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Unsettling

No Relief in Debt Settlement

UC Irvine School of Law Consumer Law Clinic

The University of California, Irvine School of Law (UCI) Consumer Law Clinic provides advocacy to low-income consumers affected by burdensome debt and loans through litigation, policy analysis, and community education and outreach. Students and faculty collaborate to bring consumer protection claims and provide direct representation in state and federal court to improve financial stability for vulnerable Californians.

The Consumer Advocacy Project Justice & Diversity Center | Bar Association of San Francisco

The Consumer Advocacy Project (CAP) serves low income San Francisco consumers through education and outreach, clinics and full scope representation with the help of trained volunteer attorneys.

East Bay Community Law Center

EBCLC was founded in 1988 by law students from UC Berkeley's School of Law. It is the largest provider of free legal services in the East Bay and Berkeley Law's largest clinical offering.

California Low-Income Consumer Coalition

CLICC is a statewide coalition of 14 legal aid providers that strives to ensure that all people, regardless of their income or background, have opportunities under the law to achieve their full potential, and to have their voices heard and their needs recognized by the Legislature.

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1. What is Debt Settlement?

Debt settlement companies (also called "debt relief" or "debt adjusting" companies) are companies that promise consumers to renegotiate, settle, or in some way change the terms of the consumer's debt to a creditor or debt collector.[1] Targeted advertisements for these services can frequently be heard on the radio or seen online with promises of relieving consumers of the pressure of mounting debt. But, dealing with debt settlement companies can be risky.[2] Distressed consumers often seek the services of debt settlement companies when they are at their most overwhelmed. As such, the debt settlement companies claims of quick results —like settling a consumer's debt with at least one creditor within four to six months of the program enrollment[3] —is too enticing to ignore. Often, these companies promise to complete the entire settlement program within 24-60 months.[4] Many consumers enter the debt settlement program with little to no research about the service, and often consumers fail to understand the actual service until they are served with a debt collections lawsuit.

A Model of Destruction

When a consumer enrolls in a debt settlement plan, they enroll the debt accounts that they wish to settle. It is not uncommon for consumers who only seek to settle one or a limited number of accounts to be encouraged by the companies to enroll more.[5] Once enrolled, the companies typically ask the consumer to sign a power of attorney for the enrolled debts to be able to negotiate with the creditors or debt collectors on the consumer's behalf.[6] Consumers are encouraged to cease all communication with the creditors or debt collectors, which is an immediate relief for these overburdened consumers. As a part of the program, debt settlement companies request consumers to make monthly payments into a settlement account.[7] This simplicity and the sense of being

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[1] Consumer Fin. Prot. Bureau, What Are Debt Settlement/Debt Relief Services and Should I Use Them?, https://www.consumerfinance.gov/ask-cfpb/what-are-debt-settlementdebt-relief-services-and-should-i-use-them-en-1457/ (last reviewed Mar. 1, 2021).

[2] *Id.*

[3] Am. Fair Credit Council, Fact: Debt Settlement Offers Vital Lifeline to Consumers, https://americanfaircreditcouncil.org/wp-content/uploads/AFCC_MythbustersOnePager10_FINAL.pdf (last visited Mar. 10, 2021); ClearOne Advantage, When Will My First Account Be Settled?, Question to Debt Relief Frequently Asked Questions, https://www.clearoneadvantage.com/resource/faq (last visited Mar. 10, 2021); Freedom Debt Relief, Do You Start Negotiating with My Creditors Right Away?, Question to Frequently Asked Questions, https://www.freedomdebtrelief.com/faq/ (last visited Mar. 10, 2021).

[4] ClearOne Advantage, What Are the Pros and Cons of Debt Settlement?, Question to Debt Relief Frequently Asked Questions, https://www.clearoneadvantage.com/resource/faq (last visited Mar. 10, 2021); Will S. Dobbie, Financial Outcomes for Debt Settlement Programs: Estimates for 2011-2020 4 (2021) (noting that 74% of individuals successfully settle an average of 55% of their enrolled debt in the first 36 months)

[5] Freedom Debt Relief, Should I Include All of My Credit Cards in the Program?, Question to Frequently Asked Questions, https://www.freedomdebtrelief.com/faq/ (last visited Mar. 10, 2021) ("The program will generally not work . . . unless you enroll all of your high balance (greater than $500) credit card accounts.")

[6] Cal. Civ. Code § 1788.17; 15 U.S.C. § 1692c(b).

[7] Am. Fair Credit Council, *Step 2. The Consumer is Accepted into a Debt Settlement Program*, Subheading to *Debt Settlement 101*, https://americanfaircreditcouncil.org/debt-settlement-101/ (last visited Mar. 10, 2021).

responsible by making high, but affordable payments, are other initial sources of relief for the consumer. However, the monthly amount of these payments is based on a loose calculation of the difference between the consumer's income and utility expenses, and many consumers are left with very little left over each month.

*"**Charge Off**": The uncollected credit card balances that have been overdue so long they are removed from the books and charged against a bank's loss reserves... For a card issuer, this is an accounting measure the creditor uses to move your account from an asset to a liability. For an individual, it's far more, **having a debt charged off has a serious, negative impact on a consumer's credit.***

Additionally, despite the consumer making monthly payments into the settlement account, the debt settlement company does not begin to settle the debts until a sufficient amount of money has been accumulated.[8] This means that the enrolled debts — on which the consumer was making current payments — are now past due. 30 days. 60 days. 90 days. 120 days.[9] Charged off.[10] And each marker results in negative impacts to the consumer's credit report. It should also be noted that the industry's estimate of four to six months for the first settlement coincides with the charge off date for open and closed end credit.[11] This is deliberate. Freedom Debt Relief, one of the largest national debt settlement companies and an accredited[12] American Fair Credit Council (AFCC) member, tells consumers "... *the most effective way to get creditors to negotiate is by showing them you are unable to pay your debt in full due to a financial hardship. Letting your payments go into default is a good way to do this. Once your creditors understand that you are unable to pay in full, they are more likely to accept a reduced amount as settlement.*"[13] Furthermore, debt settlement companies are prohibited from collecting any fees until a settlement has been approved by the consumer and the consumer has made the first payment towards the settlement.[14]

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[8] Am. Fair Credit Council, *Step 3. The Debt Settlement Company Negotiates with the Consumer's Creditors, Subheading to Debt Settlement 101,* https://americanfaircreditcouncil.org/debt-settlement-101/ *(last visited Mar. 10, 2021).*

[9] Fed. Fin. Insts. Examination Council, *Uniform Retail Credit Classification and Account Management Policy*, 65 Fed. Reg. 36903 (June 12, 2000), https://www.fdic.gov/regulations/laws/federal/00uniform.pdf. Banks are typically required to report losses within 120-180 days, establishing a charge off policy for open-end credit at 180 days delinquency and closed-end credit at 120 days delinquency.

[10] CreditCards.com, *Charge-Off. Definition in Credit Card Glossary: Terms and Definitions,* https://www.creditcards.com/credit-card-news/glossary/term-charge-off/ *(last visited Mar. 9, 2021).* A "charge off" refers to "the uncollected credit card balances that have been overdue so long they are removed from the books and charged against a bank's loss reserves… For a card issuer, this is an accounting measure the creditor uses to move your account from an asset to a liability. For an individual, it's far more: Having a debt charged off has a serious, negative impact on a consumer's credit."

[11] Fed. Fin. Insts. Examination Council, *supra* note 9.

[12] Am. Fair Credit Council, Become an AFCC Member, https://americanfaircreditcouncil.org/become-a-member/ (last visited Mar. 10, 2021). ("Accredited Membership represents the highest level of membership available in the American Fair Credit Council . . . Accredited Members agree to undergo a separate and independent audit of their operational practices and must demonstrate their strict adherence to the AFCC Code of Conduct.")

[13] Freedom Debt Relief, Can You Settle Credit Card Debt If You Are Still Current?, Question to Frequently Asked Questions, https://www.freedomdebtrelief.com/faq/ (last visited Mar. 10, 2021).

[14] 16 C.F.R. § 310.4(a)(5)(i).

During the enrollment, the delinquent debt itself grows with interest and fees. If the debt settlement company requests a cease and desist on behalf of the consumer, the creditor or debt collector is left with no other means to collect the debt than a lawsuit[15], to which the consumer is not immune. It is not uncommon for consumers to learn that their enrolled accounts have not been paid until after they are served with a lawsuit or sometimes a notice of entry judgment.

