Opening Statement of Senator Norm Coleman
Chairman
Permanent Subcommittee on Investigations

Hearing on

Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling

Good morning, and welcome to today's hearing. We are holding this hearing to address the continuing and ongoing problems within the credit counseling industry.

Consumer debt has more than doubled in the past ten years. The nation's credit card debt is currently tops 735 billion dollars -- or an average of nearly 7,000 dollars per household. Since 1996, more than one million consumers have filed for personal bankruptcy each year, with a record 1.7 million new filings in 2003.

Since the 1960s, 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 credit counselors. Credit counselors conducted a detailed budget analysis for the consumer, analyzed their spending habits, determined why the consumer was in debt, and educated the consumer on how to avoid falling back into debt. One such agency, FamilyMeans Consumer Credit Counseling Service, will testify about how the industry has been run successfully for all of these years. Even today FamilyMeans provides 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 on 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 it provides 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 costs that consumers may be required to cover. Those associations prove that self-regulation an effective means of keeping this industry consumer friendly.

Under the traditional social service model, consumers who could not afford to make all of their monthly credit card payments often enrolled in a debt management plan, or "D-M-P" 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 industry 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, non-existent counseling and education, promised results that never come about, ruined credit ratings, poor service, and in many cases being left in worse debt than before they initiated their debt management plan.

We will hear testimony today from 2 insiders who once worked for 2 of the nation's largest non-profit credit counseling agencies. They describe the operations at these non-profits as telemarketing sweatshops designed to take advantage of thousands of people in bad financial positions.

One of the insiders, describes the scene: "It was a boiler room mentality. There was a large board at the front of the room that reminded me of the leader board in 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 to deliver a service of education or counseling.

The Federal Trade Commission and the Attorney General 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? 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 business 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 other than actual credit counseling. The new model looks to the consumer to provide those revenues.

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, 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 practice the reverse -- they provide no bona fide education or counseling and place every possible consumer onto a debt management plan, charging unreasonable or exorbitant fees.

Over the past several months, Subcommittee staff has conducted interviews of individuals, agencies, and for-profit corporations who 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 partner.

Our hearing today focuses on three particular credit counseling "conglomerates." 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 practices 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 likely violate the Federal Trade Commission Act.

Our investigation has revealed common patterns of improper conduct by these 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 purpose of turning their 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;

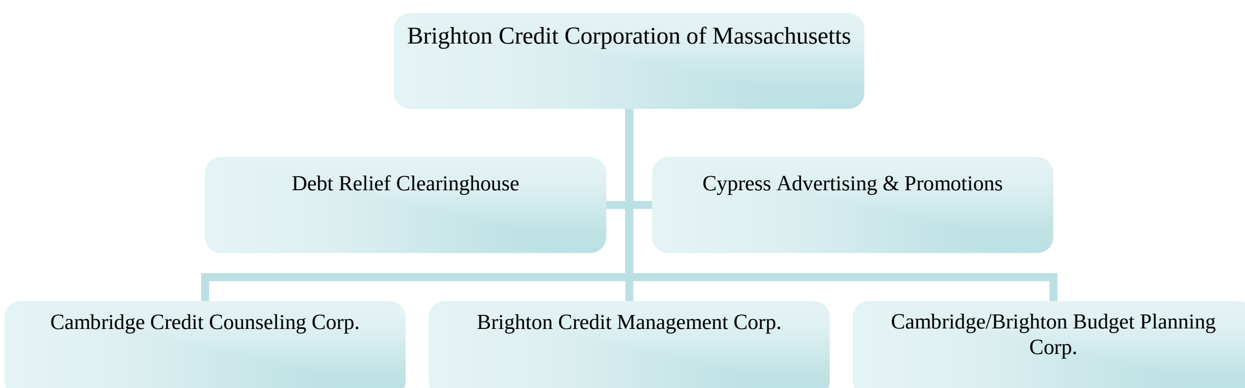
- Multiple non-profit credit counseling agencies have been organized by the insiders in order to provide multiple streams of revenue for the for-profit back-office processing companies;

- Regardless of what business model is used, debtors receive 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, evincing 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.

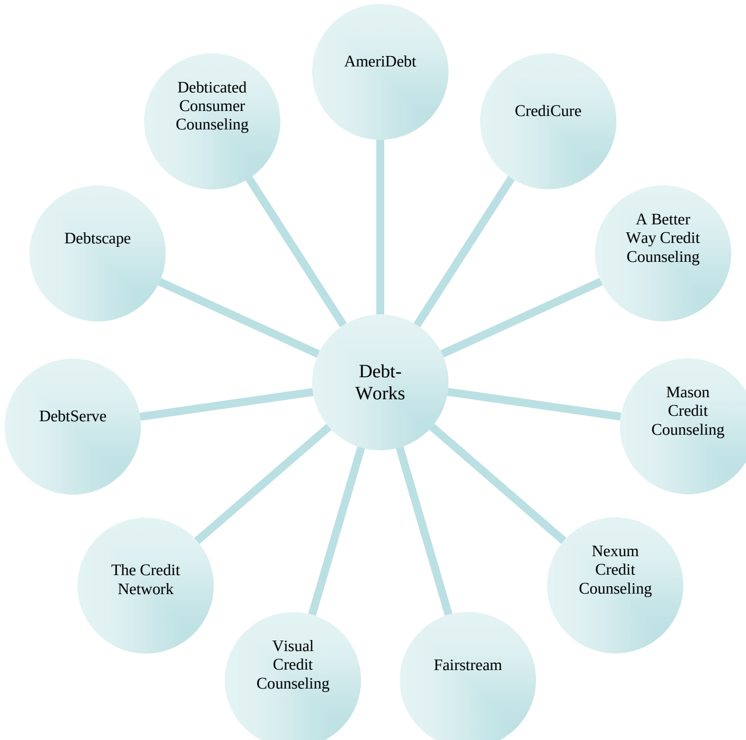
One of the conglomerates we have invited to testify today is the Cambridge-Brighton family of companies. [Display Exhibit #1] Cambridge-Brighton consists of three credit counseling agencies and three for-profit affiliates. Cambridge-Brighton is owned and operated by two brothers -- John and Richard Puccio -- 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 the 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 company 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 revenue in excess of 40 million dollars.



