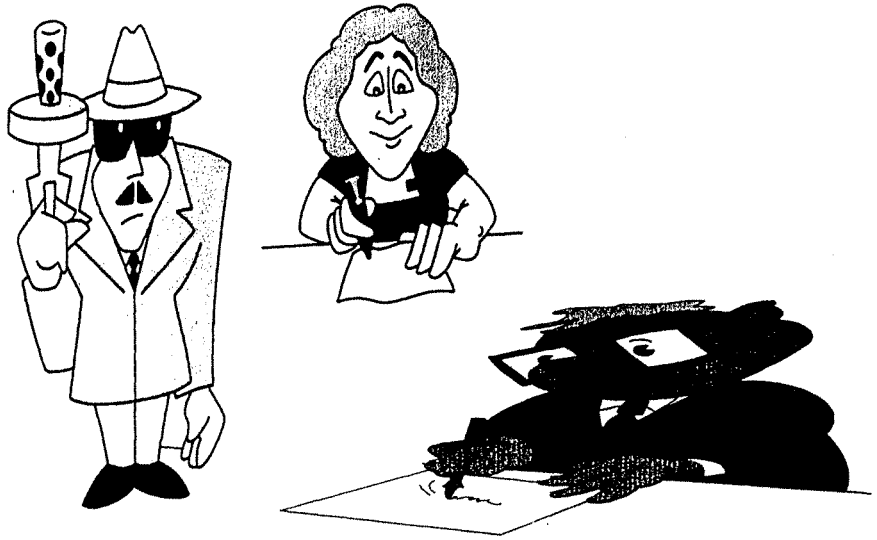
LIKE SNEAKING AWAY ??

RUN FOR YOUR LIFE !!

**DebtWorks Employee Training Document**

Permanent Subcommittee on Investigations
EXHIBIT #17

# WAS THE CLIENT FORCED TO SIGN THE AGREEMENT ?



**DebtWorks Employee Training Document**

# TRANSCRIPT OF PROCEEDINGS

## UNITED STATES SENATE
## PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
## COMMITTEE ON GOVERNMENTAL AFFAIRS

**In the Matter of:**

**CREDIT COUNSELING INVESTIGATIONS**

**Deposition of**

**JOHN PUCCIO**

**Washington, D.C.**
**July 1, 2004**

Permanent Subcommittee on Investigations
EXHIBIT #18

UNITED STATES SENATE

COMMITTEE ON GOVERNMENTAL AFFAIRS

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

- - - - - - - - - - - - - - - - - -x
:
In the Matter of: :
:
CREDIT COUNSELING :
INVESTIGATION :
:
- - - - - - - - - - - - - - - - - -x

Washington, D.C.

Thursday, July 1, 2004

The deposition of JOHN PUCCIO, called for examination by counsel for the United States Senate, Committee on Governmental Affairs, Permanent Subcommittee on Investigations, Room SH-320, Hart Senate Office Building, commenced at 2:03 p.m., before Pamela Briggle, a notary public in and for the District of Columbia, when were present on behalf of the parties:

APPEARANCES:

On behalf of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs:

STEVEN GROVES, ESQ.
Counsel for the Majority
JOSEPH KENNEDY, ESQ.
General Counsel for the Majority
KATHERINE E. ENGLISH, ESQ.
Counsel for the Majority
DAN BERKOVITZ, ESQ.
Counsel for the Minority
Committee on Governmental Affairs
Permanent Subcommittee on Investigations

On Behalf of the Witness

CHRISTOPHER D'AMATO
Senior Vice President
ALFONSE D'AMATO
Park Strategies, LLC
101 Park Avenue
Suite 2506
New York, New York 10178

ALSO PRESENT:

CHRIS VIALE

C O N T E N T S

| WITNESS | EXAMINATION BY COUNSEL FOR PSI |
| --- | --- |
| John Puccio | 4 |

EXHIBITS

| PUCCIO DEPOSITION EXHIBITS | MARKED |
| --- | --- |
| Exhibit A | 39 |

1 P R O C E E D I N G S

2 Whereupon,

3 JOHN PUCCIO

4 was called for examination by counsel for the Committee on

5 Governmental Affairs, Permanent Subcommittee on

6 Investigations and, after having been first duly sworn by

7 the notary public, was examined and testified as follows:

8 EXAMINATION BY COUNSEL FOR THE SUBCOMMITTEE

9 BY MR. GROVES:

10 Q Good afternoon, Mr. Puccio. How are you?

11 A I'm okay.

12 Q Great to hear it. Great to hear it. I explained

13 before we got started some of the ground rules, and do you

14 understand everything that we talked about off the record as

15 far as taking breaks if you need to and so forth.

16 A Yeah.

17 Q Why don't we just start off by you giving your

18 name and date of birth and current residence for the record.

19 A Okay. John Puccio. April 25, 1955. And I reside

20 at 17 Windsor Drive, and that's in Muttontown, New York.

21 Q And although we have interviewed you--you've sat

22 for an interview, at least one interview, with our staff in

23 the past--let's talk a little bit about your background.

24 Why don't you bring us up--tell us about your employment

25 history prior to becoming involved in credit counseling.

1 A Okay. Let's go back, I guess, to 19--I have to go
2 into the 1970s. I worked at a chemical company in Brooklyn,
3 New York, and that job function was to sell maintenance
4 chemicals to school districts and municipalities. Later on,
5 I ended up forming my own company, and that lasted, oh,
6 let's say, somewhere--oh, going back a long ways--between 8
7 to 10 years.
8 Q Okay. Was that also in chemical sales?
9 A That was chemicals, yes.
10 Q And what happened after those 8 to 10 years?
11 A Then I just basically moved on. I was in the car
12 business for a while, Toyotas, selling Toyotas.
13 Q Sales?
14 A Sales. Actually, at that time I did everything.
15 And then really just more or less doing a lot of different
16 type of things before I finally got into the debt management
17 industry.
18 Q And what first led you into becoming involved in
19 the debt management industry?
20 A The idea of helping people. How I grew up, I grew
21 up in a middle-class household where, you know, my dad was
22 the type of person that you help people that are in need of
23 help. And that's pretty much what attracted me to the idea
24 of the business when I had first heard about it.
25 Q Was he in the debt management industry--
26

1 A No.
2 Q --or what was his profession?
3 A My dad actually owned real estate. He had a beer
4 and soda distributor and also a gas station, and we're going
5 back many years.
6 Q Right.
7 A He's no longer with us. In fact, today's actually
8 his 25-year anniversary since he passed on.
9 Q And how were you employed just prior to becoming
10 involved in the debt management industry?
11 A I'm sorry. I don't understand the question.
12 Q How were you employed just prior to being involved
13 in the debt management industry?
14 A How did I get into the business in terms of how
15 did I form the companies?
16 Q No. What was your employment just before you
17 formed the companies?
18 A It probably would be the car business. I took
19 about a year or two off in between, and then pretty much
20 went into the debt management business at that time.
21 Q Okay.
22 A Two years later.
23 Q And how is it that you first heard about the debt
24 management business?
25 A I had heard some individuals talking, just
26 casually talking, and it intrigued me, listening to the

1 conversation, and didn't know, you know, a whole lot about
2 the industry at the time. But I did some research and saw
3 that there was a great need for the type of business that
4 could turn around and help people get out of debt. And--
5 Q So tell us about--and then you made the decision
6 to form your own debt management business?
7 A That's correct.
8 Q And what steps did you take to form that business?
9 SENATOR D'AMATO: Maybe you want a time line, like
10 approximately what year he started.
11 THE WITNESS: 1993, this would be.
12 BY MR. GROVES:
13 Q This was when you--1993 is when you--approximately
14 when you started.
15 A Got into the debt management industry.
16 Q Okay. What steps did you take to enter into the
17 industry?
18 A Basically did everything myself, just calling up
19 creditors to understand what they were expecting of the
20 consumer, basically doing my own in-house knowledge of
21 trying to understand, you know, how people were getting
22 extensions of credit when possibly they couldn't really
23 afford to get it. I was just trying to get a whole
24 understanding of the industry. And when I did first start,
25 I was starting by myself, so what I ended up doing is
26 dealing with the consumer as well as the banks. So I was

1 kind of hearing it from both sides, which ended up being a
2 tremendous benefit for me to move forward because I was
3 starting to understand how both sides were feeling about
4 exactly the industry itself.
5 Q Had you formed a company at this time?
6 A That's when I formed Cambridge Credit Corp.
7 Q And was your brother, Richard, also involved at
8 this point in the proceedings?
9 A Not in the very beginning. He came in, I would
10 say, within a few months, because this was all something
11 that I wanted to do myself. I wanted to make sure that it
12 was indeed what I had hoped and thought it would be, which
13 was a business, again, to try to find--you know, help people
14 and eventually help them along to get out of debt.
15 Q And why is it that your brother became involved in
16 this industry?
17 A Well, at that time I was needing help when I saw
18 that it was becoming to the point where we were becoming a
19 business to start handling clients, so I started to,
20 obviously, go out and look for help in terms of, you know,
21 people to work with me. So Richard, obviously, being my
22 brother, was one of the first people I went to.
23 Q Now, did he form his own company?
24 A No.
25 Q So you were both working for Cambridge Credit
26 Counseling?

1 A Correct.
2 Q At some--
3 A And we were, you know, incorporated together.
4 Q And that was roughly in 1993?
5 A Correct.
6 Q Now, at some point in the proceedings, a company
7 called Brighton Credit Counseling was formed?
8 A Was formed--I want to say within the six months'
9 time frame afterwards.
10 Q And who formed Brighton Credit Counseling?
11 A I did.
12 Q And what was the purpose for forming Brighton?
13 A Well, at the time what I was seeing is that there
14 was going to be two type of functions for the industry as I
15 was getting more familiar with the way the industry was put
16 together, and that was one of an enrollment process, one of
17 an education process, and then ultimately the other side of
18 the business, which would be the customer service side. And
19 my thinking was to turn one company into doing the one side
20 of that, because it's like two halves. So one half would be
21 the one company doing it, and then the other half would be
22 the second company doing it. And the names were just
23 coincidentally thought out and kind of went together, we
24 felt.
25 Q Why was it necessary to have two companies in
26 order to perform those three functions?

1 A Just at that time, it was my idea of thinking that
2 that's the way it should be.
3 Q There was no thought of just having one company
4 perform these functions?
5 A Not at that time, no, because I saw that there was
6 a trend in the industry where you would turn around and have
7 to have back support. So I just--at that time we just
8 decided to do two halves.
9 Q And what--
10 A We could have made it a whole, but we made it two
11 halves.
12 Q And where was it that you saw the trend in the
13 industry? Were there other credit counseling companies that
14 you saw this--
15 A Well, as I was, you know, obviously, starting now
16 to become more familiar with the industry, as months and
17 then years had gone by, I started seeing what other
18 companies were doing. And some, I thought, weren't doing
19 things that they were saying they were doing, and others,
20 the leaders, were doing things that they say they were
21 doing. And I just felt that I could do it better.
22 Q Were there companies that you saw in the industry
23 that had two separate companies to serve the different
24 functions?
25 A Started to see that, you know, later on in the
26 years past. It was almost like the idea that I thought of

1 was already existing and I just didn't realize it at the
2 time, because, again, I was very new to the industry and
3 learning the industry as I was going along.
4 Q Was there some division of labor between yourself
5 and your brother in terms of the Cambridge entity versus the
6 Brighton entity?
7 A I'm not quite sure I understand the question.
8 Q For example, generally, did you run one company
9 and he ran another?
10 A We basically worked together.
11 Q You jointly ran two companies?
12 A Yes.
13 Q Okay. Were you both officers and directors in
14 both companies?
15 A That's correct.
16 Q And what were the ownership interests at that
17 time?
18 A They were 50 percent--50/50.
19 Q 50/50 for Cambridge and 50/50 for Brighton?
20 A That's correct.
21 Q Thank you.
22 Now, when you first set these companies up back in
23 '93 and moving forward several years, they were not
24 originally organized as nonprofit corporations.
25 A That's correct.