The Consumer Financial Protection Bureau (CFPB) nicely summarizes the risks of debt settlement plans in a warning to consumers, which is likely seen only after the consumer looks for help when the debt settlement company services are not as expected:

> *"Debt settlement may well leave you deeper in debt than you were when you started. Most debt settlement companies will ask you to stop paying your debts in order to get creditors to negotiate and to collect the funds required for a settlement. This can have a negative effect on your credit score and may result in the creditor or debt collector filing a lawsuit while you are collecting settlement funds. And if you stop making payments on a credit card, late fees and interest will be added to the debt each month. If you exceed your credit limit, additional fees and charges may apply. This can cause your original debt to increase."*[16]

In a complaint filed with the CFPB on October 12, 2020, a customer of Freedom Debt Relief said the following:

"Hello, Im (sic) currently a member of Freedom Debt Relief and have been a member for since (sic) XX/XX/2017. I was told that all my debt would be resolved in 5 years! I feel as though Im (sic) being scammed because I recently found out that over three years Ive (sic) deposited over {$4500.00} dollars to settle debts and only {$800.00} dollars of my debt has been paid off. Please help. They wont (sic) even give me a ledger to see where all my money has been going. They also gave me a number for XXXX to obtain my ledger but apparently their offices are officially closed due to covid (sic) and I cant (sic) get ahold of a representative. Ive (sic) been paying {$230.00} dollars a month for three years and only {$800.00} dollars of debt has been paid. This is absolute fraud. Please help. -XXXX XXXX."[17]

A Loosely Regulated Industry

In spite of the risks to consumers, debt-settlement companies face few regulations at both state and federal levels. At the federal level, the Federal Trade Commission (FTC) and the CFPB oversee the industry with authority to bring enforcement actions against the companies. In 2010, the FTC promulgated a regulation under

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[15] Cal. Civ. Code § 1788.17; 15 U.S.C. § 1692c(c).

[16] Consumer Fin. Prot. Bureau, *supra* note 1.

[17] Consumer Fin. Prot. Bureau, *Consumer Complaint 3895162*, Complaint in *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3895162 (last visited Mar. 15, 2021).

the Telemarketing Sales Rule (TSR) prohibiting debt settlement companies from charging advance fees.[18] Over 40 states supplement the federal law by either banning debt settlement entirely or establishing a cap on fees that the companies can charge consumers.[19] Californians have filed 135 complaints with the CFPB where they self-identified the issue as "debt settlement," describing their frustration with false and deceptive advertising and promises not kept.[20]

Unfortunately, California's regulation of the debt settlement industry has been subject to court challenges. [21] Debt settlement companies make small modifications to their practices and contracts to circumvent existing regulation of the industry under the Proraters Law.[22] Although recent legislation[23] has helped to clarify the authority of the California Departments of Financial Protection and Innovation (DFPI) to license proraters, the law does not accurately reflect the current structure of the industry, leaving regulators and advocates struggling to enforce the intent of the state law.

The debt settlement companies in California, moreover, find ways to bypass the FTC's ban on advance fees.[24] Debt settlement companies often partner with an attorney or law firm that operates outside of the scope of the TSR[25], although non-attorneys continue to conduct the actual debt-settlement work.[26] The TSR also does not

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[18] 16 C.F.R. § 310.4(a)(5)(i).

[19] Analysis of state laws regulating the debt settlement industry, 2020. (On file with authors)

[20] CFPB Complaint Database Results for California Complaints About Debt Settlement, Consumer Fin. Prot. Bureau, https://www.consumerfinance.gov/data-research/consumer-complaints/search/api/v1/?date_received_max=2021-02-09&date_received_min=2011-12-01&field=all&format=csv&no_aggs=true&search_term=%22debt%20settlement%22&size=135&state=CA (last visited Mar. 15, 2021).

[21] *Nationwide Biweekly Admin. v. Owen, 873 F.3d 716 (9th Cir. 2017).*

[22] Cal. Fin. Code § 12000 et seq. In a 2009 case wherein the debt settlement appellant appealed the decision by the Department of Business Oversight (DBO) under the purview of the Prorater's Law claiming that they do not meet the definition of a "prorater" because they do not take actual possession of a debtor's money, the court found that the debt settlement scheme gave the debt settlement company constructive control as the debtor had limited control over his funds in a third party account thus meeting the requirements of the current definition of prorater. Nationwide Asset Services, Inc. v. DuFauchard, 164 Cal. App. 4th 1121 (2008). Soon thereafter, debt settlement companies changed their contracts with debtors to claim that debtors have "full control" over their money at all times, but the court did not agree that this change precludes them from being classified as a prorater under the current definition as the language in the contract was contradictory. Estrella v. Freedom Financial Network, LLC, 778 F.Supp. 2d 1041 (N.D. Cal. 2011).

[23] Assem. Bill 2524, 2019-2020 Reg. Sess. (Cal. 2020). AB 2524 passed the California Legislature and closed a loophole by which the Department of Financial Protection and Innovation (formerly the Department of Business Oversight) was unable to regulate the industry due to a challenge brought based on the Dormant Commerce Clause. See, e.g., Owen, 873 F.3d 716.

[24] Leslie Parrish & Ellen Harnick, *The State of Lending in America & Its Impact on U.S. Households* 4 (2014), https://www.responsiblelending.org/state-of-lending/reports/State-of-Lending-Full-6-16-15.pdf.

[25] Fed. Trade Comm'n, *Who's Covered by the Rule, Subheading to Debt Relief Services & the Telemarketing Sales Rule: What People Are Asking,* https://www.ftc.gov/tips-advice/business-center/guidance/debt-relief-services-telemarketing-sales-rule-what-people-are (last visited Mar. 11, 2021). Attorneys are not exempt from the Rule automatically, but in many cases attorneys who assist individual clients are likely not covered by the Rule, for two main reasons: 1) the TSR applies only to providers who use interstate telemarketing, that is, a plan, program, or campaign to sell products or services using the telephone; and 2) providers – including attorneys – who make their sales presentations in face-to-face meetings before enrolling customers likely are exempt from most of the Rule's provisions.

[26] Parrish & Harnick, *supra* note 24, at 4, (citing Becker& Harnick, *Debt Settlement Firms Adopt "Attorney Model" to Evade State & Federal Rules,* Ctr. for Responsible Lending (2013).

cover in-person communication, and some companies hold cursory in-person meetings with consumers to skirt regulation.[27]

The debt settlement service is an example of what economists call a "credence good."[28] For most consumers, the debt settlement service is a once-in-a-lifetime purchase**.** In such markets, consumers lack experience and may not know the quality of a product or service. As a result, consumers in financial distress often rely on the expertise of others, but these consumers often have little or no experience in evaluating that expertise and are then vulnerable to fraud and misleading claims. Such potential market failures suggest a need for further government intervention.

2. The Economic Hardships Caused by the COVID-19 Pandemic Create an Urgent Need for Regulation Over Debt Settlement Companies.

The COVID-19 pandemic has prompted a health and economic crisis perfect for the debt settlement industry to exploit. Stay-at-home and social distancing orders are necessary to mitigate the spread of the virus, but these measures have resulted in massive job loss and economic insecurity. Californians entered the pandemic with record-levels of debt[29] and unemployment, reduced hours, and insufficient government policy measures have made basic household bill payments difficult for many individuals. This is particularly true for lower-income workers, many of whom already lived paycheck-to-paycheck before the pandemic. As bills mount and unemployment begins to slowly decrease[30], conditions are ripe for consumers to be susceptible to targeted advertisements from debt settlement companies.

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[27] *Id.*

[28] Darby & Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J. of Law & Econ. 67-88 (1973).

[29] Jean Eaglesham & AnnaMaria Andriotis, *That Offer to Make You Debt-Free? It Can Make You Worse Off*, Wall St. J. (Aug. 10, 2019), https://www.wsj.com/articles/that-offer-to-make-you-debt-free-it-can-make-you-worse-off-11565409601. ("Consumer debt, not counting mortgages, hit a record $4.02 trillion . . ." as of August 10, 2019).

