Comment on Proposed Amendments to Wisconson's Debt Adjustment Services Rule

Comments

to the

Wisconsin Department of Financial Institutions

regarding

DFI—Bkg 73, Clearinghouse Rule 24-049

by

National Consumer Law Center
&
AARP Wisconsin

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The National Consumer Law Center and AARP Wisconsin submit the following comments.[1] We thank you for the opportunity to comment on this proposal.

Summary: We agree that fees should be limited to a percentage of savings, but 30% is too high. We also recommend more robust annual data reporting, prohibiting licensees from advising consumers to default on debts, and adopting other protections found in the FTC's debt relief services rule.

1. Introduction

For-profit debt adjustment, often called debt settlement, is an inherently harmful service that leaves most of its customers worse-off than where they started. In 2010, the Federal Trade Commission added the Debt Relief Services Rule[2] to the Telemarketing Sales Rule (TSR), creating important new consumer protections. But the TSR is limited to telemarketers. It also left many problems unresolved, and is widely violated. The public record of problems with for-profit debt adjustment makes clear that there is only one effective way to regulate this industry: Ban it.

Wisconsin's Department of Financial Institutions (DFI), however, is required to license adjustment services[3] and, therefore, does not have the option of banning them. But it nevertheless has the obligation to adopt rules that will "protect debtors from oppressive or deceptive practices of licensees."[4] The proposed rule, while a step in the right direction, is not sufficient to do so and should be revised.

Below we discuss the proposed rule and present recommendations for strengthening it. We then summarize the history of the for-profit debt adjustment industry and the problems it causes.

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[1] Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. www.nclc.org. For questions about these comments, please contact NCLC Senior Attorney Andrew Pizor (APizor@nclc.org).

AARP is a nonprofit, nonpartisan membership organization for people age 50 and over. AARP is dedicated to enhancing quality of life for all as we age. We lead positive social change and deliver value to members through information, advocacy and service. AARP also provides a wide range of unique benefits, special products, and services for our members. These benefits include AARP Web site at www.aarp.org, "AARP The Magazine," and the monthly "AARP Bulletin."

[2] 16 C.F.R. § 310.4(a)(5). 75 Fed. Reg. 48,458 (Aug. 10, 2010).

[3] Wis. Stat. Ann. § 218.02(3).

[4] Wis. Stat. Ann. § 218.02(7)(a).

2. The proposed rule is a good start but is not enough to prevent abuses.

2.1 Overview

DFI proposes several notable amendments to the current rule for adjustment service companies (Wis. Admin. Code ch. DFI−Bkg 73):

- Allowing licensees to charge a new performance-based fee calculated as a maximum of 30% of the amount saved on settled debts;[5]
- Requiring licensees to provide certain disclosures to consumers if advising the consumer to default on any debts;[6] and
- Changing—weakening—the current recordkeeping rule.[7]

2.2 We support the new fee structure, but the cap is too high.

We strongly support DFI's proposal to adopt a percentage-of-savings fee structure, rather than a percentage-of-debt structure. The proposed structure ensures that licensees are only paid for debts they settle. But more importantly, it aligns the licensee's incentives with the consumer's best interest. Under the proposed structure, licensees will now have a financial incentive to negotiate deep reductions in the amount of enrolled debt, something that the consumer expects but does not always receive.

Under the percentage-of-debt model, licensees receive the same fee for a good debt settlement as they would for a bad one, so they have no incentive to work harder for a better outcome. The percentage-of-savings model addresses that problem by rewarding licensees that do a better job for the consumer.

The 30% cap, however, is far too high. Every dollar paid to the licensee reduces the funds available to pay creditors and makes it harder for the consumer to save up for settlements. Most consumers will also need to save funds to pay creditors that refuse to settle. So high fees are not just expensive—they actively harm the consumer.

DFI's *Report and Recommendations Concerning Telemarketer-Sold Debt Relief Services* notes that "[p]erformance-based fee models are commonly employed in other result-driven professional services, such as financial advisers and litigation attorneys . . . ."[8] But a closer analysis of the fees charged in the two mentioned professions shows why the proposed 30% cap is too high.