1 Q And what was the reason for not organizing them as
2 nonprofits?
3 A Okay. As I--when I first started the first
4 company, Cambridge, in 1993, I made a call to New York State
5 Banking Department and ended up getting--it was an opinion
6 that I never did get in writing, which was--you know, at
7 this time turned out to be a mistake. But it was an opinion
8 that as long as you serviced clients outside of New York,
9 you didn't need a license. And that was the opinion that we
10 were given. So we went forward with servicing all residents
11 outside of New York.
12 Q So from '93 until approximately '96--
13 A 1996.
14 Q --all of your clients were outside of New York
15 State?
16 A That's correct.
17 Q Was there any other reason that you preferred to
18 run it as a for-profit company versus a nonprofit company?
19 A Well, at the time we were also looking at getting
20 licenses in various States with a lot of--more or less
21 working with the States and learning to understand how the
22 States were working, we saw that all States had different
23 statutes. None of them were copying each other. Pretty
24 much some States had no statutes. Some had statutes with
25 fee restrictions. So we were charging a fee, which at that
26 time in New York was--you only were allowed to charge up to

1 $75 for initial consultation for a debt management plan.
2 And that didn't fit into our fee structure because we had a
3 totally different fee structure with our rebate program.
4 Q And what does that have to do with the reason why
5 you chose to organize as a for-profit company?
6 A No reason. At that time that we started the
7 for-profit, we really didn't know about having to be
8 licensed as a not-for-profit.
9 Q I see.
10 A That was something that we learned as we went
11 along.
12 Q Then something changed in 1996 with the New York
13 Banking Department. Why don't you tell us about that
14 briefly.
15 A We were just sent a letter by mail--
16 SENATOR D'AMATO: Who sent the letter?
17 THE WITNESS: The New York State Banking
18 Department sent a letter saying that they required us to be
19 licensed under their statute.
20 BY MR. GROVES:
21 Q And what actions did you and your brother take as
22 a result of this letter?
23 A Well, we went to visit them a number of times and
24 tried to explain to them our model, and our model was quite
25 differently--different than all the other models that
26 were--well, really the model that was being performed by the

1 industry. And we were trying to make them understand that
2 while we were charging a fee, we were giving the rebates
3 back from the commissions from the banks. And that was
4 about a 3-year time frame in which we were negotiating.
5 Finally, they ended up licensing us, but that was after we
6 had moved. And that's where we ended up, in Massachusetts.
7 Q And when did you open the office in Massachusetts,
8 approximately?
9 SENATOR D'AMATO: Counsel, could I, just for my
10 own--did there come a time when the State issued a license
11 to you, the State of New York?
12 THE WITNESS: Yes.
13 SENATOR D'AMATO: And when was that?
14 THE WITNESS: 2000.
15 SENATOR D'AMATO: Okay. So in '96, they said--
16 THE WITNESS: Negotiated.
17 SENATOR D'AMATO: And then in 2000, you got a
18 license from New York.
19 THE WITNESS: Right. Yes.
20 SENATOR D'AMATO: Okay. I hope you don't mind if
21 I--
22 MR. GROVES: No problem, Senator.
23 SENATOR D'AMATO: Because I didn't have the time
24 line.
25 MR. GROVES: And we've been living this for
26 months.

1 SENATOR D'AMATO: It is new to me. Okay. Thank
2 you.
3 MR. GROVES: Anytime.
4 BY MR. GROVES:
5 Q And so while this negotiation was going on for the
6 New York entity, you decided to open an entity--
7 A We had done some research, and Massachusetts had a
8 statute of no fee restrictions, and it was, you know, a
9 State we felt that we could use our business model, and we
10 ended up moving there and started conducting business. And
11 that was in 1996.
12 Q And did--
13 A We actually didn't start doing business, I
14 believe, until like 1997.
15 Q Okay. Now, in Massachusetts, you organized as a
16 nonprofit?
17 A That's correct.
18 Q What was the reasoning for doing it that way?
19 A Because the statute in Massachusetts read that you
20 could offer--call it budget planning. Under their statute,
21 if you were to register as a not-for-profit, you can charge
22 fees and, therefore, you know, conduct business.
23 Q And they didn't have any particular fee structure
24 that they required?
25 A No.

1 Q Now, at some point during this process, a decision
2 was made to conduct an intangible assets transfer.
3 A Correct.
4 Q Do you know what I'm referring to?
5 A Yes.
6 Q What was the genesis of that decision?
7 A That was an accounting team that I had hired, and
8 they had put together the intangible asset agreement. I'm
9 not an accountant. I'm not really experienced to, you know,
10 say how they came to it, but, you know, they ended up doing
11 the work of an intangible asset agreement, and that's how
12 that sale came across.
13 Q And I'll only ask you what parts you know about,
14 about the agreement, and, you know, I don't want you to
15 guess or speculate.
16 A Okay.
17 Q These accountants were BDO Seidman?
18 A Correct.
19 Q Now--
20 A And then later on it was--the second examination
21 was done on that intangible sale agreement we're talking
22 about.
23 Q By KPMG.
24 A By KPMG, yes.
25 Q Now, what I need you to rack your brain on--I know
26 this is going back a couple years; do the best you can. The

1 idea to come up with the intangible assets transfer, who
2 came up with that idea?
3 A It was presented to me. It was presented to me by
4 my accountants and, actually, at the time my attorneys as
5 well. Since I was moving--you have to--I think we may have
6 to take a few steps back. We were moving roughly--from New
7 York to Massachusetts, we were moving roughly, I want to
8 say, six to seven thousand clients, plus not only were we
9 moving the clients, we were moving all the software that was
10 invested into the 3 years beforehand along with all the
11 technology that we had built into those three years that we
12 were in New York. So all that was tied into the valuation.
13 Q Now, was BDO Seidman brought on for the purpose of
14 the intangible assets transfer?
15 A No.
16 Q You had been dealing with them for years before?
17 A I'm going to say maybe a year before or so we were
18 introduced.
19 Q Now...
20 A The time frames I'm just not--I want to point out
21 I'm just not 100 percent accurate on certain time frames.
22 Q We won't hold you to do that. We know this is
23 going back several years, and there are documents that
24 support when exactly the times are. So don't worry about
25 that, okay?
26

1 A Okay.
2 Q Just the best of your recollection.
3 Now, how did BDO Seidman and your attorneys at the
4 time present this intangible assets transfer to you?
5 A How did they?
6 Q Yes.
7 A Just like putting on a presentation.
8 Q I'm assuming they came to you with an
9 idea--correct me if I'm wrong but this is a transfer that
10 resulted in quite a substantial gain-
11 A Correct.
12 Q --for yourself and for your brother?
13 A Right.
14 Q I'm just wondering how is it it was presented to
15 you, because essentially, wasn't this a transfer of assets
16 from one company wholly owned by you to another company
17 wholly owned by you?
18 A You could--you could say that, but, again, I'm not
19 an accountant, and how they prepared it and--you know, they
20 basically said to me that this is what you're giving up,
21 you're moving--you're bringing your client base, you're
22 bringing everyone you've invested of your own money that you
23 started from day one in 1993, and this is an intangible sale
24 agreement that just needs to be valued. And this is how it
25 works, and this is a common transaction that's done with

1 companies at different times, or whatever. But I don't
2 know.
3 SENATOR D'AMATO: Can we go off the record for a
4 second?
5 MR. GROVES: Yes.
6 [Discussion off the record.]
7 BY MR. GROVES:
8 Q Let's be clear, you only need to answer the
9 questions that I ask you. Now, who owned these intangible
10 assets at the time that they were sold?
11 A The intangible assets were owned by me and my
12 brother, since we had the companies, the for-profit
13 companies.
14 Q And who were you selling the assets to?
15 A The newly formed company in Massachusetts.
16 Q Cambridge?
17 A Yes.
18 Q That's Cambridge Credit Counseling Corp.
19 A Yes.
20 Q And that was an entity wholly controlled by you?
21 A And I had board members that we put on, you know,
22 as the company continued to grow.
23 Q So would you agree that essentially it was a sale
24 of intangible assets from a company you owned to a company
25 that you controlled?
26

1 SENATOR D'AMATO: That you and your brother
2 controlled.
3 THE WITNESS: Yes, you could say that.
4 MR. GROVES: Okay.
5 BY MR. GROVES:
6 Q Now, I know in some of the papers that have been
7 given to me regarding subsequent settlement discussions
8 between different State Attorneys General they talk about
9 disgorgement of profits. To your knowledge, is there
10 anything about any of the revenue that was generated as part
11 of the intangible asset transfer that has been disgorged?
12 A No.
13 Q Okay. So the revenue generated from the
14 intangible asset transfer is still the property of you and
15 your brother?
16 A Correct.
17 Q Okay. Now, what was your role--prior to recent
18 events, what was your role at Cambridge Counseling Corp.?
19 Well, strike that. Let me take a step back.
20 A Okay.
21 Q Who was it specifically at BDO Seidman who
22 presented this intangible assets transfer idea to you?
23 A There were a few of the partners--well, not
24 partners. You know, representatives or--
25 SENATOR D'AMATO: Most of them are partners.
26 THE WITNESS: Okay. One, Christopher Orella.

1 BY MR. GROVES:
2 Q Orella?
3 A Yes.
4 Q Do you have the spelling on that?
5 A O-r-e-l-l-a.
6 Q Okay. Was he the main person at BDO who presented
7 this?
8 A Yeah, he had his team, but I guess you would call
9 him, you know, as far as--one of the main people, yes.
10 Q And you also said that the idea was presented by
11 your attorneys at the time; is that correct?
12 A Mm-hmm.
13 Q And who were your attorneys at the time?
14 A I have to think about that one. I'm not quite
15 sure.
16 SENATOR D'AMATO: We'll get that information for
17 you and provide it.
18 MR. GROVES: Okay.
19 SENATOR D'AMATO: If you can think of it before,
20 fine. If not, we'll get it.
21 MR. GROVES: Right, if it comes to you later.
22 THE WITNESS: Okay.
23 MR. GROVES: Just let it go.
24 BY MR. GROVES:

1 Q Okay. Now, prior to recent events, what was your
2 role at Cambridge Credit Counseling Corp., the Massachusetts
3 corporation?
4 A Well, basically to manage the business, the
5 day-to-day operations, appointing staff, to also manage
6 other staff, to constantly stay ahead of the curve in
7 upgrading the systems for the clients so the clients can
8 indeed get the best service available in the industry.
9 Q Now, at some point an entity--we've spoken about
10 the one in Florida--pardon me. Strike that--about the one
11 in New York and the formation of the one in Massachusetts.
12 At some point one was formed down in Florida. Is that also
13 correct?
14 A Yes.
15 Q What was the name of that entity?
16 A Brighton Credit Management Corp.
17 Q And do you roughly recall the approximate date
18 that that company was formed?
19 A Oh, I want to say--around the year 2000?
20 Q And, again, we won't hold you to these dates, just
21 the best of your recollection.
22 Now, what were the circumstances of starting that
23 company down in Florida?
24 A Well, the location. I mean, we liked to have a
25 presence outside of just Massachusetts as well as New York,
26 so Florida was obviously an attractive location.

1 Q Any other reasons?
2 A Pretty much--pretty much that's, you know, where
3 it started, and they, again, like all the other States, they
4 had different statutes. So their statute was one that you
5 could operate as a for-profit, and that was another reason,
6 too, that we had gone there, along with an order to do
7 business. We did get an order to do business.
8 Q Right.
9 A From the State.
10 Q Now, did Brighton Credit Management Corp.--let's
11 just call it the Florida entity. Did the Florida entity use
12 the--were they going to use the same software and technology
13 that the New York and Massachusetts companies were using?
14 A You can't do it. You can't move from one--I mean,
15 they were going to emulate that, but it had to go through
16 their own investment.
17 Q Explain that, please.
18 A Well, it was a separate entity.
19 Q Right.
20 A So...
21 Q Well, I'm just trying to see the difference
22 between--I mean, there was a transfer of intangible assets,
23 software and business know-how, from New York to
24 Massachusetts, correct?
25 A The client base from the New York entities went to
26 the Massachusetts company. That's right.

1 Q The client base was nothing to do with the
2 intangible asset.
3 A Okay.
4 Q I've read that, and there's no discussion of the
5 client base.
6 A In the actual sale agreement? Again, Steve, I'm
7 not--I'm not an accountant. The answer to this is, you
8 know, kind of--
9 Q Well, let me ask you a direct question then. In
10 your answer to my previous question about the assets that
11 were transferred from New York to Massachusetts, you talked
12 in terms of, you know, the software and the technology and--
13 A Know-how.
14 Q --business know-how, and that amounted to--the
15 sale price was over $14 million.
16 A Mm-hmm.
17 Q Now, subsequently, you opened a site down in
18 Florida, correct? And that uses the same software as New
19 York does, correct?
20 A I'm going to have to--I'm not really sure-
21 SENATOR D'AMATO: You're not sure whether it was
22 the same software--
23 THE WITNESS: Right.
24 SENATOR D'AMATO: --or whether it was similar and
25 a new package, for example?
26 THE WITNESS: Right.