[30] *See California Unemployment Rate Rose to 5.3 Percent in March, Emp. Dev. Dep't (Apr. 17, 2020),* https://www.edd.ca.gov/newsroom/unemployment-april-2020.htm*; see also California Unemployment Lowers Slightly to 16.3 Percent in May, Emp. Dev. Dep't (June 19, 2020),* https://edd.ca.gov/newsroom/unemployment-june-2020.htm*; see also California Unemployment Increased 0.9% Since November 2020, Emp. Dev. Dep't (Jan. 22, 2021),* https://www.edd.ca.gov/newsroom/unemployment-december2-2020.htm. California's unemployment rate was 5.3% in March 2020, rose to 16.4% in April 2020, decreased to the lowest rate since the lockdown orders started at 8.1% in November 2020, and increased slightly to 9.0% in December 2020, the most recent available data as of the date of this writing.

A Writhing Economy

Nationwide, the pandemic and shutdown orders have created an economic shock.[31] Over 74% of small businesses reported lost revenue between April 26th and May 2nd of 2020, and half of U.S. households experienced income loss between March 13th and July 21 2020.[32] 20.5 million jobs were lost in April 2020 alone.[33] Many workers who did not lose their jobs took pay cuts or reduced their hours.[34] While some jobs were regained after the initial shock of the pandemic, the regrowth rate in the last half of 2020 was slow. The Bureau of Labor Statistics reported that by November 2020 there were still 9.8 million fewer jobs nationwide than there were before the COVID-19 crisis began.[35]

Americans who lost their jobs or had their wages reduced are more likely to report facing difficulty paying bills, dipping into savings accounts, or borrowing money.[36] A Pew Research Center study from September 2020 found that "one in four adults have had trouble paying their bills" and one third have tapped into retirement accounts or savings since the beginning of the coronavirus outbreak.[37] Lower-income individuals have been hit hardest, with 46% saying that they have had difficulty paying bills during the pandemic and 32% describing difficulties with paying rent or making mortgage payments.[38] Increased unemployment additionally means lost health insurance, and more Americans are now paying out of pocket for medical expenses or individual insurance plans.[39] Americans already frequently turn to consumer credit to pay for medical bills.[40]

Negative effects on household finances across the U.S. and in California are likely to last for the foreseeable future. In July 2020 researchers predicted that by February 2021, 4.5 million individuals across the United States will have experienced unemployment for 26 weeks or more, with two million experiencing

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31 *See* Jialan Wang et al., *Bankruptcy and the COVID-19 Crisis* (Sept. 12, 2020) (unpublished manuscript) (on file with SSRN).; Lauren Bauer, Kristen E. Broady, Wendy Edelberg & Jimmy O'Donnell, *Ten Facts about COVID-19 and the U.S. Economy,* Brookings (Sept. 17, 2020)*,* https://www.brookings.edu/research/ten-facts-about-covid-19-and-the-u-s-economy/#:~:text=The%20COVID%2D19%20crisis%20also,(U.S.%20Census%20Bureau%202020a)*. (*"The economic crisis is unprecedented in its scale: the pandemic has created a demand shock, a supply shock, and a financial shock all at once.")

32 Wang et al., *supra* note 23 (manuscript at 2) (citing U.S. Census Bureau 2020a, b).

33 Cardiff Garcia & Stacey Vanek Smith, *A Brutal Jobs Report*, NPR.org (May 8, 2020), https://www.npr.org/2020/05/08/853143026/a-brutal-jobs-report.

34 Kim Parker et al., *Economic Fallout from COVID-19 Continues to Hit Lower-Income Americans the Hardest*, Pew Social Trends (Sept. 24, 2020), https://www.pewsocialtrends.org/2020/09/24/economic-fallout-from-covid-19-continues-to-hit-lower-income-americans-the-hardest/.

35 Cardiff Garcia & Stacey Vanek Smith, *Jobs Friday: The Four Labor Markets*, NPR.org (Dec. 4, 2020), https://www.npr.org/2020/12/04/943241113/jobs-friday-the-four-labor-markets.

36 Parker et al., *supra* note 34.

37 *Id.*

38 *Id.*

39 David Brancaccio & Rose Conlon, *There's Been a Dramatic Spike in Americans' Economic Anxiety*, Marketplace (May 5, 2020), https://www.marketplace.org/2020/05/05/covid-19-economic-anxiety-spike-food-groceries-rent-mortgages-health-care/.

40 *See* Lorie Konish and Sharon Epperson*, One-Third of Credit Card Users Have Debt Due to Medical Costs. These Steps Can Help You Manage Those Bills,* CNBC (Dec. 13, 2019), https://www.cnbc.com/2019/12/13/33percent-of-credit-card-debt-is-medical-bills-how-to-manage-those-debts.html; David U. Himmelstein et al., *Medical Bankruptcy: Still Common Despite the Affordable Care Act*, 109 Am. J. Pub. Health 431 (2019).

unemployment for 46 weeks or longer.[41] This has borne out in California. As of the end of December 2020, the state had regained only 44 percent of the 2.6 million jobs lost in March and April of 2020, with the majority of these job losses concentrated among "some of the most vulnerable workers in the economy," those without a college degree and in the service economy and hospitality sectors.[42] California's unemployment rate, particularly among black and brown communities, remains high.[43] Since the beginning of the pandemic "almost half of California's workforce has filed for unemployment insurance benefits," and the unemployment rate for communities of color in California is improving at a much slower rate than white workers since the initial hit at the beginning of the pandemic.[44]

Federal Relief Fails to Address Problems with Consumer Debt

The Coronavirus Aid, Relief, and Economic Security (CARES) Act and the American Rescue Plan, the Federal government's response to the pandemic's economic fallout, provides limited relief that is unlikely to help consumers who carry debt in the long run.[45] For example, the CARES Act allowed holders of federally-backed mortgages the opportunity to request up to a year of forbearance on home payments.[46] However, these forbearances simply mean that deferred payments must be paid later, and interest still accrues on the loan.[47] Similarly, the Act's rent-forbearance program, which only applies to certain types of housing, merely puts off rent payments to a later date. Forbearance plans assume that consumers will have more money later, which is a flawed assumption, particularly for lower-income households.[48] Moreover, credit cards and other privately held unsecured debt received no specific relief from the CARES Act[49] or the American Rescue Plan, nor did either bill provide protection from debt collection.[50] In fact, consumers with collection judgments risk levy of stimulus payments.[51] Reliance on forbearance as relief, along with continued inadequate support from federal legislation,

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[41] Gabriel Chodorow-Reich & John Coglianese, *Projecting Unemployment Durations: A Factor-Flows Simulation Approach with Application to the Covid-19 Recession* 3 (NBER Working Paper, Paper No. w27566, 2020), https://ssrn.com/abstract=3658862.

[42] Margot Roosevelt, *A 'Full Reverse': California Joblessness Spiked in December, Thwarting Recovery*, L.A. Times (Jan. 22, 2021, 5:40 PM) https://www.latimes.com/business/story/2021-01-22/california-unemployment-spiked-december-covid-surged.

[43] Alissa Anderson, *COVID-19 Recession at Six Months: California's Unemployment Remains High*, Cal. Budget & Pol'y Ctr. (Sept. 2020), https://calbudgetcenter.org/resources/californias-unemployment-remains-high/.

[44] *Id.*

[45] *See* Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *The Folly of Credit as Pandemic Relief*, 68 UCLA L. Rev. Disc. 126 (2020).

[46] Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, § 4022, 134 Stat. 281 (2020).

[47] Foohey, Jiménez & Odinet, *supra* note 45, at 130.

[48] *See id.*; *see also* Abbye Atkinson, *Rethinking Credit as Social Provision,* 71 Stan. L. Rev. 1093 (2019).

[49] *Credit Card Debt During Coronavirus, Consumer Fin. Prot. Bureau (May 19, 2020),* https://www.consumerfinance.gov/about-us/blog/credit-card-debt-during-coronavirus-relief-options-tips/.

[50] Foohey, Jiménez & Odinet, *supra* note 45, at 143.

[51] Chris Morris, *Your Stimulus Check Could Disappear Before You Ever See It, Thanks to Debt Collectors*, Fortune Mag. (Mar. 12, 2021 8:12 AM) https://fortune.com/2021/03/12/stimulus-check-3-can-debt-collectors-garnish-3rd-round-stimulus-checks-payments-direct-deposit-irs-update/.

has created a situation where consumer debts are likely to accrue in the long run, and the most vulnerable consumers are left in worse financial shape.[52]

Conclusion: The COVID-19-Induced Recession Makes Consumers Vulnerable to Harmful and Underregulated Debt Settlement Practices.