Financial Advisers: Financial advisers are not comparable to debt adjusters. They

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[5] Proposed Rule § 3, creating DFI-Bkg 73.01(1)(c).

[6] Proposed Rule § 13, creating DFI-Bkg 73.04(10).

[7] Proposed Rule § 14, repealing and recreating DFI-Bkg 73.05.

[8] Wisc. Dep't of Financial Institutions, Report and Recommendations Concerning Telemarketer-Sold Debt Relief Services at 6 (June 2024).

charge less than proposed and are more heavily regulated. Under Securities and Exchage Commision rules, financial advisers may only charge performance based fees for qualified clients. Currently a qualified client is defined as one with a net worth over $2,200,000 and more than $1,100,000 worth of assets under management.[9] Such clients are likely to be more financially sophisticated than the typical consumer and, therefore, better able to protect themselves.[10] And, even when it is allowed, performance-based billing is rare. A 2023 survey found that only 1% of firms use it.[11] More common is charging a percentage of assets under management. But that type of fee is typically no more than 1%.[12] This is far less than the proposed 30% cap.

Litigation Attorneys: Some types of litigation attorneys charge contingency fees that are often around 30% of the amount recovered. But attorneys are subject to strict supervision by state bar regulators. Most notably, attorneys have a fiduciary duty to act in the best interest of their client. Debt adjustment services have no such duty.

Another critical difference between attorneys charging contingency fees and debt adjustment services is that attorneys often expend far greater resources of their own when litigating a client's case. An attorney charging a contingency fee will advance all litigation expenses, such as court reporter fees for depositions, expert witness fees, document production fees, medical examinations, travel expenses, and court costs. Depending on the nature of the case, these can easily exceed tens of thousands of dollars. If the case is unsuccessful, or if the judgment is insufficient, the attorney loses this money. Attorneys must also have years of training before they may represent a client. As a result, their time is more valuable. Because the attorney takes a greater personal risk for the client and provides a more valuable service, a 30% contingency fee is reasonable.

In contrast, debt adjusters have far fewer qualifications, far less supervision or responsibility, and put far less of their own time or assets into negotiating a debt settlement. As such, a 30% fee would be a windfall. We recommend a much lower fee

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[9] 15 U.S.C. § 80b–5(a); 17 C.F.R. § 275.205-3; Securities and Exchange Commission Rule 205-3 Fact Sheet, available at https://www.sec.gov/files/rules/final/2021/ia-5904-fact-sheet.pdf.

[10] 15 U.S.C. 80b-5(e).

[11] Josh Welsh, Performance-based fees gaining ground among advisors, study says, InvestmentNews (Jan. 19, 2024), available at https://web.archive.org/web/20240905014308/https://www.investmentnews.com/rias/performance-based-fees-gaining-ground-among-advisors-study-says/248263.

[12] *See* Bernice Napach, How to Pick a Financial Advisor, BuySide WSJ (June 21, 2024), available at https://web.archive.org/web/20240904021950/https://www.wsj.com/buyside/personal-finance/financial-tips/how-to-choose-financial-advisor.

cap, closer to the 10% cap used in Connecticut.[13]

2.3 Prohibit advising default

Currently Wisconsin allows debt adjustment services to advise consumers to default on their debts. While defaulting may increase a negotiator's leverage, that does not justify the harm it causes (as explained in § 4.3), especially given that there is no guarantee that the creditor will settle rather than suing.

It is also unfair to honest businesses and may even be tortious interference with a contractual relationship. Chase Bank, for example, has successfully sued a number of debt adjusters for telling customers to stop paying their credit card bills.[14]

The proposed disclosures will not protect consumers, nor can any other disclosure.

2.4 Require better recordkeeping and annual data reporting.

Without adequate data collection, DFI cannot do its job. DFI should require each debt adjustment company to submit annual reports with sufficient data to determine whether the company is performing as promised to its customers. The data collected will also, in the aggregate, help DFI determine whether future rule changes are necessary, or whether for-profit debt adjustment should be banned entirely.