1 SENATOR D'AMATO: In other words, it may not have
2 been the same system?
3 THE WITNESS: It's--
4 MR. GROVES: I only want Mr. Puccio--let's--we
5 have to be very careful here, Senator, because this is--this
6 is different.
7 SENATOR D'AMATO: Okay.
8 BY MR. GROVES:
9 Q I don't want you to answer a question that you
10 don't know--
11 A I'm not really sure, you know, the actual answer
12 to that. I'd like to be able to possibly get the answer to
13 you.
14 Q Okay. Now, what about the business know-how? Was
15 that--the people down in Florida, they were going to use the
16 same type of business know-how that was used in New York
17 entity; is that correct?
18 A Are you saying as far as me training them or
19 whatever?
20 Q Sure.
21 A You could say that, yes.
22 Q Everything that you had learned from New York and
23 Massachusetts was going to be utilized somehow down in
24 Florida?
25 A Yes.

1 Q My question is: Is there a reason why there
2 wasn't an intangible assets agreement between New York and
3 Florida?
4 A I don't have the answer to that question.
5 Q Okay. What was your role in the Florida entity
6 once it opened roughly in 2000?
7 A Well, I was president and, again, pretty much like
8 I had done with the other companies, coming in and doing the
9 day-to-day operations, hiring and having, you know, the
10 other employees, making sure that they were designating
11 management correctly, and at the same time making sure that
12 servicing the clients and the business was being run
13 properly.
14 Q Okay. Now, we know that the issues of salary have
15 become kind of an issue both--
16 A Yes.
17 Q --in our investigation and at the hearing. I know
18 that you've taken some new measures in recent times to kind
19 of revamp the system.
20 A Yes.
21 Q Prior to these measures, which we've all
22 discussed--I've discussed with Chris at length as well.
23 Prior to those measures, how were your salary and your
24 brother's salary agreed to, and how were they--how did you
25 reach the amounts that you--
26

1 A Well, we had studies--we had studies done, and,
2 again, with the time frames, I don't know the times of the
3 studies as the years have gone by because we're talking
4 about 1996, '97, all the way up to the present. But we
5 started out the first year or two, I believe, at a salary
6 of, say, $140,000, whatever the numbers were. And then as
7 business grew, we had the salaries be examined on the type
8 of business, the number of employees, the type of revenue
9 that the company was generating to all go before an outside
10 independent firm to obviously look at our salaries if we
11 were going to end up taking on more salary.
12 Q And which firm was that? This was a firm that did
13 a salary study?
14 A Outside, yeah. I don't have the name at
15 my...yeah, I'd be able to get that to you. I don't have the
16 name.
17 Q Okay. That's another piece of information that we
18 can get later. Don't worry.
19 Do you remember the approximate year that the
20 first--I'm not supposing that there has to be a salary study
21 every--you know, at every month or every turn of the key.
22 A Right.
23 Q But do you recall the first year that a salary
24 study was conducted?
25 A I want to say two or three years into the--1998,
26 '99, I want to say somewhere around that time frame.

1 Q Okay.

2 SENATOR D'AMATO: And we'll try and get you more

3 precise information

4 BY MR. GROVES:

5 Q Have you had a chance to discuss what happened at

6 the hearing with any of your employees or perhaps with Chris

7 about what happened at the hearing that we had on this

8 investigation?

9 A Yes.

10 Q Was the discussion of a former client brought up,

11 a Raymond Schuck?

12 A It was brought up to me, yes.

13 Q Have you had a chance since that time to examine

14 what happened in his particular case?

15 A I haven't really been, Steve, in--I've been on

16 leave since all this happened, and Chris has been

17 communicating with me. But from what I understand, we were

18 trying to find out what exactly had happened with Mr.

19 Schuck, and, you know, we were very disappointed that, you

20 know, he didn't come to us or ask for, you know, something

21 in terms of a refund. In fact, I think Chris had mentioned

22 that we did even refund him some of his money while still

23 continuing on our program. But yet he still was a witness

24 at the hearing, which I thought was kind of odd. But with

25 that being said, it's important to--I'd like to be able to

26 point out, anyway, you know, that this is one individual. I

1 think if you look at every company in America, you know,
2 General Motors or anyone else, I think you're always going
3 to have someone unhappy. But, you know, if you go over the
4 years, we've dealt with hundreds and thousands of consumers,
5 and, you know, for the one Mr. Schuck, I think I could
6 produce a lot more people that could say great things, you
7 know, on the opposite side of Mr. Schuck. So--but I was
8 very disappointed to hear that Mr. Schuck was not only
9 unhappy, because we've always had zero tolerance with all of
10 our clients, that's why in our opinion we have the lowest
11 rate of complaints in the industry because we try to make
12 sure that every client is treated fairly and properly.
13 Q Now, is there anything that Mr. Schuck said, to
14 your knowledge, that was incorrect or a lie?
15 A I don't know the--again, I wasn't there at the
16 hearing.
17 Q Understood.
18 A Yeah, I just--
19 Q Understood.
20 A I don't know.
21 Q What about did you discuss with anyone the
22 testimony of former employee John Pohlman?
23 A He was mentioned to me, and--
24 Q Have you been told about some of his testimony at
25 the hearing and have you had a chance to analyze--

1 A Again, just a little bit, because I haven't really
2 been involved with the day-to-day other than I was told he
3 was only working for us for a few weeks.
4 Q Okay. Now, he discussed some things about the
5 set-up at the company. He was a short-time employee, to be
6 sure.
7 A Okay.
8 Q He mentioned something about a board that
9 displayed the number of sales that a particular employee
10 had. Are you familiar with this board?
11 A Yes.
12 Q Could you describe it to us for the record?
13 A It was basically a board that would put what each
14 counselor's--we monitored how the counselors were working
15 with the clients. Nothing more than a monitor. I would
16 call it as a monitor board.
17 Q Monitor board.
18 A Mm-hmm.
19 Q Is this an electronic board?
20 A Yes.
21 Q Is it a digital type of board?
22 A I believe so.
23 Q Okay. And what items are up on this board? What
24 does the board display?

1 A Again, I'd have to--I'd like to be able to get
2 back to you as far as what exactly is--I mean, I don't want
3 to say--
4 Q I'll ask questions. Maybe it will refresh your
5 memory. Are names of employees on the board?
6 A First and last name, I'm not sure, because--okay.
7 Q Or part of their names? Maybe their first name or
8 something, or last name?
9 A I would say so.
10 Q Maybe their first name?
11 A Yeah, I believe so.
12 Q Was it their name or the name that they took on as
13 part of their sales position?
14 A It would probably be their first name, I would
15 say.
16 Q Okay. And would there be some value up there on
17 the amount of fees that that particular employee was
18 bringing into the company?
19 A It was more of--you know, when you have 50 or 60
20 individuals working on the phones and you're really not
21 knowing if they're really working on the phones and are they
22 truly talking to clients and educating them, you know, this
23 board was able--would be able to tell someone that's
24 managing these people that there is work being done within
25 the company with regards to the client, and that's what this
26 was for.

1 Q And how would the board tell the managers that?
2 A Again, I really wasn't in that room with these
3 people because we would change, you know, different things.
4 There would be incentives put--when I say "incentives," in
5 terms of we changed over the years, where the longer a
6 client stayed on the program would reflect the counselor's
7 pay. And I think if you see that there's been a lot of
8 changes--
9 Q Absolutely.
10 A --with regards to the counselors and how they were
11 being paid. And this was--again, as the business was
12 growing and going, the industry was doing it one way. We
13 were following it somewhat. We felt we could do it somewhat
14 better where the counselor would not only feel that they're
15 being rewarded, but they're also--you know, they're being
16 monitored by seeing how hard they're working. And that was
17 the point of the board.
18 Q He also spoke in terms of monitoring employees,
19 and he said that there were security cameras in that room or
20 some form of camera.
21 A Yeah, well, they're more for a break in, you know,
22 just the regular security, you know, like an alarm or
23 anything else.
24 Q Why don't you describe how the cameras were set up
25 in this room?

1 A I think--that was a long time ago, but I want to
2 say there were four cameras, maybe one in each of the
3 corners.
4 Q And this was an interior room in your building in
5 Massachusetts, was it not?
6 A Yes.
7 Q And I was wondering what was the--what security
8 function that that was serving.
9 A Well, if someone had broken into the office after
10 hours.
11 Q I mean four cameras--there's no cash in this room,
12 is there?
13 A No, no. Well, it's just basically, again, another
14 monitoring piece of equipment.
15 Q Were there cameras in other parts of the office
16 that did the same thing?
17 A There was a few other cameras throughout the
18 office, correct. The interior, the exterior--yeah.
19 Q What other interior cameras were in the office?
20 A What others or saying how many or--
21 Q Well, there were four--the room that we're talking
22 about where there was one in each corner--
23 A Yeah, I don't know exactly the number of cameras.
24 SENATOR D'AMATO: There were only two cameras in
25 that room.
26 THE WITNESS: Oh, okay.

1 MR. GROVES: Hold on. Let's--
2 SENATOR D'AMATO: Yes, but--
3 MR. GROVES: Senator D'Amato, this is sworn
4 testimony--
5 SENATOR D'AMATO: I understand, but what I'm
6 saying, he's not really sure, and I don't want him to get
7 into a situation, and I object with-
8 THE WITNESS: Okay.
9 SENATOR D'AMATO: Just stop. If you recall
10 cameras, just say you recall them, were they there to
11 monitor, if they were there to monitor the operation, say
12 it.
13 THE WITNESS: Okay.
14 SENATOR D'AMATO: But there were only two cameras
15 that we understand are in that room. Okay. So he said
16 four. He's not hiding anything.
17 MR. GROVES: I know. And you can feel free to
18 clean this up also on redirect.
19 SENATOR D'AMATO: All right.
20 BY MR. GROVES:
21 Q But going forward, again, best of your
22 recollection, the testimony, you know, it's not like we can
23 nail you to the cross on this. We're just talking
24 about--you've testified that you were there to run the
25 day-to-day operations of the company. You made decisions
26 regarding personnel.

1 A Okay. Well, if I could back up, running the
2 day-to-day didn't mean I had to be there every day because I
3 can't be in two places at once.
4 Q Three places.
5 A Right. So, you know--
6 Q I'm just trying to--
7 A --talking, communicating with all my staff on the
8 telephone is to me involved in the day-to-day operations as
9 opposed to physically being there, Steve. So--
10 Q So your testimony is that the cameras that were in
11 the room with the employees were for security purposes.
12 A Yes.
13 Q Okay. Now, was there--there was also testimony
14 from Mr. Pohlman about having to check in and out of the
15 room via some type of key card. Can you explain some of
16 that process to us?
17 A This, again, was done, as we continued to expand
18 and put more employees in the office, and I don't really
19 even know how exactly that works, the key card. So if I
20 could--you know.
21 Q That's the right answer. If you don't know, you
22 don't know.
23 All that being said, was there anything else--was
24 there anything in Mr. Pohlman's testimony that you've heard
25 of that you disagree with or you think is inaccurate or an
26 outright lie?

1 A I'm just not all that familiar with Mr. Pohlman's
2 testimony.
3 Q That's fine.
4 A Being I've just not been kind of involved over the
5 last few months with the company.
6 Q Okay. Now, the next series of questions I'm going
7 to ask, you may be hampered by your limited involvement in
8 the company, because I'm going to talk about some of the
9 changes that have been made.
10 A Okay.
11 Q Why don't you first give us your understanding
12 about--well, first, let's take a step back. Tell us about
13 your involvement in helping Cambridge change into the new
14 entity that it's going to become. What's your involvement
15 there?
16 A Okay. What would be my involvement with the new
17 model, you're saying, once it's implemented?
18 Q Or--
19 A I mean, it is implemented. I take that back. But
20 once I get back in terms of the company?
21 Q No, no. We can get there. But you're still in
22 flux. Off the record, we talked about some changes that had
23 been implemented--
24 A Okay. Well, I--
25 Q --rather than the other changes that have not been
26 implemented.