With the gradual rollout of the COVID-19 vaccine, the economy will begin to reopen and with it we will see a decrease in joblessness.[53] Consumers will emerge from the aftermath of the pandemic and return to the workforce with heavy debt incurred to survive the year of closures.[54] Depleted savings and deferred bills will pressure consumers to find alternatives to dealing with payments once forbearance policies have ended and consumers return to work.

> *Consumers with high debt and a reliable income are the best targets for debt settlement companies. A high enrolled debt balance ensures a high fee for debt settlement companies, regardless of their ability to reduce the debt,[55] and a steady income from the consumer means that the consumer is likely to be able to continue participation in the program despite growing debt, little progress, and monthly maintenance fees.*

As the rest of this white paper shows, without proper regulation, debt settlement companies may leave consumers in long-lasting, worse financial shape.

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[52] Foohey, Jiménez & Odinet, *supra* note 45, at 128-129; Laurence du Sault & Jackie Botts, CalMatters, *Why Personal Debt Looks Healthy Despite Worst Year for Jobs,* CalMatters, https://calmatters.org/california-divide/2021/02/why-personal-debt-looks-healthy-despite-worst-year-for-jobs/ (last updated Feb. 22, 2021) (noting that traditional economic indicators are failing to capture the pandemic's toll on low-income consumers).

[53] Margot Roosevelt, *Get Ready for Another Roaring '20s, UCLA Economic Forecast Predicts*, L.A. Times (Dec. 9, 2020), https://www.latimes.com/business/story/2020-12-09/california-economy-ucla-forecast-covid-vaccine.

[54] Du Sault, *supra* note 52 Ernesto Martinez of the Mission Economic Development Agency says this is "probably the largest wealth stripping event of our lifetime."

[55] Parrish & Harnick, *supra* note 24, at 3. A study by the Center for Responsible Lending found that typical fees range from 20-25% based on the enrolled debt amount.

3. Predatory Behavior by Debt Settlement Companies

Deceptive Advertising

Consumers struggling to make ends meet search the internet for information, help, guidance, and answers with low barriers. Using direct marketing through mail, email, and targeted advertisements on radio and social media[56], debt settlement companies appeal to vulnerable consumers who believe they have no other options. An advertisement from Freedom Debt Relief[57] shows how debt settlement is designed to target those who feel they have nowhere else to turn.

Two Californians involved with ClearOne Advantage LLC felt they were subject to a bait-and-switch by the debt settlement company. P.L., a client of the East Bay Community Law Center (EBCLC) in Berkeley, California, believed a salesperson over the phone who promised that the service would pay off her three to four credit cards in four months and that her credit score would improve so much that she would be able to buy a house.[58] This turned out to be untrue, and P.L. later learned that ClearOne was paying $100 monthly to just one of her creditors in a structured settlement that she did not recall approving.[59] Another EBCLC client, D.C., received forms that stated ClearOne does not “charge, collect, or accept fees prior to the settlement of a debt,” but later learned that this was not true.[60]

The CFPB brought an action against debt settlement company DMB Financial, LLC on December 1, 2020 alleging violations of the Telemarketing Act, the Telemarketing Sales Rule, and the Consumer Financial Protection Act over deceptive and misleading marketing, and sale of debt settlement and debt relief services. [61] Two years prior, DMB Financial and payment processor, Global Client Solutions, Inc., were also sued by the Massachusetts Attorney General for deceptive and misleading practices.[62] The CFPB complaint tells a story of a company that engaged in industry-wide practices that harm consumers. DMB told consumers to stop paying creditors, which resulted in increased interest and fees after enrollment in the DMB plan.[63] DMB calculated its fees based on the debt amount after enrollment, rather than before enrollment, wrapping in all the late fees and

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[56] *See* Facebook Ad Library Search for “Freedom Debt Relief” on Feb. 14, 2021, Facebook, https://www.facebook.com/ads/library/?active_status=all&ad_type=all&country=US&view_all_page_id=69869352985&sort_data[direction]=desc&sort_data[mode]=relevancy_monthly_grouped (last visited Mar. 11, 2021); infra note 76.

[57] *See id.*; See *infra* note 78 and image capture.

[58] Interview by Roger Huddle, clinical law student, with P.L., East Bay Cmty. Law Ctr. client (Feb. 13, 2018) (On file with authors).

[59] *Id.*

[60] Forms titled “Direct Debit Authorization” (Mar. 11, 2019) (on file with authors).

[61] *Consumer Fin. Prot. Bureau v. DMB Fin., LLC,* No. 1:20-cv-12147 (Mass. Dist. Ct. Dec. 1, 2020) [hereinafter *CFPB v. DMB*].

[62] *Massachusetts v. Glob. Client Solutions*, No. 1:18-cv-11120 (Mass. Dist. Ct. Nov. 28, 2018).

[63] Complaint for Plaintiff ¶ 11, *Consumer Fin. Prot. Bureau v. DMB Fin., LLC,* No. 1:20-cv-12147 (Mass. Dist. Ct. Dec. 1, 2020).

delinquency charges into the balance against which they would assess a percentage in calculating their fees.[64] The CFPB further found that DMB misled consumers by failing to disclose in a clear and conspicuous manner how and when the debts would be settled– consumers did not know the amount of money or percentage of each outstanding debt they would need to accumulate for a debt to be settled.[65]

In 2017, the CFPB also brought claims against Freedom Financial Network, LLC and Freedom Debt Relief, LLC[66] asserting that the Freedom entities violated a previous consent order from a 2011 settlement regarding disclosure of fees.[67] The CFPB also found that Freedom Debt Relief overpromised to consumers about its ability to negotiate with creditors, and then instructed consumers to settle their own debts. Freedom Debt Relief's instructions to consumers included "directions to mislead their creditors by concealing the fact of their enrollment in Freedom's debt settlement program."[68] The CFPB notes the deceptive and misleading practice of charging fees to consumers for debts that the consumers themselves negotiated – something that they could have done for free, without signing up with a debt settlement company.[69]

> *"There was no box [on the CFPB complaint database system] to check for this debt settlement company. Having combined two credit cards my enrolled balance was {$22000.00} (sic) to pay off over 36 months back in XX/XX/2019. Usually these companies tell you that you will pay around 50-60% of the balance. However, after the last card settled, in total I would be paying out {$21000.00} (sic) a whopping savings of 1.4 %. Based on their calculator on their website, they show bogus savings amounts. I asked them to lower my next 17 payments but they refused."*[70]

Abusive Advertising through Direct Unsolicited Communication

Debt settlement companies send unsolicited spam email messages, including to one consumer who ended up suing the debt settlement company in Orange County Superior Court. The consumer received 21 spam messages linking to Freedom Debt Relief's website and containing the domain names of third-party companies to lend false legitimacy to the messages and avoid spam filters.[71] Other consumers received excessive and harassing automated calls and texts from the debt settlement company, even after the consumers repeatedly requested that

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[64] Complaint for Plaintiff ¶¶ 26, 51, 53, *Consumer Fin. Prot. Bureau v. DMB Fin., LLC*, No. 1:20-cv-12147 (Mass. Dist. Ct. Dec. 1, 2020).

[65] Complaint for Plaintiff ¶¶ 62-63, *Consumer Fin. Prot. Bureau v. DMB Fin., LLC*, No. 1:20-cv-12147 (Mass. Dist. Ct. Dec. 1, 2020).

[66] Complaint for Plaintiff, *Consumer Fin. Prot. Bureau v. Freedom Debt Relief, LLC,* No. 3:17-cv-06484 (N.D. Cal. Nov. 8, 2017) [hereinafter *CFPB v. FDR*], https://files.consumerfinance.gov/f/documents/cfpb_freedom-debt-relief-llc_complaint_112017.pdf.

[67] *Schneiderman v. Freedom Debt Relief, LLC, AOD No. 10-167 (2011) [hereinafter NY v. FDR],* https://ag.ny.gov/sites/default/files/press-releases/2011/Schneiderman%20v%20Freedom%20Debt%20Relief.pdf.

[68] *CFPB v. FDR*, *supra* note 66, ¶ 62.

[69] *CFPB v. FDR*, *supra* note 66, ¶ 63.

[70] Consumer Fin. Prot. Bureau, *Consumer Complaint 3717782,* Complaint in *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3717782 (last visited Mar. 15, 2021).