When assessing debt adjustment, the single most important question is whether it causes consumers more harm than good. The most effective way to answer that question is to compare the total amount of debt enrolled by an individual consumer with the total amount of those debts when the consumer completes or leaves the program. If the consumer's total debt burden is lower, after accounting for associated debt adjustment charges, then the debt adjustment service may have provided a measurable financial benefit.[15] But if the value of any savings on settled debts is less than the cost of accretion (the accumulation of interest, late fees, overlimit fees, and the like) on unsettled debts, charges for debt adjustment services, and taxes owed on canceled debt, the debt adjuster will have done more harm than good.

Currently, DFI does not collect the necessary data to answer this critical question. Neither the existing rule, DFI−Bkg 73.05 (Office records and procedures), nor its proposed replacement clearly requires collecting the amount of each debt enrolled for

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[13] Conn. Dep't of Banking, Debt Negotiation Schedule of Maximum Fees, available at https://portal.ct.gov/dob/consumer-credit-licensing-info/consumer-credit-licensing-information/debt-negotiation-schedule-of-maximum-fees (last viewed Sept. 11, 2024).

[14] *See, e.g.,* Chase Bank USA N.A. v. Consumer L. Ctr. of DelRay Beach LLC, 2015 WL 4556650, at *4 (D. Del. July 29, 2015); Chase Bank USA, N.A. v. Allegro L., LLC, 2013 WL 3149461 (E.D.N.Y. June 19, 2013).

[15] This measurement will not address other risks of debt settlement, such as increased collection activities, harm to credit scores, and the related emotional toll.

each customer. Debt adjusters presumable already track such figures, so it would not be burdensome to explicitly add such a requirement to the rules.

The other critical figure necessary to evaluating an adjuster's performance is the value of each enrolled debt at termination of the contract with the adjustment service. Existing rule DFI−Bkg 73.05(1)(j) could be interpreted as imposing such a requirement by requiring office records to include the "[c]urrent balance due each creditor." But the proposed rule deletes that requirement, leaving DFI completely unable to determine the final value of debts that do not settle. As explained in § 4.4, this number is critical to determining whether a consumer benefits from debt adjustment.

Rule DFI—Bkg 73.09 (Annual reports and financial statements) is wholy inadequate because it fails to require licensees to report any of the data described above. Instead, it merely directs licensees to submit "a report giving such reasonable and relevant information as the division may require concerning the business transacted by the licensee."[16] The information required by the current annual reporting form (Form LFS220) is insufficient to enable DFI to "protect debtors from oppressive or deceptive practices of licensees."[17] We urge DFI to codify a more detailed reporting requirement.

2.5 Incorporate the TSR's protections into state law.

Wisconsin's current and proposed debt adjustment regulations are broader than the FTC's TSR, because they apply to *all* debt adjustment services, regardless of whether they use telemarketing. But they are weaker because they lack some of the safeguards found in the TSR.

The proposed amendments will be a significant change for the debt adjustment industry in Wisconsin and will likely attract new licensees. So it is important to ensure that those not subject to the TSR obey the same rules. Otherwise, some licensees, such as those relying on the internet or in-person transactions, may find new ways to abuse Wisconsin consumers. Therefore, we recommend that Wisconsin import the TSR's additional safeguards into state law. In particular, we recommend adding the following rules to DFI−Bkg 73.04 (Prohibited practices):

- Prohibit licenseses from requesting or receiving payment on any renegotiation, settlement, reduction, or alteration of a debt arranged by the licensee until the customer has made at least one payment to the creditor pursuant to the agreement arranged by the licensee.[18]

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[16] DFI—Bkg 73.09(1).

[17] Wis. Stat. Ann. § 218.02(7)(a).

[18] *See* 16 C.F.R. §310.5(i)(B).

- Adopt additional protections regarding the trust fund authorized by DFI−Bkg 73.03(3) (Business procedure) by specifying that:[19]
    - that the consumer owns the funds held in any trust fund required by the licensee and must be paid accrued interest on the funds;
    - the entity administering the trust fund is not owned or controlled by, or in any way affiliated with a debt adjustment service;
    - the entity administering the trust fund does not give or accept any money or other compensation in exchange for referrals of business involving debt adjustment services; and
    - the consumer may withdraw from the debt adjustment service at any time without penalty, and must receive all funds in the account, other than funds earned by the licensee, within 7 business days of the consumer's request.