1 A Well, to make sure, for example--
2 Q Mr. Puccio, let me cut you off.
3 A Okay. Sure.
4 Q Because I didn't go through my standard spiel that
5 I used to do in litigation with you at the beginning, which
6 was: She can only listen to one of us at once.
7 A Oh, I'm sorry. Okay.
8 Q And we have to be very careful--it's almost a
9 game--that we wait until the last--one person's finished
10 with their question before they're answered, and I wait
11 until you're done with your answer--
12 A Okay.
13 Q --before I ask another question, because she can't
14 write us all at once. And it's normal, you know, we're
15 having a normal conversation.
16 A Okay.
17 Q But that will help. So the question that I'm
18 asking is: What is your current involvement in assisting
19 Cambridge and the related entities to evolve into what it's
20 going to become in the future?
21 A Well, basically what I would be doing is working
22 alongside Chris making sure, for example, we've implemented
23 the 90-day refund policy, so that would be something that
24 would have to be closely watched since I believe we're the
25 only company that's offering that long of an extension as
26 far as a refund. And just basically, you know, keeping up

1 to the new model, making sure that, I guess, for lack of a
2 better way of putting it, that it works.
3 Q Okay. What I'm going to do is I've marked a piece
4 of paper that was given to me by Senator D'Amato that has a
5 couple of indications about which changes have already been
6 implemented, three changes. This is marked as Exhibit A.
7 [Puccio Deposition Exhibit A
8 marked for identification.]
9 BY MR. GROVES:
10 Q Could you take a moment and review the three
11 bullet-pointed items at the top of this page?
12 [Pause.]
13 THE WITNESS: Okay.
14 BY MR. GROVES:
15 Q Have you had a chance to review the three bulleted
16 points?
17 A Yes.
18 Q And the first bulleted point regards the change in
19 fee structure. Is that accurate?
20 A Yes.
21 Q And is that fee structure now a $75 maximum
22 start-up fee?
23 A Yes.
24 Q And a maximum $50 monthly fee?
25 A Yes.

1 Q And this is the fee structure that is currently in
2 place in all three of your entities?
3 A That's correct.
4 Q Okay. The second bulleted item, that discusses
5 the 90-day refund policy.
6 A Yes.
7 Q And that is a change that has already been made?
8 A Yes.
9 Q And that policy applies to all three of the main
10 enrollment entities, correct?
11 A Yes.
12 Q And the fee structure, let me be more accurate
13 about the fee structure one. That fee structure is
14 currently in place in all three of the enrollment entities?
15 A Yes.
16 Q Okay. And I should, just for the record, the
17 enrollment entities being the ones in Massachusetts, New
18 York, and Florida. Is that accurate?
19 A Yes.
20 Q Okay. And the third bulleted point, that
21 involves--
22 A The educational--
23 Q --the educational video and the workbook. I think
24 that's an important change. Why don't you describe for the
25 record what that change entails?

1 A Yeah. Well, the consumer--whether a consumer
2 becomes a client or not, they're sent a free copy of an
3 education video and an educational workbook as well.
4 Q Okay. And this is a change that's been
5 implemented already, correct?
6 A To my knowledge, yes.
7 Q And if it has been implemented to your knowledge
8 already--and I'll actually take, you know, Senator D'Amato's
9 and Mr. Viale's representation that it has been implemented.
10 A Okay.
11 Q That would be implemented at all three locations
12 as well?
13 A Yes.
14 Q Okay. So this change means that any caller that
15 calls in and requests some form of counseling or wants to
16 know about the program and at the end of the call decides,
17 for whatever reason, not to enroll or is informed by a
18 Cambridge employee that they won't qualify, they will be
19 sent a video in the mail?
20 A Yes.
21 Q And they will be sent a workbook in the mail?
22 A Yes.
23 Q Thank you. This will be attached to the
24 deposition, so when you get a copy of the depo, this will be
25 attached to the end of it.
26 A Okay.

1 Q And I understand that there's been--there are
2 several other changes that I've reviewed in a document that
3 Mr. Viale gave me sometime ago as part of an ongoing
4 settlement process or an ongoing restructuring process. Are
5 you familiar with the rest of those changes?
6 A I'm not quite sure which ones you're talking
7 about.
8 Q Fair enough. Fair enough. That was a poor
9 question.
10 Let's first talk about--are you familiar with the
11 restructuring of the entities themselves?
12 A Yes, somewhat familiar, yes.
13 Q Okay. For the record--and you may have a limited
14 understanding of this because I know this is, again,
15 something involving accountants and lawyers. But give us
16 your understanding about the restructuring of the entities
17 themselves.
18 A Well, ultimately there will be a holding company
19 that will be the top of the--if you're going to break them
20 down, all the companies will come from the holding company,
21 which ultimately will be the not-for-profit holding company.
22 So whether they're the for-profit-related companies or the
23 not-for-profits, they're all underneath the holding company.
24 Q And that would be the Cambridge Credit nonprofit
25 holding company?
26

1 A Correct.
2 Q And do you know off the top of your head how large
3 a board of directors that Cambridge Credit nonprofit holding
4 company will have?
5 A Approximately nine. That was the number that we
6 had heard in terms of from the Attorney General's office.
7 Q Okay. Now, will there be a separate board of
8 directors for Cambridge Credit Counseling Corp.?
9 A I don't--I really don't--
10 Q Fair enough. You don't know.
11 A Right.
12 Q We can find those answers out otherwise. Just
13 tell me what you know.
14 A Okay.
15 Q Now, there's also the New York not-for-profit
16 Cambridge/Brighton.
17 A Yes.
18 Q To your knowledge, will they have their own board
19 of directors?
20 A Yes.
21 Q Okay. Now, earlier we were kind of jumping ahead.
22 We're there now. Are you planning on serving as a director
23 on the three boards of directors here at the top of this
24 pyramid?
25 A It's still in discussion.
26 Q Still in discussion. Fair enough.

1 What about your brother, Richard? Do you know
2 about what his involvement will be prospectively?
3 A Again, it's still in discussion.
4 Q Fair enough. Now, I appreciate the change
5 regarding the video and the workbook that has been made.
6 Why don't you enlighten us about other changes that the
7 Cambridge entities, if any, are making regarding more
8 counseling and education? Tell us about that.
9 A Well, again, since I really haven't been involved
10 in the day-to-day over the last few months, we've always
11 strived, even before--you know, I had somewhat of a
12 shortcoming, but we've always strived on continuing to
13 strengthen our education, reaching out to schools and
14 universities, which Chris has been taking a heavy lead role
15 in that. And so--
16 Q And this--
17 A --it's always been--we've always tried--I'm sorry
18 to interrupt you, but we've always tried to, again, you
19 know, be the best that we can be and show that we truly are
20 the best at what we do. And, obviously, the education,
21 besides just the regular customer service of dealing with
22 clients and their accounts with the creditors, the other
23 side is educating them to hopefully them never coming to,
24 you know, the path that they came down to, to where we
25 finally, you know, got together with them. So the education

1 is always something we've always strived to do more of and
2 to be very active in the community.
3 Q And the details of that, it may be more of a fair
4 question for me to ask Chris about this.
5 A Okay.
6 Q But, you know, just so we can get through this
7 deposition, is it fair to say that since you're not
8 currently involved in day-to-day operations that beyond this
9 third bullet point that we've discussed on Exhibit A, you're
10 unaware of more--of what steps have been taken to broaden
11 that program? Is that fair?
12 A I think that's fair to say.
13 Q Fair enough. Let's talk about the good payer
14 program. We're familiar with it moving up to this point.
15 There's transition going on.
16 A Yes.
17 Q To your knowledge, what is the status of that
18 program moving forward prospectively?
19 A Well, monies that have been already sent to
20 clients obviously have been sent. Monies that clients
21 now--that are due, these good payer monies will be sent out
22 along the same time frame and the way we've done it all
23 along. And then finally, when all these clients are paid
24 their fair share, you know, half of their fair share from
25 the old model, then we'll, you know, obviously move to the
26 new model.

1 Q What you're testifying is that under the new model
2 and the way things are being set up that the good payer
3 program, the rebate program, is not something that is going
4 to be moved forward prospectively for new clients, new
5 enrollees?
6 A That would be--yes, that would--yes.
7 Q Fair enough. And tell me about--I'm sure it comes
8 down to a business decision, but is there anything more that
9 you can tell me regarding the decision to stop the good
10 payer program?
11 A No, just the change of the--the new change.
12 Q Fair enough. Let's talk about bonuses. One of
13 the issues that came up in our interviews and our
14 discussions were incentives for your employees. And I
15 understand with other conversations with Mr. Viale that
16 there's been some changes there. Do you have knowledge
17 sitting here today about some of those details?
18 A Not fresh knowledge to--no. Actually, this is
19 something that Chris works with closely with his team, and
20 so I really wouldn't--I don't have that information for you
21 right now at this time.
22 Q Okay. As part of the structure moving forward,
23 there is something called an audit board that is being named
24 and is going to function. Are you familiar with this audit
25 board?
26 A No, I'm not familiar.

1 Q Okay. What about the compensation committee
2 that's been discussed as part of--
3 A Yes.
4 Q As part of negotiations.
5 A Yes.
6 Q Why don't you tell us about what the
7 compensation--well, strike that. We're talking about
8 several changes here. We've talked about bonuses, and we've
9 talked about some counseling and education. But is it your
10 testimony that sitting here today these three bulleted
11 changes are the only ones that have been fully implemented
12 to date?
13 A Yes.
14 Q To your knowledge.
15 A To my knowledge, yes.
16 Q There may be other--
17 A Yes.
18 Q There may be other knowledge out there, but to
19 your knowledge.
20 A Yes, yes.
21 Q Okay. Like, for example, can you testify whether
22 or not the audit board has been formed and is functioning?
23 A No.
24 Q Can you testify whether the compensation committee
25 has been formed and is functioning?
26 A No, I could not.

1 Q Can you testify regarding whether a chief
2 financial officer has been hired?
3 A No, I could not.
4 Q Can you testify whether or not a code of ethics
5 has been developed and implemented?
6 A No, I could not.
7 Q Fair enough. What about any changes to the
8 disclosures that are being made to customers on their
9 contracts with Cambridge? Is that another item that you can
10 testify about or too detailed at this point?
11 A Yes, only because these changes now are happening
12 while I'm on leave, so that's why it's kind of difficult for
13 me to give you, you know, answers--
14 Q And these changes--
15 A These changes are happening as we speak, and--
16 Q Right, they can happen day to day, right?
17 A Right.
18 Q Okay. And if I come back to you in the future
19 asking for updates on these things, I'm sure that you or Mr.
20 Viale can provide those, correct?
21 A Absolutely.
22 Q Okay. Why don't you bring us up to speed on--are
23 you tracking any of the regulatory actions or suits that
24 have been brought against Cambridge?
25 A When you say--
26 Q Tracking, as you being kept up to speed on them?

1 A Somewhat. Chris has been handling all the
2 day-to-day operations.
3 Q Okay.
4 A Since I've been out.
5 Q Do you know what the current status of the IRS
6 audit is today?
7 A No, I do not know the status.
8 Q Do you know what the--I know that you're in
9 negotiations with Massachusetts.
10 A Yes.
11 Q Do you know what the current state of the
12 negotiations are?
13 A I do not.
14 Q And what about the action brought by North
15 Carolina? Do you know the leading edge of that case?
16 A I do not.
17 MR. GROVES: Mr. Berkovitz, do you have any
18 questions?
19 MR. BERKOVITZ: I don't have any questions.
20 MR. GROVES: Then I would request to take a
21 5-minute break, get you some more water.
22 THE WITNESS: Thanks.
23 MR. GROVES: I'll go over my notes, but we may be
24 done. And, of course, if you want to do any redirect, we
25 can do so at that time. Is that fair?
26 SENATOR D'AMATO: More than fair.