[71] *Allan v. Freedom Debt Relief, LLC*, 2020-01156156-CL-MC-CJC (Orange Cnty. Super. Ct. 2020)

all the solicitation calls cease.[72] In a class action lawsuit filed against the debt settlement company, consumers reported receiving unsolicited texts saying, "Debt-Help: Need to pay $10,000 + in cc bills? We're here to help! We can save you a ton of money. Call for more info. Respond no to quit" and "Cash Help: Dunk (sic) have structured settlement and need cash immediately? Have cash approved in 48 hours or less. Call 7868084370."[73]

Targeted Advertisements

In November 2019, Google updated its AdWords policy to "restrict the advertisement of debt settlement, debt management services, and credit repair services."[74] The acknowledgment by Google that this industry is problematic (at the same time, Google entirely halted advertisements by credit repair services), has not entirely stopped internet advertising by many of the largest debt settlement companies, because companies "certified by Google" are still permitted to buy AdWords.[75]

The debt settlement industry also engages in targeted advertisement campaigns on other forms of social media that can be tracked by viewing the advertisement libraries of some of the largest debt settlement companies. Data about the user's selected target audience for these advertisements is not publicly available. However, Facebook allows users to select target audience criteria based on locations, age, gender, languages, detailed targeting (including or excluding people from an audience based on criteria such as demographics, interests, and/or behaviors), connections, custom audiences (based on people already known to the user), and lookalike audiences (new people based on a user defined custom audience list).[76] Freedom Debt Relief, with a quarter of a million likes on Facebook, runs an active advertisement campaign that saw a dramatic increase in advertisement buys in December 2020 to February 2021. One advertisement ran in 2019, five advertisements in December 2020, and 28 more were added in 2021 for a total of 34 active advertisements running as of February 2021.[77] Advertisements from Freedom Debt Relief show a variety of stock photos of people of various ages and ethnicities, and target across all Facebook social media platforms (Facebook, Instagram, Facebook Messenger, and Audience Network). While debt settlement companies claim that low-income consumers are not the target demographic for their program, the fixed income that many low-income consumers receive, especially senior citizens, makes them a good fit for debt settlement companies. A filter in the Facebook advertisement library for

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[72] *Pizer v. Freedom Debt Relief, LLC, 4:19-cv-07542 (N.D. Cal. 2019); Berman v. Freedom Fin. Network, LLC,* No. 4:18-cv-01060 (N.D. Cal. 2018)*;* Better Business Bureau Complaint Dated 2/08/2021, https://www.bbb.org/us/md/baltimore/profile/debt-relief-services/clearone-advantage-0011-90096368/complaints *(last visited Mar. 15, 2021).*

[73] *Berman*, 4:18-cv-01060.

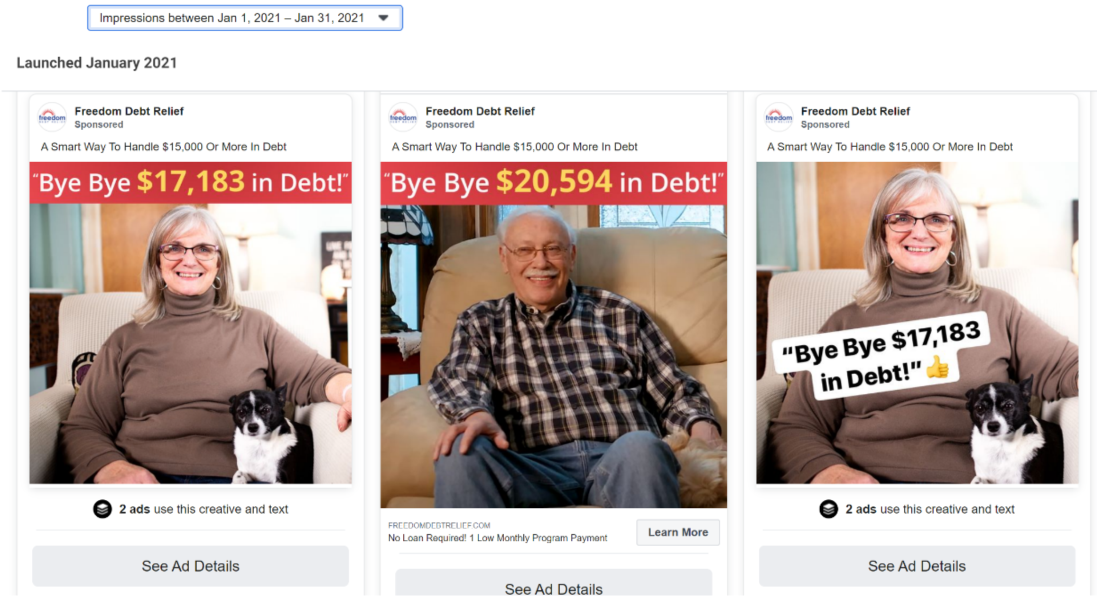
[74] Google LLC, *Update to Financial Products and Services Policy (November 2019)*, Update to *Advertising Policies*, https://support.google.com/adspolicy/answer/9508775?hl=en#:~:text=In%20November%202019%2C%20Google%20will,longer%20be%20allowed%20to%20serve (last visited Mar. 11, 2021).

[75] *Id.*

[76] Facebook, Inc., *Creating a New Audience*, Subheading to *About Reaching New Audiences*, Facebook Business Help Center, https://www.facebook.com/business/help/717368264947302?id=176276233019487&helpref=page_content (last visited Mar. 11, 2021).

[77] Facebook Ad Library Search for "Freedom Debt Relief" on Feb. 14, 2021, Facebook, https://www.facebook.com/ads/library/?active_status=all&ad_type=all&country=US&view_all_page_id=69869352985&sort_data[direction]=desc&sort_data[mode]=relevancy_monthly_grouped (last visited Mar. 11, 2021).

Freedom Debt Relief to sort by largest number of impressions during the month of January 2021 shows that the advertisements that are getting the most traffic are the three that show pictures of senior citizens with relatively low debt balances.[78]



Conflict of Interest: Origination of Loans and Securitization Business

California currently governs debt settlement companies as proraters under the Financial Code with oversight by the Department of Financial Protection and Innovation (DFPI).[79] The Proraters Law prohibits the origination of loans by proraters.[80] The debt settlement industry in California asserts that it is not covered by current law but has no case law to substantiate the claim.[81] Debt settlement companies engage in third-party relationships with companies that offer consolidation loans to people enrolled in the debt settlement company's programs.[82] An overview of the secondary market in relation to securities reveals a relationship between some debt settlement companies and subprime loan underwriting. This alternative product offering is yet another way debt

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[78] *Id.* (filter by "Impressions by Date;" select "Date range" and choose Jan. 1, 2021 and Jan. 31, 2021 using the calendar).

[79] Cal. Fin. Code § 12000 *et seq.*

[80] Cal. Fin. Code § 12323.

[81] *Nationwide Asset Services, Inc. v. DuFauchard*, 164 Cal.App.4th 1121 (2008); *Estrella v. Freedom Fin. Network, LLC*, 778 F.Supp.2d 1041 (N.D. Cal. 2011). Debt settlement companies sought to circumvent a prior ruling, *DuFauchard*, 164 Cal.App.4th 1121, by changing their contracts with debtors to claim that debtors have "full control" over their money at all times, but the court did not agree that this change precludes them from being classified as a prorater under the current definition as the language in the contract was contradictory, *Estrella*, 778 F.Supp.2d 1041.

[82] *FREED ABS Trust 2020-2CP*, Kroll Bond Rating Agency 19 (May 20, 2020) [hereinafter *FREED ABS Trust*] https://www.ncjustice.org/wp-content/uploads/2020/07/Freedom-Asset-Backed-Securities-Offering.pdf?eType=EmailBlastContent&eId=4a40abae-3fdf-4677-bfce-cd04e0be4498. [hereinafter *FREED ABS Trust*] Freedom FinancialAsset Management, LLC ("FFAM") utilizes Cross River Bank as its originator for all loans originated through the Freedom program.

settlement companies prey on vulnerable consumers and resist oversight by the DFPI.[83][84] Originating and lending to individuals enrolled in debt settlement plans creates a conflict of interest between the debt settlement company's promises to consumers – obtaining an affordable settlement amount – and the debt settlement company's interest behind offering consolidation loans provided through its affiliated lender –to carry a high balance to profit off interest which is achieved when the consumer cannot afford the payment on the settlement.

