NATIONAL FOUNDATION FOR CREDIT COUNSELING
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The National Foundation for Credit Counseling has provided the following excerpts from

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

a report by the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs United States Senate.

To view the complete 54-page report, go to http://frwebgate.access.gpo.gov/cgi-bin/useftp.cgi?IPaddress=162.140.64.88&filename=sr055.pdf&directory=/diskb/wais/data/109_cong_reports.

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

R E P O R T

PREPARED BY THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

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III. OVERVIEW OF THE CREDIT COUNSELING INDUSTRY

A. History of the Credit Counseling Industry

"The practice known as "credit counseling" was initiated by creditor banks and credit card companies during the mid-1960s in an effort to stem the growing volume of personal bankruptcies. Most, if not all, of the original CCAs were members of the National Foundation for Credit Counseling ("NFCC").[4] NFCC member agencies were generally community-based, non-profit organizations that provided a full range of counseling, often in face-to-face meetings with consumers. Trained counselors would advise consumers about how to remedy their current financial problems, counsel them on budget planning, and educate them as to how to avoid falling into debt in the future. These counseling sessions were traditionally one-on-one meetings in which an educated counselor performed a detailed analysis of an individual's income, expenses, debts, and other budget requirements. A consumer would meet with a counselor more than once and for significant periods of time, often over an hour.

After a budget analysis, the counselor might recommend that the consumer readjust his or her budget, utilize a debt management plan, or seek legal assistance, possibly to declare bankruptcy.

From the outset, a popular credit counseling option was the "debt management plan" ("DMP"). In order to initiate a DMP, a consumer would authorize the credit counselor to contact each of the consumer's unsecured creditors—primarily credit card companies. The counselor would then negotiate with each creditor to lower the consumer's monthly payment amount, to lower the interest rate, and to waive any outstanding late fees. All of the consumer's lowered monthly payments were then "consolidated" into a single payment.

The consumer would send a single payment to the CCA, which would then distribute payments to each of the consumer's creditors.

DMPs were prevalent because each party involved—the consumer, the creditor, and the CCA—received a tangible benefit. Consumers got their finances under control and received concessions from their creditors, such as reduced interest rates, waiver of late fees, and forgiveness of overdue payment status. Creditors, rather than taking a loss from a bankruptcy, received all of the principal debt owed by the consumer. The CCA, in return for organizing the DMP, would receive "fair share" payments from the creditor to cover their expenses, salaries, and operational costs. The fair share remittance generally amounted to 12–15% of the payments received by the creditor as a result of the DMP.

This mutually beneficial system operated smoothly for several decades. Some NFCC CCAs charged nominal fees or requested contributions from consumers. Such fees or contributions were used to defray their costs for counseling and initiating and maintaining the DMP. Such fees and contributions were small in comparison to the creditor concessions received by the consumer. Today, the fees charged by NFCC CCAs remain minimal. The average initial fee to set up a DMP with a NFCC agency in 2002 was $23.09 and the average monthly maintenance fee was $14.[5]

Growth in consumer credit card debt in the 1990s however, brought many new and aggressive entrants into the credit counseling industry. Since 1994, 1,215 CCAs have applied to the IRS for tax exempt status under Section 501(c)(3).[6] Over 810 of these applicants applied between 2000 and 2003.[7] There are currently 872 active tax-exempt CCAs operating in the United States.[8] Many of these new entrants are not centered around community-based, face-to-face counseling, but rather upon a nationwide, Internet and telephone-based model focused primarily, if not solely, upon DMP enrollment. Many of the new entrants are set up on a for-profit model. The for-profit model is designed to provide the maximum benefit to related for-profit corporations, which enter into contracts with non-profit CCAs to siphon off revenue from the CCA. A common method used by the for-profit entity to collect revenue from the CCA is to set itself up as a "back-office processing company," which contracts to provide data entry and DMP payment processing for the CCA. The Subcommittee found that these contracts are often executed by officers or directors of a CCA who have familial ties or close business relationships with the owners of the for-profit entity. The Subcommittee also found that, in many instances, multiple non-profit CCAs would send processing fees to a single for-profit company, which reaped substantial profits."

[Taken from pages 4 and 5 of "PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING"]

V. REGULATION AND ENFORCEMENT

"The credit counseling industry is currently governed by a patchwork of professional, state and Federal standards, some of which are mandatory and others of which are voluntary. They include standards issued by credit counseling professional associations, guidelines issued by creditors, state statutes, and Federal tax and fair trade laws.

A. Industry Self-Regulation

The credit counseling industry has two major membership associations, the NFCC and the Association of Independent Consumer Credit Counseling Agencies ("AICCCA"), each of which has issued mandatory membership standards for their members.[152] The NFCC standards, adopted through the Council on Accreditation for Children and Family Services ("COA"), are the more restrictive of the two. COA is an independent third-party not-for-profit accrediting body that has reviewed or accredited more than 1,400 international social service programs.[153]

If applied throughout the industry, these professional standards could significantly address the abusive practices identified in this Report. (emphasis added)

For example, agencies seeking COA accreditation are reviewed in eight specific areas:

- **Mission and Purpose**—determines whether consumer needs and preferences guide the organization in its design and delivery of services.
- **Quality Assurance**—evaluates the effectiveness and efficiency of services provided and corrects any observed deficiencies.
- **Governance and Administration**—determines whether the organization is governed and administered according to legal requirements and sound principles of effective management and ethical practice, evaluated by neutral oversight through a diversified board.
- **Human Resources**—evaluates the organization's ability to deploy personnel and foster efficient, effective service delivery for clients.