1 MR. GROVES: All right. Let's take a 5-minute
2 break. Off the record.
3 [Recess.]
4 MR. GROVES: Back on.
5 BY MR. GROVES:
6 Q A question I should have asked you in the
7 beginning, the reason for the delays leading up to the
8 deposition were for medical reasons. What I want to make
9 sure is that if there's any--that you're not on any type of
10 medication that would restrict your ability to testify
11 coherently and to the best of your ability.
12 A No--now?
13 Q Now, sitting here right now.
14 A No.
15 Q All the testimony you've given is--
16 A I'm okay.
17 Q You're competent to testify today, yes?
18 A Yes.
19 Q Okay. There was an issue, speaking of Mr.
20 Pohlman, regarding the selection of a pseudonym while you're
21 employed at Cambridge. Tell us about the selection of
22 pseudonyms by new employees who are going to be interfacing
23 with customers.
24 A I'm not quite sure I understand the question.
25 Q A name other than your own. Were names chosen--

1 A Yeah. Yes. Okay. The reason why, as we
2 continued to grow with everyone coming in and having the
3 same names, it became--in the very beginning we used
4 everyone's same name. It became chaotic with all clients as
5 well as the creditors calling up asking for John and asking
6 for Jim, there's five Jim's, five John's getting transferred
7 back and forth. So what we implemented was where everyone
8 could use, say, their last name, because they won't have the
9 same last name, and they would use a first name that would
10 be different. Many people had middle names, so if their
11 middle names weren't the same as other people's middle
12 names, so that was the whole purpose of it with regards to
13 the names, just to--once we implemented it, it then started
14 to be a lot easier to handle the phone calls coming in,
15 obviously, because we're only speaking to one Mike and Jerry
16 and so on.
17 Now it got to the point where each office may have
18 the same name of the person, whereas it wasn't like five in
19 one office and four in another office. So that was the
20 point to that.
21 Q And these names are chosen off of a list so you
22 can keep track of who's got what name?
23 A Yeah, I mean, most of the times the people ask if
24 they can use a certain name that, like I said, whether it's
25 their middle name, some people use their father's name or

1 mother's name or something like that. But that's--and they
2 use their last name.
3 Q As long as it's not a name that someone else--some
4 other person at the same location already has?
5 A Correct.
6 Q Okay. And that's a practice that's done at the
7 three enrollment locations?
8 A Yes.
9 Q Okay. Now, we spoke about--
10 SENATOR D'AMATO: Could I, just for a point of
11 clarification, go off the record a second?
12 MR. GROVES: Off the record.
13 [Discussion off the record.]
14 MR. GROVES: Back on.
15 BY MR. GROVES:
16 Q We discussed some of the changes that Cambridge
17 was making over the past several months and discussed at
18 some degree your participation in assisting with those
19 changes. My question to you is whether each of the changes
20 that have been made already and the changes that have been
21 proposed to have been made have met with your approval and
22 are ideas that you want to go forward with.
23 A For example, the three bullets that we went
24 through first?
25 Q Let's talk about those first, sure.

1 A Yes. When it was brought up to me, I certainly
2 approved and agreed with it, yes.
3 Q Okay. And to the extent that you can speak to
4 them, how about the rest of the proposed changes that we've
5 also talked about that are in other documents? Are those
6 things that you've approved with already or are you--what's
7 the status of--
8 A Well, ultimately, I'll work with Chris and, you
9 know, between the--from now until the new implementation of
10 further changes, I'll work with Chris on that.
11 Q And because--
12 A Where we both, you know--
13 Q Because of your position in the various entities,
14 these changes would all have to come to you for approval.
15 Is that accurate?
16 A Yes, I would say so, yes.
17 Q Okay. Now, some of them, in the description of
18 the restructuring, will lead in--I'm trying to remember the
19 exact terminology in there, but will lead to some
20 significant financial losses for those people, including
21 yourself, who had ownership interests in the for-profit
22 entities. Is that an accurate statement?
23 A Just if you can, just repeat the question again.
24 Q Sure thing.
25 Madam Court Reporter, can you repeat that
26 question?

1 [Whereupon, the pertinent portion of the record,
2 as recorded, was read by the reporter.]
3 BY MR. GROVES:
4 Q Are you familiar with the description of the
5 reorganization that's going to happen?
6 A Yes.
7 Q And part of that description makes it clear that
8 there will be some significant financial losses to you. Is
9 that accurate?
10 A Okay. Yes.
11 Q Well, why don't you tell me about that. What's
12 your understanding of what losses you may--
13 A Well, yeah, actually, until the model's put in
14 place, that really is a hard question to answer.
15 Q Fair enough. What's your understanding that if
16 the model was put in place, some of the differences in
17 income that you personally would receive?
18 A Well, again, a tough question. Going back to some
19 of the for-profit-related companies, if you look on the Form
20 990s, you'll see that there was significant profit in, for
21 example, Debt Relief Clearinghouse, whereas today it's
22 operating at a loss. And the simple reason, just the nature
23 of the market has changed, advertising has increased,
24 competition has increased. So it's a hard question to
25 answer because, you know, Debt Relief right now is operating
26 at a loss.

1 Q Let me see if I can ask it better. The
2 restructuring, the proposed restructuring, is something
3 that's been--you're doing in part with your negotiations
4 with Massachusetts. Is that true?
5 A Yes.
6 Q And if it went as it's stated in the proposal, it
7 talks in terms of, you know, large disgorgement of profits
8 for the principals of the for-profits.
9 A Right.
10 Q Is that accurate?
11 A Okay.
12 Q If the settlement goes forward as planned and as
13 structured, I just want to get your answer on this, whether
14 that is something that you're personally willing to do in
15 order to--
16 A Yes.
17 Q --bring these subject matters to a close?
18 A Yes, absolutely.
19 MR. GROVES: Okay. Dan, do you have any
20 follow-up?
21 MR. BERKOVITZ: No.
22 SENATOR D'AMATO: But probably yes, you--
23 THE WITNESS: Probably, but predicting the future
24 is hard to do, you know.
25 MR. GROVES: Fair enough.
26 Do you have any redirect, Senator?

1 SENATOR D'AMATO: No. I can only say that I want
2 to thank you on the record, and the staff, for your
3 courtesy, for giving us and Mr. Puccio the opportunity to
4 come in, because as you know and we indicated, he was
5 medically unable to participate. And we look forward to
6 providing additional information, and we'll do so in
7 affidavit as it relates to some of the matters that we think
8 we could bring about some clarification. And we stand ready
9 to answer any other additional questions that you or staff
10 may have, or the committee.
11 MR. GROVES: Thank you very much, Senator. Thank
12 you, Mr. Puccio.
13
14 [Witness excused.]
15
16 [Whereupon, at 3:33 p.m., the deposition was
17 concluded.]
18

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## *CERTIFICATE OF NOTARY PUBLIC*

I, **PAMELA BRIGGLE**, the officer before whom the foregoing deposition was taken, do hereby testify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me stenographically and thereafter reduced to typewriting under my direction; that said deposition is a true record of the testimony given by said witness; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this deposition was taken; and further, that I am not a relative or employee of any attorney or counsel employed by the parties hereto nor financially or otherwise interested in the outcome of the action.

Pamela Briggle

PAMELA BRIGGLE

Notary Public in and for
the District of Columbia

My commission expires: May 14, 2005

- The consumer's fee structure has been restructured so as to provide for an initial reduced fee of $75.00 and a monthly fee of $50.00, which will be subject to a sliding scale based on a consumer's ability to pay (to the degree in some cases where the consumers will pay no monthly fee at all).
- A new refund/cancellation policy will be initiated so as to provide a 90 day period of rescission for any consumer of their initial fee; this 90-day money-back guarantee, the longest and *only one of its kind in the industry,* will also advance the organization's core mission of providing superior services to consumers.
- Regardless of whether a consumer becomes a Cambridge Credit customer, the consumer will be sent a free copy of an educational video and a copy of a comprehensive educational workbook.

Cambridge Credit continues to explore new ways to engage the public about the importance of financial education. Through educational outreach, I commend Mr. Viale who has spearheaded Cambridge Credit's financial educational efforts. As recently as June 23, 2004, on behalf of Cambridge Credit, Mr. Viale accepted the Gold Medal Award from Junior Achievement of Western Massachusetts for its longstanding commitment to educating youth on the importance of good financial management. Through age-appropriate curriculum and programming, Junior Achievement prepares students for the key economical and workforce issues they will face in the future. Programs begin at the elementary school level, through the middle and high school grades and teach children how they can impact the world around them as individuals, workers and consumers. Cambridge Credit continues to support Junior Achievement in 2004 by offering funding opportunities and by providing the curriculum for classroom educational programs.

PENGAD-Bayonne, N. J.
DEPOSITION
EXHIBIT
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# STATEMENT FOR THE RECORD

**STATEMENT OF PRESTON O. DUPPINS, JR.**
**PRESIDENT AND CHIEF EXECUTIVE OFFICER**
**GENESIS FINANCIAL MANAGEMENT, INC.**

**PROVIDED TO THE U.S. SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS**
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**
**HEARING ON "PROFITEERING IN A NON-PROFIT INDUSTRY:**
**ABUSIVE PRACTICES IN CREDIT COUNSELING"**

**MARCH 24, 2004**

Mr. Chairman, my name is Preston Duppins. I am the President and Chief Executive Officer of Genesis Financial Management, a nonprofit 501(c)(3) credit counseling agency located in Tampa, Florida. I was asked by the Subcommittee to present this testimony today.

First of all, let me state for the record that I am proud of my role as the President of a credit counseling agency ("CCA") as well as my 12-year history in the industry. It is important for the Subcommittee to understand that there are good credit counseling agencies in the country that serve a very important and valuable role. It is my personal goal to someday have the best credit counseling agency in the nation that would be a model for providing financial education and counseling to the public. However, before that can occur, I believe I must find a way to extricate Genesis from its existing business relationship with a for-profit service provider called Amerix. I tell you this not because you need to learn about an ongoing business dispute in the credit counseling industry, and not because the problems that Genesis faces with Amerix pose a threat to the thousands of consumers helped by Genesis, but because they are representative of a larger and widespread problem in the industry – that of the **excessive *control* of for-profit companies over nonprofit credit counseling agencies, and the excessive *benefit* that these for-profit companies derive from the nonprofit CCAs. In many situations – including mine – the nonprofit CCA is benefiting the private interests of the for-profit company *more than* it is benefiting the general public it was designed to serve. This excessive "private benefit" – as the federal tax code calls it – not only threatens the tax exemption of the CCA, but is harming debt-burdened consumers nationwide and threatens to undermine the integrity of the entire credit counseling industry.**

**How It All Started.** Fresh out of service in the Air Force, I got my start in the credit counseling business in 1992 when my friend Bernie Dancel – now CEO of Ascend One, the parent company of Amerix – offered me a job working the phones signing up consumers for debt management plans in his apartment in Columbia, Maryland. Bernie was running a one-man satellite office for Kimberly Credit Counseling. Bernie formed National Credit Counseling Services later that year, which eventually evolved into one of the largest and well known CCAs, Genus Credit Management. Bernie later spun off Amerix as a for-profit service provider, with Genus remaining as the nonprofit CCA. The idea was for the nonprofit to perform all of the educational functions while Amerix performed everything else – from advertising to client and creditor

Permanent Subcommittee on Investigations
EXHIBIT #19

services to back-end payment processing – all for a fee, of course. I served as Vice President of Operations for Amerix for several years. In 2001, Bernie offered for Amerix to loan me start-up capital to form a new nonprofit CCA I would head, which I incorporated as Genesis Financial Management. Genesis' tax exemption as a 501(c)(3) organization was recognized by the IRS in mid-2002.

From the outset, I began to feel the extreme control exerted by Amerix. In attempting to negotiate our first Service Agreement in 2002, Genesis asked that certain changes be made. For example, we asked to remove interest earned on bank accounts, as well as returned check fees charged to consumers, as revenue that Amerix received a percentage of, because Amerix did not share the expense of the bank fees. Every time an issue such as this was brought to Amerix's attention, the answer was the same: "If you don't like it, then we simply won't provide you with any start-up capital." Understanding that I had already committed to relocating my family to Florida, resigning my position with Amerix, and performing many of the necessary start-up tasks, stopping the process at this point was not a viable option. I thus proceeded with an extremely one-sided contract that gave Amerix the vast majority of the revenues from Genesis' operations, required Genesis to purchase all of Amerix's services, and gave Amerix enormous control over Genesis. I believed that as our CCA grew, we eventually would be on a level playing field with Amerix. Unfortunately, that never occurred.

**Excessive Control by Amerix Over Genesis.** Overall, the structure of the relationship between Amerix and Genesis is one in which Amerix – a for-profit company – has far too much control over Genesis – a nonprofit organization – despite my continued efforts to maintain control over Genesis and despite Bernie Dancel's initial assurances to me to the contrary. Amerix takes advantage of its superior role for the purpose of maximizing its own revenue, as well as increasing its own marketability. As a nonprofit organization, I have other priorities. Unfortunately, Genesis had little negotiating leverage when entering into its agreements with Amerix, as it needed the funds offered under the Credit Agreement to pay start-up and initial operating expenses. At the time, Genesis also needed the services provided by Amerix under the Service Agreement in order to operate. For numerous reasons, Genesis had no choice but to accept the agreements presented to it by Amerix virtually "as is."