An older adult living California reported the following story to the CFPB in August of 2019:

"I was looking for a consolidation loan so I could payoff (sic) my credit card debt before I retired. I called many banks. Although my repayment history was good, I had too much debt. I kept on hearing that there was a way to payoff (sic) my dept (sic) at a much lower amount. The salesperson told me that it was a government created program and that I would be out of debt in three years. They said I would pay into an account and they would payoff (sic) my credit cards. They disclosed that I would pay two monthly service fees—one for the service and one for an attorney—about {$12.00} each.

> *I never had a paper copy of the contract before signing it. They had me review it with them on the phone while I looked at the screen on my computer and I signed it electronically at that time. I never had a paper copy to review before I signed the contract.*

I paid each month into an account and assumed that my debts were being taken care of. I started getting calls from debt collectors and I told them that they would now be paid by Freedom Debt Relief. I called up Freedom Debt Relief and they said that the calls would stop soon – settlements took time. They never stopped. Nor did the collection letters.

They then told me of two settlements with two of my credit cards. The amounts of the settlement was much lower than what I originally owed. However, I found out that they add a fee of 21 percent on the original dept (sic), (which in most cases was higher than my original interest rate). They said that I had a (sic) agreed to that fee when I electronically signed the contract.

After a while, they called me up and said I could pay off my debts with a loan from them. This is what I wanted to do in the first place. Then they started pressuring me into taking the loan. The loan was for {$50000.00} (sic) at 22 %. I said the percentage rate was too high and they said I could not get a lower rate because I had so many delinquencies. I said that I had been paying all my cards on time until they got involved. I did not take the loan. That would have been a worse mistake than signing up in the first place."[85]

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[83] Level Debt, *Debt Solutions*, https://levelfinancing.com/debt-consolidation-loan/ (last visited Mar. 11, 2021). Level Debt, a California debt settlement company, offers and originates a consolidation loan in addition to debt management and debt settlement plans.

[84] *See* infra Appendix A: Freedom Financial Network Consolidation Loan Overview.

[85] Consumer Fin. Prot. Bureau, *Consumer Complaint 3328717,* Complaint in *Consumer Complaint Database,* https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3328717 (last visited Mar. 11, 2021).

Better than Bankruptcy? A Lack of Analysis

The debt settlement industry's trade association, American Fair Credit Council (AFCC), has commissioned an analysis of consumer outcomes for distressed debtors enrolled in debt settlement plans, with the most recent report and analysis published in January of 2021.[86] These reports, using data provided by AFCC members[87], and analyzing a representative sample of this data, tend to show that some consumers may benefit from debt settlement. However, this analysis is superficial. The report fails to engage in a deeper dive into the financial circumstances of struggling consumers to see if they can afford the debt settlement plans they enter into. The report is also silent as to whether these outcomes are optimal as compared to alternatives, including bankruptcy.[88] The 2021 Dobbie Report found that nationally, "settled accounts yield an average savings of $1,400 based on the current balance and after accounting for fees."[89] The Dobbie Report asserts multiple times that debt settlement is an alternative to bankruptcy[90], unlike a Chapter 7 bankruptcy that discharges unsecured debt within six months of filing. The report's findings show that in the three-year window for the observed sample of consumers enrolled in debt settlement plans, only "23 percent settle all of their enrolled debt."[91] The Dobbie Report finds that the majority of enrolled consumers do not settle all of the debts.[92]

In California, the homestead exemption for homeowners seeking to file Chapter 7 bankruptcy increased significantly as of January 1, 2021, from a paltry $75,000 for single homeowners (and only up to $175,000, even for low-income senior citizens), to protect a minimum of $300,000 in equity for all California homeowners.[93] For borrowers in counties where homes have a high median sale price, a borrower may exempt up to $600,000 in equity, and these amounts will now adjust for inflation.[94] This means that many more Californians who are asset rich but income poor are more likely to be eligible to discharge unsecured debt in Chapter 7 bankruptcy filings and keep their homes. AFCC's Dobbie Report provides no analysis or evidence to

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[86] *2021 Dobbie Report, supra* note 4.

[87] This data is described in greater detail in a more comprehensive report, "the Regan report," authored by Greg Regan of Hemming Morse, LLP. The data analyzed in the *2021 Dobbie Report* uses the same account-level data used in the Regan report.

[88] *2021 Dobbie Report, supra note* 4, at 2. The report acknowledges this, noting the potential value of debt settlement for consumers "not eligible for Chapter 7 bankruptcy protection or [who] wish to avoid the negative consequences of Chapter 13 bankruptcy restructuring, with the caveat: "We do not observe outcomes for otherwise similarly situated individuals who do not start a debt settlement program, meaning that we cannot estimate the causal impact of starting a debt settlement program in isolation from other factors."

[89] *2021 Dobbie Report, supra* note 4, at 1. The 2020 Dobbie Report found an average savings of $1,700 per debt.

[90] 2021 Dobbie Report, *supra* note 4, at 2, 4-5.

[91] *2021 Dobbie Report*, *supra* note 4, at 5; *2021 Dobbie Report*, *supra* note 4 App. Table 1.

[92] *Id.*

[93] Cal. Code Civ. Proc. § 704.730(a)(2).

[94] Cal. Code Civ. Proc. § 704.730(a)(2).

show why a debt settlement would be preferable to a bankruptcy discharge, despite the assertions on many AFCC members' websites that debt settlement is an "alternative to bankruptcy."[95]

4. Who Are the Losers? Creditors and Consumers

Problems for Creditor

Debt settlement companies create problems for original creditors.[96] The American Financial Services Association (ASFA), in a whitepaper from 2019, notes that debt settlement companies can "work as a roadblock to a consumer settling his or her debt."[97] When a consumer is in a debt settlement plan, a creditor that wants to work directly with a consumer to settle a debt often cannot because the debt settlement company instructs the creditor to stop communicating with the consumer.[98] Debt settlement companies typically require consumers to stop paying their original creditors and default on their loans before debt settlement companies begin to negotiate with creditors.[99] Consequently, a consumer working with a debt settlement company may not learn of options that creditors offer for working directly with consumers.

Banking regulations prescribe when and how financial institutions can designate a consumer's outstanding balance as a loss,[100] and financial institutions typically have more flexibility to negotiate a settlement agreement after a debt has been charged off and considered a loss on their books.[101] Prior to a charge off, banks following regulatory guidelines usually require a consumer to make a lump sum payment or pay a settlement within a short period of time.[102] Debt settlement companies ask consumers to stop making payments on accounts, even ones that are current, because a default gives creditors this flexibility around settlement regulations — this flexibility is available for the consumer directly as well.[103] Stopping payments also creates the impression that a

[95] Level Debt, a California corporation, advertises to consumers that they can "avoid bankruptcy and ruined credit" while obscuring the fact that defaulting on and enrolling some credit cards in a debt settlement plan while continuing to use others will have devastating impacts on a consumer's credit score. https://levelfinancing.com/5-ways-to-get-out-of-debt/ and https://levelfinancing.com/how-does-level-work/. Freedom Debt Relief's website admits "any debt settlement or debt negotiation program, including ours, could negatively affect your credit . . . If getting out of debt is more important to you than the likelihood that your score will be negatively impacted, our program could help you resolve your debt faster and for less—without declaring bankruptcy." https://www.freedomdebtrelief.com/faq/

[96] Am. Fin. Services Ass'n, *Debt Settlement Companies (March 2019)*, (Mar. 2019) (on file with the author).

[97] *Id.* at 2.

[98] *Id.*

[99] Parrish & Harnick, *supra* note 24, at 2; Am. Fin. Services Ass'n, *supra* note 96, at 2 ("[D]ebt settlement companies typically encourage consumers to stop paying their creditors which can manufacture hardships that would otherwise be avoided."); Freedom Debt Relief, *supra* note 13, ("[T]he most effective way to get creditors to negotiate is by showing them you are unable to pay your debt in full due to a financial hardship. Letting your payments go into default is a good way to do this.")

[100] Fed. Fin. Insts. Examination Council, *supra* note 9. Banks are typically required to report losses within 120-180 days, establishing a charge off policy for open-end credit at 180 days delinquency and closed-end credit at 120 days delinquency.

[101] Consumer Fin. Prot. Bureau, *Recent Trends in Debt Settlement and Credit Counseling* 3 (July 2020).

