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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
CHICAGO REGIONAL OFFICE

COMMISSION AUTHORIZED

February 9, 1990

The Honorable R. Michael Young
State of Indiana House of Representatives
Third Floor State House
Indianapolis, IN 46204

Dear Mr. Young:

The staff of the Federal Trade Commission is pleased to submit this letter in response to your request for comments on H.B. 1146.[1] We believe a substantial segment of the credit repair industry presently engages in practices that injure both the general public and individual consumers. Accordingly, we believe that effective disclosures are likely to benefit consumers. It is our view, however, that H.B. 1146 would be strengthened by providing specific disclosure language that credit service organizations must follow. Moreover, we believe that the meaning of the disclosure can be more effectively conveyed if it is short and written in simple, non-technical language.

I. Interest and Experience of the Federal Trade Commission Staff

The staff of the Federal Trade Commission, upon request of federal, state, and local governmental bodies, comments on regulatory proposals that may affect competition or consumers. The Commission staff has filed comments with the Colorado State Senate on legislation that was substantially similar to H.B. 1146.[2] The Commission staff testified before the U.S. Congress on H.R. 458, the Federal Credit Repair Organization Act, which was introduced to combat fraudulent practices in the

[1] These comments are the views of the staff of the Chicago Regional Office and the Bureau of Consumer Protection of the Federal Trade Commission and are not necessarily the views of the Commission or of any individual Commissioner.

[2] See Letter from Claude C. Wild III, Director, Denver Regional Office of the Federal Trade Commission, to the Honorable Tom Norton, Colorado State Senate (February 21, 1989).

credit repair industry.[3] In addition, the Commission staff has investigated and brought a number of enforcement actions against the kind of companies that would be covered by H.B. 1146, if enacted.[4] For these reasons, we believe that we can provide some additional perspective on the magnitude of the problem addressed by H.B. 1146, as well as on some aspects of the proposed legislation.

II. Description of H.B. 1146

H.B. 1146 (the "Bill"), if enacted, would declare that certain specific acts by credit service organizations are deceptive. It also would require, among other things, that when credit repair organizations provide services to (1) improve a consumer's credit history, credit record or credit rating, or (2) attempt to obtain an extension of credit for a consumer, they provide the consumer with certain written disclosures prior to execution of the contract for services. Our comments focus on the specific acts declared deceptive by Section 5(2) and the disclosure requirements contained in Section 6 of the Bill.[5]

III. Background of the Credit Repair Industry

The Bill applies to organizations that are popularly referred to as "credit repair organizations." The credit repair business is a relatively recent, rapidly growing phenomenon. It involves the marketing of services to consumers whose credit bureau reports contain negative information that interferes with their ability to obtain further credit. The principal method such businesses rely upon to improve credit bureau reports is the dispute procedure available to consumers under Section 611 of the Fair Credit Reporting Act ("FCRA"), 15 U.S.C. § 1681. Section 611 is designed to provide

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[3] See Testimony of Jean Noonan, Associate Director for Credit Practices, Federal Trade Commission, before the Subcommittee on Consumer Affair and Coinage of the House Committee on Banking, Finance, and Urban Affairs (September 15, 1988). See also, Letter from Daniel Oliver, Chairman, Federal Trade Commission, to the Honorable Frank Annunzio, U.S. House of Representatives (May 11, 1987).

[4] See, e.g., Federal Trade Commission v. Credit Clinic Corporation No. CA3-89-2046-H (N.D. Texas filed September 1, 1989); Federal Trade Commission v. American Credit Services, Inc. No. 89-3651-KN (C.D. Cal. filed June 20, 1989); Federal Trade Commission v. Credit Repair, Inc. No. 89-C-0344 (N.D. Ill. filed January 17, 1989); and Federal Trade Commission v. Nationwide Credit No. 88-4071 (E.D. La. filed September 15, 1988).

[5] We express no opinion as to the other provisions of the Bill.

consumers with a self-help mechanism to correct credit reports that contain inaccurate or incomplete information. Correcting and updating such information benefits consumers as well as creditors by helping to insure that credit-granting decisions are based on complete and accurate information.

The principal goal of most consumers who purchase the services of a credit repair company is not to have inaccurate information corrected. It appears instead that many of those who turn to credit repair organizations do so in hopes of minimizing significant credit problems that they have experienced in the past. Although minor inaccuracies may appear in their credit reports, by and large the negative information in the reports is accurate. Therefore, use of the dispute procedures of the FCRA is unlikely to significantly improve the reports' accuracy.