**Excessive Fees Paid to Amerix Hinder Genesis' Ability to Achieve Its Educational Goals.** Genesis is required to pay to Amerix: (a) between 67% and 85% of all revenue it generates from its clients who enter debt management plans, including "fair share" payments from creditors, (b) all voluntary contributions from clients, *and* (c) interest and principal according to the terms of the Credit Agreement. This leaves Genesis with precious few resources to fulfill its educational goals, a source of continuing frustration for me. Genesis charges some of the lowest monthly fees in industry for debt management plans, and does not charge an upfront enrollment fee, unlike the other two CCAs serviced by Amerix. I refuse to change this structure. In addition, the fact that up to 85% of all revenue received by Genesis is paid to Amerix raises significant concerns that Genesis could be seen as operating primarily for the private benefit of Amerix and not for the benefit of the general public. This absolutely is not our intent or desire.

Genesis believes that the amounts paid under the various agreements to Amerix are well in excess of fair market value. We also believe that due to significant changes ongoing in the credit counseling industry, such as increased licensing and bonding requirements and decreased fair share contributions from creditors, our relationship with Amerix cannot be sustained in its present form. Genesis has attempted to re-negotiate these agreements with Amerix, without success. We understand that two of the four Amerix-serviced CCAs merged in 2004 due to financial difficulties arising from the factors just described.

Contractually, CCAs have to accept "all or nothing" pricing that is based upon a percentage of total revenue received by the CCA. This maximizes Amerix's revenue, but works to the economic disadvantage of its CCAs. Amerix argues that its fees are justified based on the significant upfront risk it has taken by investing in the marketing of the CareOne trademark, and that this marketing results in Amerix being able to send new clients to Genesis. This argument notwithstanding, we believe that Amerix actually assumes very little risk under any of these agreements – but certainly benefits tremendously from them.

**Minimum Assist Rate.** Under its Service Agreement with Amerix, Genesis is required to maintain an "Assist Rate" of not less than 30%. The Assist Rate is defined as "the ratio of new Clients enrolled to First Time Calls received per month"; in other words, it is the percentage of all callers that we sign up for debt management plans. This is something that Genesis believes – and that the IRS Commissioner has said – is in direct contravention of our tax-exempt status, as it requires Genesis to emphasize debt management plans to the exclusion of all other debt reduction and financial management solutions, when that may not be in the interest of the consumer. Amerix has continually pressured Genesis to meet or exceed the Assist Rate requirement; in the eyes of Amerix, Genesis has continually failed to meet its Assist Rate requirement.

Genesis also has disputed the Assist Rate obligation, in that Genesis has no control over whether the callers sent to Genesis by Amerix are good candidates for debt management plans – all of which should be irrelevant if our goal, as stated by the IRS, is to help consumers deal with their financial problems through the most appropriate means, not through the means that happen to generate the most revenues for Amerix.

Last year Amerix presented a proposed amendment to its Service Agreement with Genesis that provided Genesis additional latitude on its Assist Rates for a couple of months, in exchange for Genesis' agreement to terminate any employee who failed to meet his or her Assist Rate quota. Genesis rejected this offer from Amerix as contrary to our employee compensation structure, which does not reward or penalize employees for the percentage of callers signed up for debt management plans. We believe such a structure would be direct conflict with our nonprofit and tax-exempt purposes, as well as our own business philosophy.

**Genesis Has Been Unable to Terminate Its Agreements with Amerix as It Cannot Afford to Pay the Excessive Termination Fees, and, in the Alternative, Does Not Wish to Relinquish Control of Its Existing Accounts to Amerix or to a CCA Controlled by Amerix.** Even in the event of a material breach by Amerix that results in the termination of the Service Agreement or

Service Mark Agreement, unless Genesis relinquishes the debt management plans it is servicing to Amerix or to a CCA controlled by Amerix, Genesis must pay to Amerix residual fees equal to the number of clients who have made one or more payments to Genesis at any time within 120 days prior to the date of the termination multiplied by $200. This equates to approximately $3.5 to $4 million. From a practical standpoint, even though Genesis has wanted to leave Amerix for almost a year, Genesis does not want to relinquish control over its accounts to Amerix, due to Genesis' inability to pay these excessive termination fees. In other words, Amerix has Genesis over a financial barrel.

**Amerix's Agreements Limit Genesis' Ability to Work with Other Vendors.** Under its agreements with Amerix, Genesis is prohibited from hiring any other service provider for the life of the Service Agreement. In an effort to mitigate its damages, and in anticipation of eventually leaving Amerix, Genesis has arranged to test and use, for approximately 100 of its customers, an alternative software system that does not involve Amerix. This has resulted in a claim against Genesis by Amerix in arbitration, such claim which was recently denied.

**Amerix Has Continually Failed to Be Responsive to the Changing Business and Regulatory Climate for Genesis.** From industry accrediting bodies such as the AICCCA to certain creditors to federal agencies such as the IRS and the FTC, there appears to be a growing recognition that nonprofit CCAs have strayed from their traditional mission of credit counseling and education. In response, the AICCCA amended its accreditation standards last year to require that most consumer contact – both the initial telephone call and all customer service after a debt management plan is established – must be handled solely by employees of the nonprofit CCA and not by a for-profit company. To their credit, creditors such as MBNA and Sears have required essentially the same thing in order to be eligible for fair share payments from them (along with numerous other requirements). Unfortunately, at least until now, Amerix has refused to make the necessary changes to comply with this requirement. Just last week we learned that, in advance of today's hearing, Amerix was going to cease handling any initial calls from consumers (it had been handling the majority of such calls for its largest affiliated CCA, American Financial Solutions, which we understand was recently expelled from membership in AICCCA as a result of failing to satisfy this membership criterion). It appears that Amerix still believes that it is appropriate (and, in Amerix's view, permissible under AICCCA's Code of Practice) for its employees to provide telephone-based and other customer service to consumers *once* a debt management plan has been established. This contrasts with Genesis' firm belief, which we have expressed to Amerix, that the financial counseling and education of consumers must continue throughout the relationship – not just on the initial telephone call – and must be provided by the trained counselors employed by the nonprofit. Amerix's clear motivation has been the perpetuation of its existing revenues and profits, for as long as possible, even if it is to the detriment of its affiliated CCAs and the consumers they serve.

**Amerix Has Continually Marketed its Other Services to Genesis' Clients, without the Approval and Over the Objections of Genesis.** The CareOne Web site markets other products and services to Genesis' clients, without the authorization and despite the repeated protests of Genesis. These products and services are not in furtherance of Genesis' nonprofit purposes and only serve to generate more revenues for Amerix from Genesis' clients. Likewise,

FreedomPoint Mortgage – an Amerix-controlled mortgage business – made outbound marketing calls to Genesis's clients without our permission. Genesis' repeated objection to these offensive marketing efforts has further poisoned the relationship between our organizations.

**Credit Counseling Agencies Need a Dramatic Change of Focus.** The credit counseling industry's focus on consumer debt has been a *reactionary* one. This needs to change, with CCAs becoming more *proactive* about debt. Credit counseling agencies need to do more than simply react to consumer indebtedness by putting consumers on a debt management plan. This approach to consumer debt has been an abject failure. CCAs must begin to thwart consumer debt *before* it occurs and not just be the beneficiaries of it. To accomplish this change, CCAs need a radical shift in focus and organizational structure. Presently most CCAs consider providing a debt management plan to be "education." In truth, most CCAs provide very little education, particularly in comparison to their profitable debt management activity. As long as 80% or more of CCA revenues continue to come from debt management plan enrollments, CCAs will continue to ignore the educational responsibilities upon which their tax exemption is rooted. Creditor reductions in fair share payments to CCAs have contributed to this trend, but that does not excuse CCAs from fulfilling their educational mission. If and when Genesis is able to extricate itself from Amerix, it will focus on the prevention of consumer debt through education in a way that very few CCAs do – through preventative education, financial distress intervention, and post-debt management financial planning.

Balanced spending across these three major areas will allow Genesis to help consumers avoid the pitfalls that have befallen so many, develop expanded programs for people who do fall into financial difficulty, and work diligently to establish support for those who have come through financial difficulty and are taking their next steps toward financial freedom. The goal should not be to keep people from falling into financial difficulty. Illness, layoffs and unplanned events will continue to occur in people's lives. The goal should be to prepare our population for those problems. If through early financial education – starting in the formative years of school – you adopt sound financial habits, then when life throws you for a loop, which it will, you can fall back on those principles and keep yourself afloat during difficult times. This should be the goal of every credit counseling agency. By achieving this goal, we can stop more bankruptcies before they are filed, we can stop credit counseling before it is needed, and we can – hopefully – eventually work ourselves out of a job. Unfortunately, despite their assertions to the contrary, most CCAs – as well as the for-profit service providers such as Amerix that exert tremendous control over and gain excessive benefit from them – do not share this goal, have no real commitment to financial education, and are most interested in maximizing their profits from those most vulnerable in our society.

* * * * *

I commend the Subcommittee for shedding light on these critical problems in the credit counseling industry and for helping to facilitate much-needed solutions.

# STATEMENT FOR THE RECORD

**TESTIMONY OF DAVID C. JONES**
**PRESIDENT, ASSOCIATION OF INDEPENDENT CONSUMER CREDIT COUNSELING AGENCIES**
**Submitted to**
**SENATE COMMITTEE ON GONVERNMENTAL AFFAIRS**
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**
**Regarding**
**"ABUSIVE PRACTICES IN CREDIT COUNSELING"**
**Washington DC**
**March 24, 2004**

Chairman Coleman and members of the Subcommittee, for the past four years I have served as President of the Association of Independent Consumer Credit Counseling Agencies (AICCCA). I am the retired President of a prominent consumer credit counseling and education services company. I have been associated with the credit counseling industry for the past seven years. I currently dedicate my efforts to improving credit counseling and consumer education throughout the industry. I hold BS, MBA, and Ph.D. degrees and I am a graduate of the Brookings Institution Center for Public Policy Education.

On behalf of AICCCA's members, I want to thank the Subcommittee for inviting me to provide our views to you today. We share and support the Subcommittee's goal of assuring that consumers facing substantial debt problems can consult with a non-profit credit counseling agency with the knowledge that they will receive assistance based on their own best interests, and not the best interest of the agency.

## AICCCA FOUNDING AND STANDARDS

The AICCCA was formed in May of 1993 to support independent credit counseling agencies nationwide. It currently has 50 members serving over 750,000 clients repaying their unsecured debts through legitimate debt management plans. Together, these agencies annually return over $3.2 billion in consumer payments to the nation's creditors. The AICCCA has championed fair pricing, stringent ethical guidelines, and consumer protection standards governing the activities of its members. Three years ago, the AICCCA instituted independent agency accreditation requirements through the International Standards Organization. That accreditation to ISO-9001 includes thorough annual Code of Practice audits and represents the most rigorous, independent, audit-based accreditation and oversight in our industry today. Our current Code of Practice is attached to this testimony as an Appendix.

The AICCCA provides for self-regulation of its member agencies through strict membership standards and a Code of Practice that is the basis for independent

Permanent Subcommittee on Investigations
EXHIBIT #20

accreditation by the International Standards Organization under ISO-9001. This independent third-party accreditation, combined with an equally independent certification of all agency counselors by the Institute for Personal Finance-AFCPE, provides significant assurances for consumers needing counseling services that they will be treated fairly and competently. The National Foundation for Credit Counseling (NFCC) has separate but similar requirements for its members. However, the many agencies that do not belong to either of these associations are not bound by such rigorous standards.

## AN INDUSTRY FACING UNPRECEDENTED CHALLENGES

Traditionally, credit counseling has been supplied by non-profit agencies that offer debt-burdened consumers family budget counseling and personal finance education, as well as direct intervention with creditors to obtain their consent to a workout plan to pay down debt on an affordable schedule. Only those consumers who would benefit from a debt management plan and who were likely to successfully complete it were enrolled. This service was supplied largely free to consumers and was supported in large part by creditors who routinely returned 15% of the funds forwarded to them by the agency as a "fair share" contribution. As credit cards and other forms of unsecured consumer credit proliferated, so did the number of borrowers experiencing repayment difficulty. Greater demand for credit counseling spawned more credit counseling companies. With a bigger marketplace, some of the new agencies began to view the development of debt management plans as a source of profit. Consequently, creditors began to see many more proposals for debt management plans to the extent that the traditional contribution amounts became quite large expenditures for them.

With large fair share expenditures beginning to become significant entries on their income statements, and with many more questionable debt management plans being received, creditors began to reduce the percentages paid to the credit counseling agencies. All creditors gradually adopted that practice. The result today is an average fair share contribution of only about six percent, or about a sixty percent reduction over the past seven years. In addition, creditors have cut back significantly on interest rate reductions and other concessions to borrowers enrolling in debt management plans, making these plans less attractive and more difficult to afford for debtors in danger of bankruptcy.