[102] *Id.*

[103] *Id.* at 2.

consumer will no longer pay the full amount owed, which can strong arm creditors into considering a settlement.[104] However, allowing accounts to default not only harms the consumer's credit score and leaves consumers vulnerable to lawsuits,[105] but financial institutions also have financial and regulatory incentives to avoid losses and prevent consumer accounts going into default.[106]

Debt settlement companies may ask consumers to stop talking to their creditors, send creditors cease-and-desist letters, or use legal authorizations to direct communication from creditors to the debt settlement companies.[107] Creditors then cannot communicate with consumers about options, and consumers may not know that they can continue to work with their creditors, even after a charge off.[108] Creditors often offer hardship programs or settlements directly to consumers, or work with credit counselors to help consumers come up with a plan.[109] Consumers also may not realize that creditors are not required to communicate with debt settlement companies[110] and not all creditors will negotiate with debt settlement companies.[111]

Debt settlement companies can lead creditors to count losses they might not otherwise accrue if consumers negotiate with creditors directly. If consumers work with debt settlement companies, funds that could go towards a payment plan or a direct settlement with the creditor go to the debt settlement company's fees, to payment processing service charges, and/or to taxes on the amount of the forgiven loan.[112] Moreover, creditors are harmed if debt settlement companies fail to forward funds that a consumer intended to use to pay down debts.[113] The position of American Financial Services Association is "that the best recourse for a distressed ["consumer] is to work with their creditors to assess the options available and select the one that suits the [consumer's] personal circumstances… AFSA would like to see debt-settlement firms better regulated and the

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[104] Bev O'Shea, *Debt Settlement: How It Works and Risks You Face*, Nerd Wallet (June 8, 2020) https://www.nerdwallet.com/article/finance/how-does-debt-settlement-work.

[105] Parrish & Harnick, *supra* note 44, at 5 (describing the harm charge offs cause to a consumer's credit score).

[106] *See* Diana C. Banks, *Debt Relief Options through Creditors & Third-Party Debt Relief Offerings*, Consumer Fin. Prot. Bureau Livestream Recordings (Mar. 10, 2020, 9:00 AM), https://www.consumerfinance.gov/about-us/events/archive-past-events/evolutions-in-consumer-debt-relief-event/; *see also*, Off. of the Comptroller of the Currency, *Credit Card Lending: Account Management and Loss Allowance Guidance, OCC Bulletin 2003-1* (Jan. 8, 2003), https://www.occ.treas.gov/news-issuances/bulletins/2003/bulletin-2003-1a.pdf (describing generally accepted accounting principles and interagency policies on loss allowances for institutions engaged in credit card lending).

[107] Am. Fin. Servs. Ass'n, *supra* note 84, at 2. Debt settlement companies must obtain permission, often in the form of a power of attorney, to speak with the consumer's creditors and debt collectors. Cal. Civ. Code § 1788.17; 15 U.S.C. § 1692c(b).

[108] Banks, *supra* note 106.

[109] Consumer Fin. Prot. Bureau, *supra* note 101, at 2.

[110] Am. Fin. Services Ass'n, *supra* note 96, at 1; Consumer Fin. Prot. Bureau, *supra* note 1.

[111] Parrish & Harnick, *supra* note 24, at 7 (reporting that a 2012 survey of credit card issuers found that only 63% of credit card company respondents reported that they negotiate with DSCs).

[112] *See* Parrish & Harnick, *supra* note 24, at 3.

[113] *See* Am. Fin. Servs. Ass'n, *supra* note 96, at 2 (explaining that consumers are harmed if DSCs fail to pass along payments to creditors); Rosario Méndez, Fed. Trade Comm'n, *Signs of a Debt Relief Scam,* (June 16, 2017), https://www.consumer.ftc.gov/blog/2017/06/signs-debt-relief-scam?page=1 (describing a scam where a company claiming to offer debt relief services kept consumer funds rather than using them to settle debts).

creation of a formal mechanism for the reporting bad actors. AFSA is committed to representing the consumer credit industry in the formation of such oversight."[114]

> *In sum, banks and other creditors have incentives to see that debt settlement companies are properly regulated so that original creditors do not accrue unnecessary losses and so that consumers communicate directly with them to work out payment plans.*

The Harm to Consumers

Immediate and Lasting Harm: Negative Impact on Credit Scores and Spending Protected Income

The very model of debt settlement is to stop making payments to creditors and debt collectors to force them into settlement negotiations on behalf of the consumer.[115] Consumers who enter into debt settlement plans are those who have been paying multiple debts and are looking for a way to manage those debts and payments.[116] With payment history being the largest consideration for a consumer's FICO score at 35% of consideration[117], those consumers who enter the debt settlement plan can suffer immediate negative impact to their credit report as they incur new delinquencies on multiple accounts at the same time. These negative infractions will remain on a consumer's credit report for seven years.[118] Worse yet, credit reports are reviewed for housing[119] and employment[120] screening, and a negative report can severely limit a consumer's options. In 2018, the Department of Defense announced that it would "continuously" monitor the financial status of servicemembers with security clearances—meaning that a past due bill or error could jeopardize the servicemember's clearance status.[121]

Debt settlement companies do not assess the consumer's sources of income. Data reported by the industry does not include analysis of whether consumers are using means-tested or retirement-based sources of income, like Social Security or disability benefits, to pay for debt settlement plans.[122]

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[114] Am. Fin. Servs. Ass'n, *Debt Settlement Companies*, https://afsaonline.org/wp-content/uploads/2020/10/Debt-Settlement-Companies-Issue-Brief.pdf.

[115] Freedom Debt Relief, *supra* note 10 ("[T]he most effective way to get creditors to negotiate is by showing them you are unable to pay your debt in full due to a financial hardship. Letting your payments go into default is a good way to do this.")

[116] *2021 Dobbie Report*, *supra* note 3, at 4. Individuals in debt settlement programs enroll an average of 6.93 accounts.

[117] myFico, *What's in My FICO Scores?*, Subheading to *Credit Scores*, https://www.myfico.com/credit-education/whats-in-your-credit-score (last visited Mar. 11, 2021).

[118] 15 U.S.C§ 1681c(c)(1).

[119] 15 U.S.C§ 1681b(a)(3)(F).

[120] 15 U.S.C§ 1681b(a)(3)(B).

[121] Anthony Camilli & Joshua Friedman, *WARNO: New Security Clearance Guidelines Make It More Important Than Ever for Servicemembers to Monitor Their Credit*, Consumer Fin. Prot. Bureau: Blog (Aug. 20, 2018), https://www.consumerfinance.gov/about-us/blog/warno-new-security-clearance-guidelines-make-it-more-important-ever-servicemembers-monitor-their-credit/.

[122] *See generally, 2021 Dobbie Report*, *supra* note 3, (noting a lack of reported data on consumer income level and source of income).

Many legal services providers report that low-income consumers are entering into debt settlement contracts and paying the monthly payments with their social security benefits[123], public assistance[124], or other income that is legally protected from the collection of a judgement.

This often leaves vulnerable consumers struggling to choose between paying for their debt or medication or food. Furthermore, when legal aid providers seek to cancel the debt settlement contract and recoup the payments, monthly fees for the settlement account are taken leaving the consumer with less than a full refund.

Slow Bleeding: Consumers End up Filing for Bankruptcy Anyway

For the consumers who have assets to protect, mainly a source of income that is not protected under the law, bankruptcy is on the horizon. In the last three years alone, more than 50 consumers who entered into bankruptcy while in a debt settlement plan have filed adversary proceedings asserting wrongdoing by debt settlement companies like Freedom Debt Relief, National Debt Relief, Freedom Financial Network, and Liberty Debt Relief.[125] In one adversary proceeding, San Diego consumers who filed Chapter 13 bankruptcy faced illegal collection activity by debt settlement companies ClearOne Advantage, LLC, Pacific Debt Inc., and Global Client Solutions LLC when these debt settlement companies, working in tandem, continued to take payments of over $800 from the consumer's bank account in violation of the bankruptcy stay.[126]

Some consumers who end up filing bankruptcy after enrolling in a debt settlement plan will end up paying more money than if they had simply filed for bankruptcy. These consumers pay thousands of dollars into a debt settlement plan only to end with a bankruptcy on their record at the end. Debt settlement companies portend to offer a different kind of "fresh start" than a bankruptcy, but may end up driving consumers into bankruptcy after their credit scores drop, leaving consumers worse off.