3. Debt adjustment has long been recognized as problematic.

As Wisconsin has long recognized, for-profit debt adjustment services pose a significant risk to consumers and should be carefully regulated. As early as 1935, the State Banking Commission noted the problem of high fees and the need for regulations to prevent abuse.[20] Nor has Wisconsin been the only state to recognize the need to curb debt adjuster abuses. A 1964 American Law Reports annotation observed "that the business of debt adjusting is fraught with opportunities for defrauding debtors, and more than a dozen states have enacted legislation prohibiting the business . . . ."[21] In 1978, a Washington State legislative report noted the industry's "turbulent and controversial history" and tactfully stated "it appears that the nature of the business, together with the nature of the client population, is not conducive to the highest ethical level of operations and/or the best interests of the client."[22]

In 2010 the FTC responded to evidence of widespread problems by amending the Telemarketing Sales Rule to address debt relief services.[23] The final rule imposed

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[19] *See* 16 C.F.R. §310.5(ii).

[20] Report of the State Banking Commission and Interim Advisory Legislative Committee to Investigate Finance Companies at 56 (1935).

[21] Legislation regulating, taxing, or forbidding business of debt adjusting, 95 ALR 2d 1354-55 (1964).

[22] State of Washington, Legislative Budget Comm., Debt Adjusting, Licensing and Regulatory Activities - Sunset Audit at 7, 11 (Rpt No. 77-13, Jan. 20, 1978).

[23] 75 Fed. Reg. 48,457 (Aug. 10, 2010).

several consumer safeguards on providers, the most significant of which prohibits debt relief services from accepting payment in advance of providing the promised relief.[24]

But the 2010 amendment has not eliminated abuses. The TSR only applies to telemarketers—a vanishing species in the Internet Era; it lacks an effective private right of action; and it is widely violated.

As the New York City Bar Association found in 2012, when it reviewed the consumer's experience of debt settlement in New York, there are still many problems.[25] According to the Bar's report, the public record "shows conclusively that substantial numbers of New Yorkers involved in debt settlement experienced net financial harm from enrollment: increased debt, damaged creditworthiness, and stepped up collection efforts on the part of creditors."[26]

Creditors have also criticized for-profit debt settlement. As the American Financial Services Association wrote in 2019,

> Debt settlement companies are more likely than not to create problems between a creditor and a consumer where previously none existed, or actively prevent creditors from working directly with consumers to resolve any outstanding issues. It is very rare that regulators, watchdogs and other businesses and associations across the spectrum—which otherwise often disagree on fundamental points regarding credit—agree that a single industry is detrimental to consumers, but this is the case with debt settlement companies.[27]

Most recently, the Better Business Bureau reported receiving over 11,000 complaints involving debt relief and credit repair just between 2020 and mid-2023, averaging over 3000 per year. While the report did not break out the number of complaints on each subject, it detailed a litany of abuses by debt relief services and problems inherent in the nature of the service.

4. For-profit debt adjustment is inherently flawed and harms consumers.

4.1 Overview

As explained in more detail in the following sections, there are numerous problems with the for-profit model of debt adjustment. The bottom line, however, is that debt adjustment is likely to leave consumers worse-off than when they began.

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[24] 16 C.F.R. § 310.4(a)(5).

[25] N.Y. City Bar, Profiteering from financial distress: An examination of the debt settlement industry at 105-109 (May 2012).

[26] *Id.* at 1-2.

[27] AFSA, Debt Settlement Companies at 5-6 (Mar. 2019).

Debt adjustment has a high failure rate for many reasons, in part because enrollees are already financially distressed. Debt adjusters cannot stop debt collectors from demanding their money. And many creditors, including some major credit card companies, refuse to work with debt adjusters. A 2011 survey of creditors, debt buyers, debt collectors, and legal recovery firms found that only about half work with debt settlement firms.[28]

Even if a creditor agrees to settle, it takes years to save up enough money to fund a settlement. Many consumers simply can't afford it and drop out. But by that point, a lot of the damage is already done. The consumer has paid fees for the trust fund usually required by debt adjustors, their credit rating has sunk even lower, and the unpaid debts they wanted to settle are now even bigger. If they got any settlements, they will owe fees on them and taxes on the forgiven debt. Ultimately, debt adjustment leaves many consumers *worse off*.