The effect of reduced fair share support has been twofold. To survive, credit counseling agencies have had to reduce traditional services or they have had to pass more of the costs for providing services on to consumers, or both. More recently, creditors have increasingly recognized that agencies which emphasize debt management plans and charge excessive fees are not operating in the best interests of either consumers or creditors and have terminated fair share contributions to such agencies. However, these agencies can afford to carry on without such creditor support and can stay in business so long as they can get their debt management plans accepted. It is not clear whether creditors could simply refuse to accept their plans, or whether additional regulatory support is required to avoid antitrust issues. Meanwhile, consumers who feel dissatisfied with or even exploited by a particular credit counseling agency and who switch to another often find that federal banking regulations bar them from receiving another "re-age" on

their accounts, leaving them hopelessly past due on payments and often triggering a bankruptcy filing.

Compounding the challenges for credit counseling agencies have been the requirements imposed by creditors to use Electronic Funds Transfer, electronic transmission of proposals, and a plethora of varying creditor performance measurement systems that agencies must respond to so that they can continue to receive fair share contributions. While these requirements make sense for individual creditors, they have collectively placed a substantial administrative compliance burden on credit counseling agencies. The AICCCA has proposed standard submission formats to major creditors regarding the extent to which most communications can at least be made uniform.

Add to this new set of requirements the legislative actions by states that wish to protect their citizens from unscrupulous agencies, and the industry is even more overwhelmed. Recent examples are New York and Maryland, which have passed well-meaning laws requiring very high bonding levels. In New York, a bond of $250,000 is prescribed and in Maryland the required bond is $350,000, which can be reduced under some circumstances. A medium-sized credit counseling agency usually can't get a $250,000 bond, much less afford to pay for it. This is compounded by the requirement to post similar bonds in multiple states. Utah, Connecticut, Kansas, Massachusetts, and Illinois are currently considering new legislation that may include significant bonding requirements. This means that services from some responsible credit counseling agencies are being denied to the very citizens that these laws were meant to protect. The agencies that may abuse the trust of these citizens are sometimes the only ones who can surmount these bonding hurdles and therefore their services are the only ones available for many of those consumers. Some of these large companies operate on the fringes of established law and have become the largest agencies in the country.

The AICCCA has suggested to state legislators that insurance coverage designed to protect consumers can be an effective alternative to bonding. The state of Georgia has enacted legislation to that effect.

Borderline agencies concentrate their efforts where they can receive the most profit: enrolling consumers in debt management plans. Some pay little attention to the need for effective credit counseling and consumer education. Consumers who don't need or can't qualify for a debt management plan may get little if any help in these cases -- or worse, they may be enrolled in a debt management plan that they cannot complete. Such agencies also usually have large advertising budgets designed to provide an ample stream of prospects for their services. In many cases, their fees are very large, sometimes equal to the client's total first month's payment to all creditors. Continuing monthly maintenance fees are also frequently high by industry standards. These initial and monthly fees from consumers obviate the need for support from creditors and are sufficient to fuel the advertising costs as well as the on-going servicing expenses. While these practices depart significantly from traditional ethical industry practices, they may not be considered illegal in many jurisdictions. They also may or may not violate IRS standards that govern their non-profit status

The reduction of fair share contributions from creditors combined with increasing operational costs has led to the industry-wide need for additional monetary support directly from consumers in order to continue to offer credit counseling services. The need for the availability of quality credit counseling to debt-burdened consumers continues to increase as evidenced by unprecedented levels of consumer debt and personal bankruptcy filings. Very low interest rates and the availability of affordable second mortgages or home refinancing have allowed consumers to take the equity from their homes to consolidate their other bills. This situation, which appears to be advantageous for consumers today, could bode ill for the future if many find themselves in difficulty again due to poor spending and saving habits that result in even larger levels of debt. Some of these consumers will not only be debt-burdened yet again but will be at risk of losing their homes to foreclosure and even more vulnerable to the practices of some predatory credit counseling agencies.

## REGULATION IN FLUX

The current regulatory landscape represents a patchwork quilt of differing and sometimes conflicting laws in some states. The industry, almost completely non-profit due to state law requirements, is subject to FTC regulations and IRS scrutiny. The AICCCA believes it is important to maintain the industry's non-profit status. Allowing for-profit agencies to operate would place even more emphasis on income-generating activities while abandoning traditional education and counseling – unless pervasive regulation and supervision were put in place to assure that consumers' best interests were served.

The state regulations are not generally well administered, leaving law-abiding agencies to strain for compliance while those who ignore the law operate without penalty, and apparently sometimes even without official notice or sanction. The IRS oversight may also be lax, as many borderline agencies appear to be continuing practices that may be in conflict with tax-exempt regulations. This situation has not escaped the notice of the press, the U.S. Congress, and some state legislators. However, many state laws seek to strictly and unrealistically limit fees and impose unreasonable surety bonding requirements. These well-meaning statutes often serve to reduce the ethical services available to their citizens rather than protect them. As previously noted, bonding levels are so high in some states that the majority of credit counseling agencies cannot secure them. Large borderline agencies can secure them and questionable practices such as selling useless add-ons or referring the consumer to a loan company allow them to operate within fee guidelines if they decide to comply with the statutes. Some continue to operate outside of the statutes in defiance of them and go undetected, or at least unpunished.

This situation has attracted the attention of the National Conference of Commissioners on Uniform State Laws (NCCUSL). A committee to draft a uniform Consumer Debt Management Act convened in Chicago in 2003, and met again this month in Virginia. I attended both meetings. This drafting effort is intended to erase the consumer abuses by some agencies while not harming those agencies that seek to serve consumers

appropriately. At its base is a rigorous licensing requirement designed to ensure consumer protection. Hopefully this process will produce a uniform state law proposal without placing undue burdens on ethical non-profit counseling agencies. This committee is led by Judge William C. Hillman of the United States Bankruptcy Court in Boston and is supported by prominent commissioners from across the country. Such a uniform statute, if enacted by the states, could provide the consumer protections that are badly needed. Thoughtful federal legislation could very well accomplish the same end. This Subcommittee may find discussions with Judge Hillman and the drafting committee helpful. What would not be helpful to the credit counseling industry would be to move from a situation of weak and inadequately enforced state regulation to one of excessive, duplicative and conflicting state and federal regulation.

Federal legislation may or may not be required depending upon state actions and strict enforcement and oversight activity by the IRS. It must also be remembered that the pending bankruptcy reform legislation, passed by the House in March and awaiting Senate action, would have the beneficial effect of empowering the Department of Justice's Executive Office for U.S. Trustees to establish minimum standards for agencies approved for bankruptcy pre-counseling for the nation's most needy consumers. Requiring evidence of third party accreditation by a nationally recognized accrediting organization, such as ISO or COA, should be a key component of such minimum standards.

## CONCLUSION

We recognize the need for strong consumer protections in the credit counseling industry. The interests of these vulnerable citizens must come first and must not be overshadowed by the for-profit interests of a few who seek to take undue advantage of their personal financial situations. But Congress should not rush to impose new federal regulation until effective enforcement of existing law has been tried. And any federal intervention must be carefully coordinated with the rapidly evolving state regulatory regime to avoid driving small but beneficial agencies out of existence.

The AICCCA stands ready to assist the Subcommittee as this inquiry continues. Thank you again for this opportunity to testify today.

## Appendix – Current AICCCA Code of Practice

**Code of Practice**

**Addendum to the ISO 9001:2000 standard**
**For**
**Consumer Credit Counseling Agencies**

***October 8, 2003***

**CODE OF PRACTICE ADDENDUM TO ISO 9001**
**Consumer Credit Counseling Code of Practice**

### 1. INTRODUCTION

This document has been produced in cooperation with BVQi-NA and the Association of Independent Consumer Credit Counseling Agencies (AICCCA), with the knowledge and review of major creditors to provide a universal Code of Practice for Consumer Credit Counseling Agencies. This Code of Practice is viewed as a customer specific requirement and shall be an integral part of the audit for those seeking ISO 9001 certification under its requirements. The document is intended to comply with credit lenders certification requirements. Consumer credit counseling agencies seeking this endorsement must achieve ISO 9001 certification and satisfy the requirements of this Code of Practice.

ISO Registration to this Code of Practice. Any ISO-certified independent registrar must agree to audit all consumer credit counseling agencies seeking their registration services to this Code of Practice regardless of their affiliation to any association and will refuse to issue certificates to such credit counseling agencies without their compliance to this Code of Practice.

This Code of Practice document has been created by AICCCA in conjunction with major creditors and an ISO registrar. The AICCCA Board of Trustees maintains proprietary responsibility for the control, ownership, and approval of this document and any subsequent revisions.

Where a service directly affecting the critical elements of the counseling function and/or the Debt Management Program is to be subcontracted, that subcontractor shall comply with this Code of Practice. If non-counseling elements are subcontracted, those vendor subcontracts will be audited to ensure that the contractual relationship embodies adequate controls with respect to the requirements of this Code of Practice. Critical credit counseling elements must be performed by a non-profit entity and are defined as all activities that are performed by qualified counselors and client service activities that are not specifically related to payment processing.

This Code of Practice does not apply to Debt Settlement activities that may be performed by a credit counseling agency.

Compliance with the principles included within this Code of Practice does not absolve the individual consumer credit counseling organization from meeting and/or exceeding their legal responsibilities and the requirements of all state and federal laws relevant to the services or products offered.

## 2. REFERENCES

Reference shall be made to the following documents and all relevant updates and amendments as applicable:

- ISO9001 — Quality Management System requirements.
- IRC 501 (c)(3) — Internal Revenue Code of the United States.
- All state and local regulations, codes, and other legal and customer requirements governing the conduct of business and consumer credit counseling agencies' activities.

## 3. INDUSTRY DEFINITIONS

The following definitions apply to this Code of Practice In addition to the definitions given in the ISO 9001 standard:

Industry — Consumer credit counseling agencies, clients, credit lending organizations, trade associations, and subcontractors.

Agency — The entity seeking registration pursuant to this Code of Practice.

Business Day — Any day that the nation's banks are open for business.

Client — The customer for whom a consumer credit counseling agency provides service.

Creditor — The credit lending entities.

Critical Credit Counseling Activities (performed by non-profit entities)
All activities that are performed by qualified counselors and client service activities that are not specifically related to payment processing (see Non-Critical Credit Counseling Activities below). These activities are subject to full ISO audit.

Non-Critical Credit Counseling Activities (may be performed by subcontract)
Activities that need not be performed by qualified counselors or client services personnel such as payment processing (i.e., proposal processing, client payment receipt and distribution, changes to client payments, creditor payment receipt, and answering creditor issues about client payments) or other vendor relationships (e.g., telephone service, software, payroll, etc.). These activities, if subcontracted, are subject to ISO audit of the contract only. If not subcontracted, these activities are subject to a full ISO audit.

Counselor — Certified consumer credit counseling agency personnel who provide guidance and assistance to the client.

Education — Any service or product provided to improve the consumer's knowledge of personal financial management that is provided over- and-above the enrollment process, whether the benefiting consumer actually enrolls in a debt management program or not.

Service — The counseling and coordination and other support provided by

the consumer credit counseling agency on behalf of the client and creditor.

Standard — Refers to the ISO 9001 Quality Standard

Subcontractor — A third party who has been contracted by a consumer credit counseling agency to provide a service, product, or support to the agency.

## 4. CODE OF PRACTICE REQUIREMENTS

The sub-clause numbers of this Code of Practice are not related to the sub-clause numbers of ISO 9001. Each sub-clause requirement is in addition to the ISO 9001 standard shall be complied with and be integral to the ISO 9001 Quality System and applies to all organizations seeking compliance to the Code of Practice. Procedures must be controlled and processes must be audited to demonstrate conformance to this Code of Practice.

This Code of Practice requires that documentation of the interaction and sequence of processes include those processes that are subcontracted except for those defined as Non-Critical Credit Counseling Activities. This documentation shall include a description of services that are provided and the legal description of the company providing those services.

## 5. ACCESS TO SERVICE

The consumer credit counseling agency's management shall define and document its policy and procedures for a client's access to service. There shall be objective evidence of conformance to demonstrate the following:

A. The consumer credit counseling agency stands ready to serve all clients who seek service regardless of:
   1. A client's ability to pay
   2. The creditors owed
   3. The dollar amount owed.