Nevertheless, credit repair companies often mislead consumers to expect that their credit reports can be improved even if the reports are accurate. In fact, however, if adverse information reported by the credit bureau is accurate, under the FCRA it may be reported for at least seven years. Bankruptcy may be reported for ten years. Although credit repair companies occasionally succeed in improving consumers' credit bureau reports, they fail to do so in most instances.

Credit repair companies typically charge from $50 to $1500 for their services. A fee of $400 to $500 per client appears to be typical. Commission staff believe that more than fifty percent of credit repair businesses move or go out of business in the first year of operation without having delivered the services paid for by their clients. Since purchasers are usually told that credit repair takes time, they often do not realize they have been defrauded until the company has disappeared. Consumers that are victims of fraudulent operations are not only deprived of the money they pay for fees, but may also forgo other steps that they might take to put their credit back on firm ground.

The proliferation of fraudulent credit repair companies is a matter of serious concern to the FTC and to other law enforcement bodies across the country. To combat the problem, the FTC has adopted a two-pronged strategy of educating consumers and bringing enforcement actions against fraudulent operators. In the past two years, the FTC has filed complaints in federal district court against six credit repair companies; four of these companies have signed consent decrees to settle the charges brought by the FTC.[6]

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[6] The Commission files a complaint when it has "reason to believe" that the law has been or is being violated, and it appears to the Commission that a proceeding is in the public interest. The complaint is not a finding or ruling that the defendant has actually violated the law. A consent decree is for settlement purposes only and does not constitute an admission of a law violation. Consent decrees have the force of law, which means that the FTC can seek civil penalties against companies that violate their consent orders.

The credit repair industry is elusive and fragmented. For this reason it is difficult, if not impossible, to determine the actual size of the industry or to estimate accurately the full extent of the economic harm done to consumers. Of course, the harm is not limited to the purchasers of credit repair services. Consumers and businesses alike benefit from a properly functioning credit reporting system. Such a system is crucial to the maintenance of a healthy economy, and both consumers and legitimate business are victimized by the abuses of fraudulent credit repair companies.[7]

The methods used by credit repair companies can adversely affect the credit reporting system. The most common method employed by credit repair companies is to dispute all of the information on a consumer's report either at one time or in "dispute rounds." Their aim is to overwhelm the system with such a large number of disputes that reverification is not possible within a reasonable period of time, causing the removal of negative information.[8] Usually this practice does not work. The credit reporting agency reverifies the information with the creditor and the accurate information stays in the consumer's report. But sometimes accurate information is removed, which injures creditors and creditworthy consumers who benefit from the reliability of the credit reporting system.

IV. H.B. 1146's Disclosure Requirements

The Commission staff agrees that a disclosure requirement could reduce a credit repair company's ability to misrepresent what it is likely to achieve. In the staff's experience, consumers who seek the help of credit repair companies lack basic knowledge about the FCRA and how the credit reporting system works. Of particular importance is the fact that they do not understand that accurate, adverse information

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[7] A recent development is the sale of instruction manuals and training seminars that teach consumers how to open and operate a credit repair company of their own. This type of marketing may add to the growth of the credit repair industry despite efforts by law enforcement authorities to establish controls.

[8] Under § 611 of the FCRA, when a consumer disputes an item, the credit bureau must reinvestigate that item unless it decides that the dispute is frivolous or irrelevant. Upon reinvestigation, information that is found to be inaccurate or incomplete must be corrected and information that cannot be verified must be deleted. However, as explained above, a credit bureau can report accurate information for seven years, except for bankruptcy, which may be reported for ten years.

will almost never be removed by a credit bureau until it becomes obsolete. These consumers easily fall prey to exaggerated or false claims by fraudulent credit repair companies.

Enclosed for your information and consideration is a copy of the Commission's comments on H.R. 458, the Federal Credit Repair Organizations Act (the "CROA"), which was introduced in Congress to combat fraudulent practices in the credit repair industry.[9] Parts of these comments are not applicable to the Bill, but the discussion of disclosure requirements is particularly relevant. In its comments on H.R. 458, the Commission favored language that would simply and succinctly explain the limitations on circumstances under which a consumer or a credit repair company may improve consumer reports, advise consumers of their right to sue a credit repair company under the CROA, and suggest contacting the FTC for more information.[10] The disclosure should also advise consumers of their right to cancel a credit repair contract within a certain period of time.[11] In addition, the comment recommended that to be most effective, any required disclosure be conveyed in simple, non-technical language on a separate sheet of paper before a consumer signs a contract or pays money to a credit repair company. Finally, the Commission recommended that credit repair companies be required to follow model language proposed by Congress.[12]

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[9] The CROA legislation has not yet been adopted. It has been reintroduced in this session, but no action has been taken, and, to our knowledge, none is scheduled.