The problems with debt adjustment services are best summarized in the conclusion reached by the NYC Bar Association's debt settlement study:

> After extensive study and analysis of the available record, the Committees conclude that debt settlement for a fee that is more than nominal is inherently flawed and cannot yield a net benefit to consumers. Even without advance fees and to the extent the new [FTC] rules are observed by operators, the targeted financially distressed consumers experience increased total debt, damaged credit, and stepped up collection efforts by creditors.[29]

4.2 Debt adjustment services have low success rates and many complaints.

Debt adjustment services have an unacceptably low success rate and now generate even more complaints than before the 2010 FTC rule.

For example,

- In January 2024, a court appointed receiver reported that nearly 70% of consumers to enroll in one major national debt relief operation canceled their enrollment.[30]
- An 2023 report from the Better Business Bureau (BBB) described an average of more than 3,000 complaints per year involving debt relief and credit repair

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[28] InsideARM Debt Settlement Survey at 5 (Oct. 2011) (53% answered "yes" to "Does Your Company Work With Debt Settlement Companies to Settle Consumer Debt?" 41% answered "no" and 6% "not sure").

[29] N.Y. City Bar, Profiteering from financial distress: An examination of the debt settlement industry at 2 (May 2012).

[30] Preliminary Report of Temporary Receiver, Consumer Financial Protection Bureau v. Stratfs, LLC, No. l:24-cv-00040-EAW-MJR at 36 (W.D.N.Y. Jan. 31, 2024).

between 2020 and mid-2023.[31] That is a significant increase from 1,800 complaints in 2009—before the FTC rule was adopted.[32]

- A 2021 industry-commissioned report revealed that over 36 months (a typical plan length), less than a quarter of customers (23%) settled all their enrolled debt; and about three-quarters (74%) settled only about half (55%) of their enrolled debt.[33]
- In Colorado, less than 8% of Colorado consumers who had entered a debt settlement program since the beginning of 2006 had settled all of their debts by the end of 2008 and 53% had dropped out.[34] Post-2010 data was similarly poor.[35]
- In New York, one debt settlement service defendant admitted that between 2005 and 2009, only about 5% of customers completed their programs.[36]
- According to a 2012 bankruptcy court decision, a major national debt adjuster had a 68% drop-out rate for the 2008-2009 period.[37] While those statistics are now dated, it is important to realize that the provider at issue is still in operation.

These poor results should not be a surprise, because debt adjustment services market to those least likely to benefit. Companies target consumers who have large amounts of

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[31] BBB, Credit repair and debt relief: BBB study finds some companies fail to deliver on big promises (undated), available at https://web.archive.org/web/20240120005153/https://www.bbb.org/article/investigations/29110-bbb-investigation-some-debt-relief-and-credit-repair-companies-fail-to-deliver-on-big-promises.

[32] Gov't Accountability Office, Testimony before Senate Comm. on Commerce, Science, and Transportation, Debt settlement: Fraudulent, abusive, and deceptive practices pose risk to consumers, n.15 at 12 (GAO-10-593T) (Apr. 22, 2010) (complaints to the BBB about debt settlement companies rose "from 8 in 2004 to nearly 1,800 in 2009.").

[33] Will S. Dobbie, Financial outcomes for debt settlement programs: Estimates for 2011-2020 (Jan. 15, 2021), available at https://aa4dr.org/reports/.

[34] 75 Fed. Reg. 48,457, 48,469–48,470 (Aug. 10, 2010). *See also id*. 48,471–48,476 (Aug. 10, 2010) (discussing available data regarding effectiveness of debt settlement); *id*. at 48,471 n.194 ("the record indicates that many consumers either receive no settlements or save less than the fees and other costs that they pay").

[35] State of Colo., 2014 Annual Report-Colorado Debt-Management Services Providers (registered debt settlement companies reported the following percentage of completed agreements--2014: .43%, 2013: 2.28%, 2012: 4.93%, 2011: 13.18%, 2010: 20.98%).