B. The consumer credit counseling agency shall provide service, or at minimum acknowledgement of the request for service, within two business days of receipt of the request, service at times convenient to the client, and service through means that are convenient to potential and existing clients.

## 6. COMMUNITY EDUCATION

The consumer credit counseling agency shall establish and maintain records of activities which address the support of or conduct of community education on issues related to consumer credit and money management. Records shall be maintained documenting the extent to which community education has been delivered.

## 7. COUNSELOR TRAINING

The consumer credit counseling agency shall establish and maintain documented records in accordance to ISO standards which address the qualifications and training of counselors. The consumer credit counseling agency shall be able to demonstrate that

counselors are:

A. Adequately trained to meet the needs of the organization
B. Certified by a qualified independent authority as identified by AICCCA or the National Foundation for Credit Counseling (NFCC)
C. Each counselor must begin the certification process within six months of hire and complete it within 12 months of hire.

**8. SERVICE RESOURCES**

The consumer credit counseling agency shall determine and provide the resources needed to:

A. Fulfill the client's service requirements
B. Fulfill the creditor's service requirements.

**9. SERVICE REQUIREMENTS**

The consumer credit counseling agency shall be able to demonstrate that:

A. Counselors conduct comprehensive interviews, to include, at a minimum:
   1) The client's complete financial position (e.g., assets, liabilities, income, and expenses)
   2) Identify and explore the root cause of the client's financial situation.

B. Counselors develop a solution which is optimum for both the client and The creditors, to include:
   1) Possible alternatives such as liquidation or leveraging of assets
   2) Financial counseling to clients who do not need payment assistance
   3) Providing a DMP to clients as an alternative to bankruptcy
   4) Advise client to close all credit lines with consideration for business or employment related purposes
   5) Encouragement to avoid additional debt while the client is improving their financial situation
   6) Communicate the consequences that obtaining new revolving debt has on the success of the DMP
   7) Identification of additional relevant community resources, which may include: family counseling, mental health counseling, and/or addiction treatment and counseling.

C. Provide the client with a documented evaluation of his/her financial status to include a recommended plan of action which addresses the identified issues.

D. Service shall be provided with documented disclosure to clients regarding the:
   1) Fee structure for services provided: if a fee is not charged for the service, then any contribution requested by the agency from the client must be clearly identified and noted that it is voluntary
   2) Creditors support of the consumer credit counseling agency through fair share contributions
   3) Potential impact on the client's personal credit report
   4) Client's responsibility to monitor financial statements/reports from creditors and the consumer credit counseling agency, to verify their accuracy, and to detect and report discrepancies.

**10. COMPENSATION AND FEES**

The consumer credit counseling agency shall maintain documented evidence that demonstrates its ability to maintain a low fee structure for services, with specific focus upon:

A. Compensation is not paid to the counselor based upon the outcome of the counseling process.

B. Fees, voluntary contributions, or requested donations from clients for the enrollment into a Debt Management Plan (DMP) do not exceed the lesser of $75 or the maximum fee allowed by law in the state of residence of the client

C. Fees, voluntary contributions, or requested donations from clients for the maintenance of a DMP do not exceed the lesser of $50 or the maximum fee allowed by law in the state of residence of the client

D. Fairshare payments to the agency are voluntary contributions directly from creditors and are not considered part of B. and C. above.

**11. FISCAL INTEGRITY**

The consumer credit counseling agency shall define, document and demonstrate procedures regarding their policies on financial disciplines and fiscal integrity to include, at a minimum:

A. An annual certified audit by an independent certified public accountant is conducted of all trust and operational books and records

B. Accurate accounting and records of all clients' deposits and debits to creditors are maintained throughout the life of the DMP

C. Funds received from clients for a DMP must be disbursed to the creditors no later than 15 days from receipt of valid funds, or by scheduled disbursement date, whichever is later.

**12. LEGAL STATUS AND GOVERNANCE**

The consumer credit counseling agency shall define and document their legal status, such that:

A. The consumer credit counseling agency is a non-profit organization which complies with Internal Revenue Code of the United States, IRC 501(c)(3) requirements

B. The consumer credit counseling agency is licensed in all states in which it conducts business as required by law

C. The consumer credit counseling agency has a diverse governing Board, the composition of which represents the interests of all its constituents

D. The consumer credit counseling agency shall have a majority of members of their governance Board who are not employed by the agency; will not benefit financially, directly or indirectly, from the outcomes of counseling sessions with clients; and who are not related by blood or marriage to other board members or employees of the consumer credit counseling agency.

**13. COMPLAINT / CONFLICT RESOLUTION**

The consumer credit counseling agency shall respond to all consumer complaints within five (5) business days and will take necessary action to resolve the complaint in a timely manner. Records of the complaint and disposition shall be maintained.

**RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD**
**SUBMITTED TO**

## THE HONORABLE MARK W. EVERSON

Commissioner
Internal Revenue Service

**QUESTION SUBMITTED BY SENATOR FRANK LAUTENBERG**

**Q. Does the IRS have sufficient resources to carry out their investigative and enforcement capabilities in this area? How much of your budget do you devote to enforcement of this type, and how has that changed over the past few years?**

Answer: Enforcement in the Tax Exempt/Government Entities Division (TEGE) has suffered as IRS staffing in the exempt organizations area fell from 1996 through 2003. However, the IRS budget for FY2004 provided additional resources to combat abuses in the tax exempt sector. In addition, the president's proposed budget for FY2005 includes a request for further enforcement resources that would help to deter abuses in the tax-exempt community.

The Exempt Organizations office of TE/GE maintains a vigorous examination program to identify and pursue abusive activities and other non-compliance in the tax-exempt community. As the below chart indicates, our budget in this area has increased over the last several years:

| | |
|---|---|
| FY2002 | $35.702 million |
| FY2003 | $35.932 million |
| FY2004 | $37.1 million |
| FY2005 (proposed) | $49.1 million |

For FY 2004, in addition to the $37.1 million, TEGE's Exempt Organization Division (EO) spends on Field Examination, EO's comprehensive compliance strategy is further supported by customer education and outreach, tax law guidance development, and a determination program that reviews applications for tax-exempt status and serves as an early warning system for emerging compliance issues.

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Permanent Subcommittee on Investigations
**EXHIBIT #21a**

**RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD**
**SUBMITTED TO**
**THOMAS B. LEARY**
Commissioner
Federal Trade Commission

**QUESTIONS SUBMITTED BY SENATOR FRANK LAUTENBERG**

1. **Does the FTC have sufficient resources to carry out their investigative and enforcement capabilities in this area? How much of your budget do you devote to enforcement of this type, and how has that changed over the past few years?**

   Answer: I believe that the FTC has sufficient resources at this time to carry out a vigorous enforcement and investigatory program in the credit counseling area. Although the Commission's budget assigns specific figures only to missions defined much more broadly than this particular area, I can tell you that since we first identified credit counseling and debt management as important consumer protection issues, the agency's activities and use of resources focused on the credit counseling industry have increased significantly. This increase reflects the investigation and litigation against AmeriDebt; other non-public credit-counseling investigations; and recent cases against three debt negotiation firms, Innovative Systems Technology, Debt Resolution Specialists and Jubilee Financial Services.

2. **You mentioned in your testimony that the FTC does not have jurisdiction over non-profit entities. Does having to make a separate determination that an agency is not a bona fide non-profit hamstring your investigations? Do we need to provide you with increased authority here?**

   Answer: The exclusion of bona fide non-profit organizations from our jurisdiction under the Federal Trade Commission Act has not deterred the agency from investigating and bringing enforcement actions against for-profit organizations or entities that falsely purport to be non-profit. Now that the staff has completed several credit counseling investigations, it is particularly familiar with the indicia of bogus non-profit claims in this area. When investigating possible unfair or deceptive practices under that Act, the agency can obtain the information necessary to determine whether an entity is a bona fide non-profit organization. Although the determination must be supported by the facts in each individual case, it is, for the most part, necessary to inquire into the facts anyway in order to prove the deception and identify the culpable parties.

   We have also had considerable success in prosecuting bogus non-profits. In the area of charitable solicitations, for example, we have successfully brought cases against fraudulent charities even though they claim to be non-profits. As you know, we filed a complaint last year against AmeriDebt, a purported non-profit, that both asserts

Permanent Subcommittee on Investigations
EXHIBIT #21b

jurisdiction and challenges as deceptive its claim to be a non-profit entity. In this case, defendants have moved to dismiss on the non-profit jurisdiction issue, and a hearing date is set for May 3, 2004. We believe the law is on our side.

Therefore, at this time, I do not believe that the FTC needs increased authority in this area.

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**RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD**
**SUBMITTED TO**
**CHRIS VIALE**
General Manager
Cambridge Credit Counseling Corp.

**QUESTIONS SUBMITTED BY SENATOR FRANK LAUTENBERG**

**Q. You claim that your disclosure of fees was full and accurate. But if this is the case, then why do so many people claim they were deceived?**

Answer: Letter response attached.

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Permanent Subcommittee on Investigations
EXHIBIT #21c

CAMBRIDGE
CREDIT COUNSELING CORP.
A Professional Debt Management Organization
67 Hunt Street
Agawam, MA 01001

ISO 9001:2000 Registered
www.cambridgecredit.org
www.goodpayer.com
Tel: 800-527-7595
Fax: 413-821-0980

April 22, 2004

Senator Lautenberg:

We take exception to your assertion that we have deceived a large number of people about our fees. It is simply untrue. In fact, you were given written testimony from John Puccio that clearly states:

"While your staff succeeded in finding a disgruntled Cambridge customer, which it could have done for virtually any business in this country, our consumer complaint rate has been less then one percent (about 600 complaints to external agencies out of 230,000 clients served in our over six years in operation). And we have many, many satisfied and happy clients that were also available to this subcommittee if you had chosen to speak with them."

The Subcommittee failed to speak with any of the satisfied clients that attended the hearing.

Out of the approximately 600 complaints noted above, a very small percentage of them are related to fees. Many of the complaints we receive are creditor-related, which has become the norm in our industry.

Your question asked, "You claim that your disclosure of fees was full and accurate. But if this is the case, then why do so many people claim that they were deceived?" You based your question on the assumption that we have taken advantage of "so many people" without considering the facts. Now that you have seen the facts, I sincerely hope that we can move this conversation on to the real problems our industry faces.

Sincerely,

Chris Viale

**RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD**
**SUBMITTED TO**
**JAMES KROENING**
Director
FamilyMeans Consumer Credit Counseling Service

**QUESTIONS SUBMITTED BY SENATOR FRANK LAUTENBERG**

**Q. Do you believe that laws requiring that credit counseling be a non-profit industry are outdated? Why shouldn't for-profit players also be permitted?**

Answer: FamilyMeans Consumer Credit Counseling Service is licensed in the States of Minnesota and Wisconsin. The laws in Minnesota and Wisconsin allow for both non-profit and for profit companies to operate. Most companies choose to be setup as a non-profit, in order to be eligible to receive donations from the creditor community. Many States do not have laws governing the credit counseling industry and this has allowed many companies to organize with no boundaries around fees and structure.

I believe that both non-profit and for profit companies should be allowed to exist in the credit counseling industry. Companies should be required to disclose there tax status in promotional material and advertising

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Permanent Subcommittee on Investigations
EXHIBIT #21d

**RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD**
**SUBMITTED TO**
**JOHN POHLMAN**
Former Employee
Cambridge Credit Counseling Corp.

**QUESTIONS SUBMITTED BY SENATOR FRANK LAUTENBERG**

**Q. Do you have reason to believe Cambridge did or did not refund its fees as it claims?**

Answer: I do not believe that Cambridge did refund fees to clients, if so asked. I would ask them to provide canceled checks for the clients they claim to have given refunds to.

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Permanent Subcommittee on Investigations
**EXHIBIT #21e**

**RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD**
**SUBMITTED TO**
**RAYMOND SCHUCK**
Victim
Cambridge Credit Counseling Corp.

**QUESTIONS SUBMITTED BY SENATOR FRANK LAUTENBERG**

**Q. Cambridge claims it refunds half of all fees to its customers. Did you see any of your fees refunded at all?**

Answer: To satisfy the complaint against Cambridge I made with the Massachusetts Better Business Bureau, Cambridge eventually agreed to what amounted to an out-of-court-like settlement to refund to me half of my initial $1,946 payment. This was done with the stipulation I would never take further action of any kind against or seek further recourse from the company.

Rather disgusted and frustrated by their treatment of me and of my situation, I agreed to this and withdrew from their program. There was no other refund from Cambridge.

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Permanent Subcommittee on Investigations
EXHIBIT #21f