[10] The Commission is the law enforcement agency charged with administering the Fair Credit Reporting Act. A state disclosure scheme might well include the name and number of the State Attorney General's office or other local law enforcement officials as well.

[11] Section 7(a)(1) of the Bill requires this disclosure. It provides that any contract for the provision of services by a credit service organization must contain, in immediate proximity to the space reserved for the signature of the consumer, the following statement: "You, the buyer, may cancel this contract at any time before midnight of the third business day after the date of the transaction. See the attached notice of cancellation form for an explanation of this right." Section 7(b) provides the specific language for the Notice of Cancellation form.

[12] In its comments on H.R. 458, the Credit Repair Organizations Act, the Commission proposed the following disclosure language.

1. You have no legal right to have accurate information removed from your credit bureau report. Under the Fair Credit Reporting Act, the credit bureau must remove accurate negative information from your report only if it is over 7 years old. Bankruptcy can be reported for 10 years. Even when a debt has been completely repaid, your report can show that it was paid late if that is accurate.

The Commission staff believes that the Bill would be more effective if it called for disclosures similar to those recommended by the Commission in its comments on the CROA rather than those presently set forth in Section 6 of the Bill.[13] The adoption of a short, simple disclosure conveying information that consumers can easily comprehend will leave less room for fraudulent operators to prey on vulnerable consumers. Fraudulent operators have often referred to the FCRA as a means of bolstering their credibility. A favorite ploy is to represent that their methods comply with the law and that they possess special expertise in interpreting and using the dispute procedures of the FCRA. If the specific disclosure language is left to the discretion of the individual operator rather than prescribed by the legislature, the resulting disclosure may be accurate and complete, but written in language that is perceived by consumers to be long and complex. As a result, it may have the unintended effect of aiding the fraudulent operator rather than assisting the consumer. Care should also be exercised by the legislature to ensure that any disclosure language that it may adopt does not similarly give fraudulent operators a tool to strengthen their sales pitches.

V. Prohibited Practices

Section 5(2) of the Bill, if enacted, would make it a deceptive act to charge a consumer a fee solely for referring the consumer to a retail seller who will or may make credit available to the consumer on substantially the same terms as those available to

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2. You have the right to sue a credit repair or credit improvement company that violates the Credit Repair Organizations Act. This law prohibits deceptive practices by credit repair companies.

3. The Credit Repair Organizations Act also gives you the right to cancel your contract for any reason within 3 working days from the date you sign it.

4. The Federal Trade Commission enforces these federal laws. For more information, call or write:

   Division of Credit Practices
   Federal Trade Commission
   Washington, D.C. 20580
   (202) 326-3225

See also pp. 3-6 of the enclosed comments.

[13] In general, affirmative disclosure requirements such as those contained in Sections 6 and 7 of the proposed Bill raise firms' costs and might impede them from adopting efficient business practices. However, given the recent history of the credit repair industry, we believe that these costs are likely to be outweighed by the benefits provided to consumers through disclosures written in simple, non-technical language.

the general public. Commission staff questions whether the practice that this section addresses is necessarily deceptive or injurious to consumers.[14] If the purpose of this provision is to protect consumers from misrepresentations by credit service organizations regarding credit extended by others, the scope of the provision appears to be broader than is necessary to accomplish this end. As a result, consumers may be deprived of a valuable source concerning the availability of credit.

To establish a good credit record, a consumer may first have to obtain a line of credit from which a credit history can be built. A credit service organization can function as a clearinghouse of information about those businesses that are likely to extend credit to a particular class of consumers. A consumer may not have access to this information without the assistance of a third party such as a credit service organization. If through the assistance of a credit service organization, a consumer who cannot otherwise obtain credit is able to do so, the consumer may consider this a worthwhile service and be willing to pay for it. Whether the credit is offered on terms that are desirable to the consumer will depend on the financial circumstances and options available to the consumer. The critical issue, in our view, is not whether the credit to be provided is available to others on the same terms or even on more favorable terms, but whether consumers understand what they are purchasing (i.e., referral services). Declaring it deceptive for a credit service organization to charge a fee for providing this assistance takes away a company's incentive to provide information that consumers may otherwise be willing to purchase.

VI. Conclusion

We believe that H.B. 1146, if enacted, would be strengthened by a disclosure requirement written in simple, non-technical language similar to the one discussed in the Commission's comments on H.R. 458.

Please let me know if you have any questions concerning this letter, or if we can be of further assistance.

Sincerely,

C. Steven Baker
Director
CHICAGO REGIONAL OFFICE

Enclosure

[14] Moreover, if this practice were injurious, staff is not certain why this injury would arise only in connection with credit extended by retail sellers as opposed to other categories of creditors.