[36] Cuomo v. Nationwide Asset Services, Inc., 888 N.Y.S.2d 850, 863 (N.Y. Super. Ct. 2009) ("Respondents themselves now contend (or admit) that of the 2,248 New York consumers who enrolled in their program from January 2005 through August 2009, only 116 consumers, or about 5% of the total, are now deemed by respondents to be successful completers of the their program.")

[37] In re Kinderknecht, 470 B.R. 149, 159 (Bankr. D. Kan. 2012), objections overruled sub nom. Parks v. Persels & Assocs., LLC, 509 B.R. 345 (D. Kan. 2014) (operating as Care One).

unsecured debt that they are struggling to pay. Such consumers are often unemployed or under-employed and are unlikely to have the discretionary income needed to fund a debt settlement plan. When the consumer is also expected to pay significant fees, the likelihood of success goes down even further.[38]

4.3 Debt adjustment services give bad advice that harm consumers.

Debt adjustment services usually tell consumers to stop paying or contacting their creditors. It is not unusual for them to also tell the consumer to have all correspondence directed to the provider's address.[39] But this is bad advice that often hurts the consumer.

From the provider's perspective, this serves two purposes: it frees up the consumer's income to be paid to the provider instead; and it prevents the consumer from receiving conflicting information from the creditor—such as that nobody has actually contacted the creditor, that the creditor will not work with such services, and that the consumer would be better off talking to the creditor directly or trying nonprofit credit counseling.

The provider, however, usually explains the advice as being necessary for the debt relief service to work. They say stopping payments will make the creditor more willing to accept a reduced payoff. Stopping communication with the creditor is justified by the promise that the debt relief service provider will now handle everything for the consumer. This advice mirrors the more legitimate advice that attorneys often give clients they represent. But, unlike an ethical attorney, the debt adjustment provider either does not explain, or downplays, the consequences in order to convince the consumer to sign the contract.

Consumers are often happy to comply with this advice because they are financially stressed and have difficulty making their payments and because they do not wish to speak to creditors or debt collectors who pressure the consumer to pay.

This advice, however, is very harmful. Any accounts that the consumer was paying go into default. Any problems with the consumer's credit rating will get worse. The consumer's debts burden will continue to grow as creditors impose additional late fees, over-balance fees, and others. Additional interest—often at a higher penalty rate—also

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[38] State of Washington, Legislative Budget Comm., Debt Adjusting, Licensing and Regulatory Activities - Sunset Audit at 17 (Rpt No. 77-13, Jan. 20, 1978) (noting that the debtor adjuster's fee puts the debtor deeper into debt and the adjuster's setup fees, cancellation fees, and other aspects "impede the flow of cash to creditors").

[39] *See, e.g.,* Brown v. Mortg. Def. Program, L.L.C., 2011 WL 4007945 (E.D. Mo. Sept. 8, 2011) (borrower lost home to foreclosure and filed bankruptcy after company promised forensic loan audit and to sue mortgage company, advised homeowner to stop paying mortgage); Press Release, N.C. Dep't of Justice, AG Cooper Shuts Down Foreclosure Fraudsters (Aug. 23, 2006) (scammer instructed homeowners not to talk to their mortgage company, urging them to let the "experts" handle all communications), available at www.ncdoj.gov.

continues to accrue. The debt settlement industry blithely calls this phenomenon "accretion."[40]

While the consumer is ignoring the creditor's communications, the creditor's collection efforts continue. Debts that have not yet been sent to collection will often be referred to aggressive collection agencies. It is also common for consumers to be sued by their creditors.

