Written Statement

of

Michael Malesardi
Chief Financial Officer
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Before the
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate

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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

- timely manner. In addition, creditors may fail to notify the agency's processing center of benefits changes, address changes, and or electronic format changes.

- 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:

  - No Grace Period. Creditors will often drop consumers for not making payments without offering a grace period.

  - 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.