- **Service Environment**—ensures safe, accessible, and appropriate delivery for the needs of clients, employers, and other stakeholders.
- **Financial Management**—ensures that an organization manages its fiscal affairs according to sound financial practices and applicable statutory and professional requirements.
- **Professional Practices**—determines whether services are conducted with due regard to ethical and professional requirements and protects confidential information regarding clients.
- **Service Delivery**—ensures that an organization focuses its services on identifying the needs and problems of clients.[154]

In addition, to obtain and maintain accreditation, all NFCC member agencies must adhere to a rigid set of COA standards specific to the credit counseling industry. The standards include the following:

- Agencies must have annual audits of operating and trust accounts.
- Agencies must be licensed, bonded, and insured.
- Agencies must support and provide a variety of consumer education programs.
- Agencies must comply with consumer disclosure requirements.
- DMPs must include a detailed review of current and prospective income, as well as present and anticipated financial obligations.
- Funds are disbursed to creditors on behalf of the clients at least twice per month.
- Clients have a variety of deposit options including electronic methods, and are offered immediate correction of improper postings.
- Each client receives counseling, including an assessment of how he/she got into trouble, and a written comprehensive financial action plan.
- Clients receive a statement, at a minimum, every quarter. [155]

All agencies must be re-accredited by COA every 4 years. Additionally, all NFCC agencies are required to abide by strict Member Quality Standards.[156] On August 18, 2004, the NFCC announced that it had tightened its member standards to prohibit questionable practices.[157] The NFCC enhanced seven existing member quality standards and added four new member quality standards.[158] With the additions and modifications, the NFCC specifically prohibited the payment of bonuses to credit counselors, announced that public relations and marketing activities do not qualify as educational activities, and prohibited charging fees in advance of services.[159] Additionally, the NFCC required all members to complete their submission for COA certification within 9 months of their application to COA (which is half the time previously required) and to establish a formal system of addressing consumer complaints. It also specifically prohibited the practice of "pre-screening" consumers for DMPs.[160]

AICCCA maintains similar standards as part of the code of practice to which its members must adhere. For instance, AICCCA sets a maximum initial fee of $75 for setting up a DMP and a maximum $50 fee for monthly maintenance.

Several CCAs have pointed to their compliance with an industry standard named ISO 9000 as ensuring that they adhere to high standards. ISO 9000 is a generic set of quality assurance standards that are followed by many large businesses, but it is not specific to the credit counseling industry.[161] Pursuit of ISO 9000 standards may be helpful as a first step toward improving performance, because it requires careful documentation of business procedures. But ISO 9000 does not address business products or services. For instance, nothing in the ISO 9000 standard provides guidance to an entity on how much it can charge, what services it should offer, or what should be done with excess funds.

Self-regulation also has limitations. First, although NFCC and AICCCA standards are mandatory for members, joining the association itself is voluntary. CCAs that wish to operate pursuant to lower business standards or no standards can simply refuse to join.

Unrestrained by strict standards of practice, these CCAs may even obtain a competitive advantage over those who adhere to more ethical conduct. Second, it is unclear whether the associations have the resources and mechanisms needed to monitor and consistently enforce compliance with their standards. Weak enforcement reduces the efficacy of even strong standards.

B. Creditor Standards

(1) History of the Creditor-Credit Counseling Agency Relationship

In the late 1950s, credit card issuers played a key role in developing what we refer to today as the credit counseling industry. Originally, they helped establish local offices, known as Consumer Credit Counseling Services ("CCCSs"), which offered face-to-face counseling related to an individual's finances. These counseling sessions were viewed as comparable to other social services available at the time such as substance abuse or family counseling. These CCCSs took a comprehensive approach to treating a consumer's financial instability. Through tools such as debt management plans, referrals to other social agencies (to address other problems associated with the symptoms of the financial stress), and adequate financial education and counseling, these CCCSs nursed debt-ridden consumers back to financial health.

The NFCC is the parent organization of the CCCSs and historically has worked with creditors to operate and fund these non-profit credit counseling agencies through fair share payments.[162] The purpose of these fair share payments was to provide funding for the non-profit agencies to establish educational programs, implement debt management programs, and assist with operating expenses.[163] This funding afforded CCAs the financial freedom to offer their services to customers without charge or to make payment of a modest fee voluntary. The consumers' voluntary contributions were relatively small amounts and were waived when necessary for hardship cases.

Fair share payments are typically paid by creditors on a monthly basis on the aggregate debtor payments managed by a CCA. Until the mid-to-late 1990s, this payment was typically 12–15% of the aggregated debtor payments. In recent years, the expense associated with fair share payments has increased, at times taking up 25–30% of the budgets of the collections departments at major creditors.[164] This increase has caused some creditors to reduce their fair share payments to a lower percentage. In addition, to improve the debt management plans they receive, some creditors have moved to performance-based fair share models. These models link the percentage of fair share payments each credit counseling agency receives to the success rates of the DMPs that the creditor receives from each CCA.[165]"

[Taken from pages 32 to 35 of "PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING"]