Some creditors are reported to initiate collection lawsuits when they learn that the consumer has engaged a debt settlement service. For example, in 2011, Maryland's debt-settlement regulator reported that a quarter of debt settlement customers were sued by at least one creditor by the end of 2011.[41]

By failing to communicate with creditors, the consumer loses opportunities to participate in legitimate debt relief programs offered by the creditor, such as programs offered in partnership with nonprofit credit counseling agencies. Rather than getting the relief promised by debt relief services, the advice they provide often leads to bigger debts, more creditor harassment, and ultimately debt collection lawsuits.[42]

Despite advertisements and promises, consumers who try debt adjustment often suffer damaged credit-worthiness and increased debt as creditors pile on fees and penalty interest. While debt adjustment companies often promote their service as a way to avoid bankruptcy,[43] their customers often end up in bankruptcy nevertheless.[44]

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[40] National Consumer Law Center, An Investigation of Debt Settlement Companies: An Unsettling Business for Consumers (Mar. 2005). *See* Ctr. for Responsible Lending, The State of Lending: Debt Settlement (June 30, 2014), *available at* www.responsiblelending.org (estimating that consumers must settle at least two-thirds of enrolled debt to benefit from program after accounting for accretion and debt settlement fees). *See also In re* Sinnot, 845 A.2d 373 (Vt. 2004) (describing the lack of actual work performed by a law firm offering debt settlement services).

[41] Leslie Parrish, A Roll of the Dice: Debt Settlement Still a Risky Strategy for Debt-Burdened Households, 18 Cityscape 55, 59 (2016) (citing Maryland Office of the Commissioner of Financial Regulation, 2011 Maryland Debt Settlement Services Provider Consumer Activity Report Summary (2014)).

[42] *See* American Financial Services Association, Debt Settlement Companies at 2 (Mar. 2019) ("Debt settlement companies can, ironically, work as a roadblock to a consumer settling his or her debt."). *See, e.g.*, Duran v. J. Hass Grp. L.L.C., 2012 WL 3233818 (E.D.N.Y. June 8, 2012) (alleging consumer was told to stop paying creditors; consumer was later sued by creditor).

[43] *See, e.g.*, Consumer Fin. Prot. Bureau v. Morgan Drexen, Inc., 60 F. Supp. 1082, 1085 (C.D. Cal. 2014) (complaint alleging services were advertised as way to avoid bankruptcy).

[44] *See, e.g.*, Kendall v. Able Debt Settlement, Inc. (*In re Kendall*), 440 B.R. 526 (B.A.P. 8th Cir. 2010); Huffman v. Legal Helpers Debt Resolution, L.L.C. (*In re* Huffman), 505 B.R. 726, 747–748 (S.D. Miss. 2014) (consumer filed chapter 7, "the very contingency she had hoped to avoid by enrolling in the debt settlement program"); Baer v. Persels & Assoc. (*In re* Chance), 2013 WL 501392 (D. Kan. Jan. 16, 2013) (debtor filed bankruptcy after paying $2097 over nine months for debt management), *adopted by* 2013 WL 501413 (D. Kan. Feb. 6, 2013); Morris v. Persels & Assoc. (*In re* Good), 2012 WL 3066885 (Bankr. D. Kan. July 27, 2012) (debtors filed bankruptcy after paying thousands of dollars for debt settlement);

4.4 Debt adjustment will leave most consumers worse-off.

The debt adjustment industry touts the number of debts it settles and their percentage reductions. But the industry hides the complete financial picture facing most consumers. In truth, consumers who try debt adjustment will ultimately find that it is far from the financial panacea they were originally offered. In addition to enduring collector harassment and lawsuits for the years in the program, the consumer will also likely owe:

- Percentage-based fees for successful settlements;
- Payment of the actual settled debts;
- Federal taxes on the value of the debt cancelled through settlements (or the cost of a skilled accountant to prove qualification for an exemption);
- Monthly flat fees to the third-party account manager; and
- Payment of debts that did *not* settle—which will now be significantly larger than when the consumer signed-up for the program.

All of these expenses are likely to significantly reduce the net value of any settlements obtained. And that does not account for the impact on the consumer's mental health.