Debt Relief Clearinghouse is 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 dollars. A third for-profit company, Cypress Advertising & Promotions, serves as an advertising broker and has been paid over 6 and a half million dollars since 1999. In total, the Cambridge-Brighton for-profit companies grossed over 71 million dollars during that time period, all as a result of consumers being enrolled on debt management plans.

From where did all of this money originate? It comes from consumers who have looked to Cambridge for assistance with their debts. Where some credit counseling agencies charge 25 dollars or no fee at all to set up a debt management plan, the Cambridge-Brighton agencies charge a full months payment as an up-front fee. Mr. Raymond Schuck (*"shook"*) will testify as to how he was charged close to 2,000 dollars 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 a worse financial condition than when he started, and he declared bankruptcy.

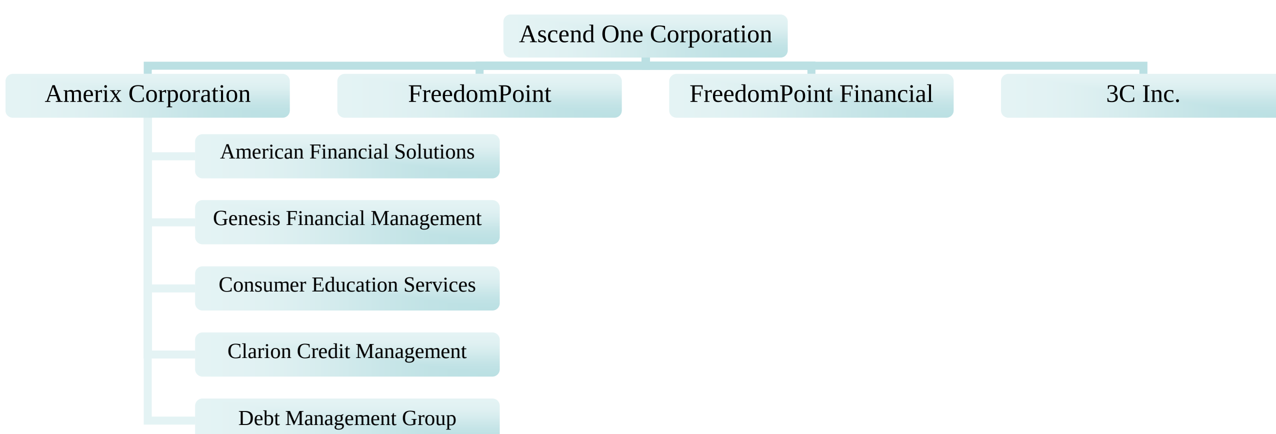
The second conglomerate that is testifying today consists of AmeriDebt and its for-profit affiliate DebtWorks, now known as The Ballenger Group. The credit counseling agency known as AmeriDebt was operated for several years by Mrs. Pamela Pukke as a stand-alone entity, enrolling consumers in DMPs and 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 consumers 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, Mr. Andris Pukke.



Employees who had been trained at AmeriDebt fanned out to form additional credit counseling agencies which provided additional streams of revenue for DebtWorks. [Display Exhibit #2] DebtWorks and Mr. Pukke assisted in the formation and organization of the 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 & 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 dollars. Again, it was the consumer who paid all of this 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 dollars. Ms. Jolanta (*"yo-lan-ta"*) Troy will testify today about how she thought her first payment to AmeriDebt of 783 dollars was going to be sent to her creditors, only to find out that AmeriDebt actually kept that money. She had specifically told AmeriDebt that she could not afford to make the large, up-front contribution. Ms. Troy wrote to AmeriDebt, asking for the money to be returned, but AmeriDebt flatly refused. Ms. Troy received no actual counseling and education. She was simply enrolled on a debt management plan and left to her own devices. Like Mr. Schuck, Ms. 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 is the Ascend One conglomerate. [Display Exhibit #3].



The Ascend One conglomerate began, like AmeriDebt, as a single credit counseling agency called Genus Credit Management, which was operated by Mr. Bernaldo Dancel. Like AmeriDebt, Mr. Dancel simply split his agency into two parts, renaming 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 of their revenue to Amerix. In all, between 1998 and 2002, Amerix received gross revenues in excess of 386 million dollars, all generated by debt management plans. Other revenue is realized by Ascend One from consumers who are referred by their affiliated credit counseling agencies to its wholly-owned for-profit subsidiaries -- FreedomPoint Corporation and FreedomPoint Financial. Those companies market mortgage brokerage services and other products to highly-leveraged consumers. Consumers who contact credit counseling agencies affiliated with Ascend One receive little counseling or education. In fact, consumers are permitted to enroll on a debt management plan entirely over the Internet, without having spoken to a credit counselor. This practice apparently removes the expense associated with a 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 has 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 today. I am committed to discovering the causes of the problems plaguing this once consumer-friendly industry. I am equally committed to finding solutions, either by additional enforcement or by legislation, to remedy these problems.