The true measure of whether a consumer benefits from debt adjustment is whether the total amount of debt at the end of the program, plus all associated costs, is less than when they started the program. And no debt adjustment provider has been able to produce data to make that measurement.[45]

The Center for Responsible Lending (CRL) has filled that gap by creating a model of the typical consumer's debt adjustment experience. Their analysis shows that "a consumer would need to settle two-thirds of her debt to benefit," using estimates generous to the industry. But after taking into account all of the associated costs and tax liability, "the threshold for a positive financial benefit increases to settling at least five of six debts."[46]

These numbers are particularly significant in light of the industry's own data showing that less than a quarter of customers (23%) settle all their enrolled debt and about

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Moore v. Allied Consumer Services, 2012 WL 1345196 (Bankr. D. Kan. Apr. 16, 2012) (debtor paid debt settlement firm $6722 over eleven months, was sued by several creditors, and ultimately filed bankruptcy); *In re* Beebe, 435 B.R. 95 (Bankr. N.D.N.Y. 2010) (bankruptcy filed after nearly a year of unsuccessful payments to debt settlement company). *See also* Elizabeth O'Brien*, 10 Things Bankruptcy Court Won't Tell You,* SmartMoney Magazine, Sept. 30, 2009, *available at* www.tnj.com (reporting that debt settlement companies "bill their services as an alternative to bankruptcy, but in many cases they can hurt more than they help" because their "business model works squarely against the debtors' interests").

[45] *See* § 2.4 (recommending that DFI require licensees to begin collecting such data)

[46] Leslie Parrish, A Roll of the Dice: Debt Settlement Still a Risky Strategy for Debt-Burdened Households, 18 Cityscape 55, 63-64 (2016).

three-quarters (74%) settled only about half (55%).[47] Based on CRL's model, that means most debt adjustment customers would be financially harmed by enrollment in a debt adjustment program.

Although the CRL study assumed a fee calculated as a percentage of enrolled debt, rather than Wisconsin's proposed percentage-of-savings fee, all of the other expenses would remain unchanged. Consumers will still owe fees to third-party dedicated account providers as well as tax liability on cancelled debt. And consumers will still be liable for the increased cost of debts that do not settle.

That means the proposed 30% of savings fee cap is too high. To protect consumers who try debt adjustment, Wisconsin must adopt a lower cap (as discussed in § 2.2).

5. Consumers have better options: A comparison of debt adjustment, credit counseling, and bankruptcy.

Despite the heavily marketed message from debt adjustment services, debt adjustment is, for all but a narrow population, the worst choice when compared to nonprofit debt management plans and bankruptcy. Based on our decades of experience, the National Consumer Law Center recommends that distressed consumers start by consulting with a nonprofit credit counseling agency[48] or consumer bankruptcy attorney.[49]

Both types of entities are more carefully regulated than debt adjustment services. And their "products"—debt management plans and bankruptcy, respectively, are more predictable, reliable, and often more affordable. The chart below summarizes a comparison of these three options. While bankruptcy, in particular, can be very technical and has exceptions, the answers in this table apply to the majority of consumers.

(continued on next page)

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[47] Will S. Dobbie, Financial Outcomes for Debt Settlement Programs: Estimates for 2011-2020 (Jan. 15, 2021).

[48] Such as the members of the National Foundation for Credit Counseling at https://www.nfcc.org/.

[49] Such as a member of the National Association of Consumer Bankruptcy Attorneys, available at https://nacba.org/.

Comparison of Debt Relief Options

	Debt Adjustment	Nonprofit Debt Management Plan	Bankruptcy
Debt reduction method	Partial payment, percentage negotiated	100% payment of principal, fees waived, interest reduced	Ch 7: typically 0% payment Ch 13: Partial payment
Can address secured debt	No	No	Yes
All creditors affected	No	No	Yes
Will collection efforts continue?	Yes	No[50]	No
Can provider predict which creditors will participate?	No	Yes[51]	Yes
Are total fees predictable at beginning?	No	Yes	Yes
Is net benefit (reduction of debt after fees) predictable at beginning	No	Yes	Yes[52]
How long each debt stays on credit report	7 years from last payment	7 years from last payment	debts: 7 years from last payment; bankruptcy itself: 10 years
Impact on credit score	Bad	Bad	Bad

Thank you for the opportunity to submit these comments.

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[50] Not for creditors that participate.

[51] This is predictable because creditors agree in advance with nonprofits to participate in debt management plans. So, when a credit counselor meets with a consumer, the roster of participating creditors is already known.

[52] Creditors have the right to dispute the dischargeability of debts and the amount they will receive in a chapter 13 plan, but such challenges are not common.