A California consumer complaint to the CFPB affirms that all too often debt settlement companies end up leaving consumers with worse credit and filing for bankruptcy, saying, "Before Freedom Debt I had zero late payment and a good credit score. Now my score is terrible with more debt and facing bankruptcy."[127]

Another debtor, in a CFPB complaint filed about DMB Financial, said, "And the thing I was desperately trying to avoid, bankruptcy, now looks like my only option at this point. My credit is forever ruined and it used

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[123] 42 U.S.C § 407.

[124] C.C.P. § 704.170; Welfare and Institutions Code § 17409.

[125] Data source: www.unicourt.com search of bankruptcy court adversary proceedings for the search term "debt relief" "Americor Financial" search conducted March 9, 2021.

[126] *Estrada v. ClearOne Advantage, LLC*, No. 19-ap-03041 (N.D. Cal. Aug. 3, 2019).

[127] Consumer Fin. Prot. Bureau, *Consumer Complaint 3447401*, Complaint in *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3447401 (last visited Mar. 15, 2021).

to be in the 700s. Now it's in the 500s; even IF a refinance on my house were possible, my credit score is so low, no bank would be willing." [128]

Language Access Issues

Consumers who speak a language other than English struggle with debt and are vulnerable to in-language targeted advertising from debt settlement companies. Bay Area Legal Aid client, J.W., who speaks Cantonese, was marketed a debt settlement plan through her email. She believes that the company found her email address on the internet or used phishing to obtain her email address.[129] She also received direct mail flyers at her home, and was shocked to receive an email thanking her for browsing the website for Whitestone Legal Group.[130] The company sent a person to her house who only spoke Mandarin, not Cantonese. She was told that she needed to sign a contract in English to settle the $53,000 in debt she incurred to try to keep her business afloat as the COVID-19 pandemic hit.[131] After months of paying $706 each month, the debt settlement company finally settled a debt, but paid it in full.[132] J.W. then asked for her funds back, but it appears from the accounting obtained by her legal aid attorney that the debt settlement company has taken over $7,000 in fees.[133] J.W. wants her money back in full, but the company has told her that she has agreed to a contract that allows them to take a total amount of $14,000 in fees over the 48-month plan.[134]

A Meritless Fee Structure and Hidden Fees

Prior to the FTC's 2010 Telemarketing Sales Rule, the common practice in debt settlement was nonrefundable advance fees.[135] The TSR bans the practice of advance fees for debt settlement services, and instead requires that the following must first take place before a debt settlement company can collect fees: 1) the debt settlement company must obtain a written settlement agreement to which the consumer consents, and 2) the consumer must make a payment to the creditor towards the settlement agreement.[136] Furthermore, the fees must either bear the same proportional relationship to the total fee for the settlement to the total enrolled debt or

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[128] Consumer Fin. Prot. Bureau, *Consumer Complaint 2912964*, Complaint in *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/2912964 (last visited Mar. 15, 2021).

[129] Interview by Clair Johnson Raba with J.W., Bay Area Legal Aid client (Dec. 17, 2020) (on file with authors).

[130] *Id.*

[131] *Id.*

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] Greg J. Regan, *Options for Consumers in Crisis: An Economic Analysis of the Debt Settlement Industry*, Am. Fair Credit Council 5-6 (Feb. 28, 2013), https://americanfaircreditcouncil.org/wp-content/uploads/Regan-Report-Options-for-Consumers-in-Crisis-as-of-Dec-121-1-1.pdf [hereinafter *2012 Regan Report*].

[136] 16 C.F.R. § 310.4(a)(5)(i)(A)-(B).

must be a percentage of the amount saved as a result of the settlement.[137] The reports commissioned by the American Fair Credit Council frame the TSR ban on advance fees as "shifting the risk"[138] to the debt settlement provider who must first perform the service before being paid a non-refundable fee for that service, which, prior to the Rule may not have been provided.[139] Despite this framing, it is actually the consumer who bears the risk. Many debt settlement companies charge a fee based on the percentage of the enrolled debt amount — 20-25%.[140] This results in a fixed fee which the industry frames as transparency for the consumer. However, when a debt settlement company fails to reach a settlement of at least the rate of the fees, the consumer owes more debt than they entered the program with.

Along the same lines, unless the debt settlement company settles all or most of the consumer's debts, the built-up penalties and fees on the unsettled debts may wipe out any savings the debt settlement company achieves on the debts it settles.[141] Consumer Advocacy Project of the Justice & Diversity Center of the Bar Association of San Francisco (JDC) client E.M. enrolled a debt for a loan with ClearOne Advantage, an AFCC member[142], listed for $594.00 on December 3, 2018.[143] Approximately five months later, on May 7, 2019, ClearOne Advantage settled the account for $747.80.[144] While not only did ClearOne fail to achieve any savings for the client, ClearOne's contract sought fees of 25% of the enrolled amount.[145] E.M. paid a total of approximately 51% *more* than the original debt to have it "serviced" by a debt settlement provider, *exclusive of the monthly account servicing fee*.

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[137] 16 C.F.R. § 310.4(a)(5)(i)(C).

[138] Greg J. Regan, *Options for Consumers in Crisis: An Updated Economic Analysis of the Debt Settlement Industry*, Am. Fair Credit Council 6 (Feb. 5, 2018) https://americanfaircreditcouncil.org/wp-content/uploads/2018.02.05-AFCC-Report-Consumers-in-Crisis.pdf [hereinafter *2017 Regan Report*]; Greg J. Regan, *Options for Consumers in Crisis: An Updated Economic Analysis of the Debt Settlement Industry*, Am. Fair Credit Council 7 (Aug. 15, 2015) https://americanfaircreditcouncil.org/wp-content/uploads/Final-2015-Report-1.pdf [hereinafter *2015 Regan Report*]; Greg J. Regan, *Options for Consumers in Crisis: An Updated Economic Analysis of the Debt Settlement Industry*, Am. Fair Credit Council 6-7 (Feb. 2021) https://americanfaircreditcouncil.org/wp-content/uploads/2020.12.31-AFCC-Report-v.1.19.21.pdf [hereinafter *2020 Regan Report*].

[139] *2012 Regan Report*, *supra* note 138, at 4 ("[T]he experience of some consumers who paid Fees but received little or no Debt Reduction colored the public perception of the industry. In October 2008, in response to this perception, the FTC opened an inquiry into the business practices of the debt settlement industry, focusing specifically on the advance-fee model. In July 2009 the FTC issued a draft rule that prohibited the advance-fee model. The FTC Rule took effect in October 2010.")

[140] Parrish & Harnick, *supra* note 24 (finding that typical fees range from 20-25% based on the enrolled debt amount).

[141] Consumer Fin. Prot. Bureau, *supra* note 1.

[142] *AFCC Uniform Program Disclosure Statement*, https://f.hubspotusercontent10.net/hubfs/6880760/AFCC%20Disclosure%20Statement%20-%20v%2002.28.20.pdf (last visited Mar. 12, 2021). While not listed as a member on the AFCC website, ClearOne Advantage's webpage has a link called "AFCC Disclosure" which opens a .pdf document with the AFCC logo and begins "ClearOne Advantage, LLC ("COA") is a member of the American Fair Credit Council . . ."

[143] Review of E.M., JDC client's, debt settlement documents provided from ClearOne Advantage.

[144] *Id.*

[145] *Id.*

Consumer complaints abound on the CFPB database about debt settlement companies, even though there is not a category for this type of financial service or product. Consumers instead write in the words "debt settlement" and then tell their stories - 1,005 of them in California alone - of how they did not receive the service for which they thought they were signing up.[146]

The CFPB complaint against DMB Financial, LLC (an accredited member of AFCC) found that despite enrollment material representations that DMB's fee would be a percentage of, or the savings of, the enrolled debt, DMB charged enrolled consumers a fee based on what DMB called the "Verified Debt," which was usually greater than overall enrolled debt.[147] The Verified Debt amounts were often greater than the debt amounts listed on the Creditor Summary Page.[148] Before 2019, DMB used the term "Verified Debt Amount" to mean the amount of debt verified by DMB based on a creditor statement submitted by the consumer, or when no creditor statement was provided, the debt balance at the time DMB contacted the creditor to negotiate a settlement.[149]

Beginning in 2019, DMB began verifying debt amounts based on the amount reported on the consumer's consumer credit report, which was obtained at or near the time of enrollment.[150] Until 2019, if DMB never received a creditor statement submitted by a consumer for a particular debt, DMB calculated its settlement fee based on the debt amount after enrollment — often the debt amount at the time of settlement — instead of the debt amount at the time of enrollment.[151] The debt amount after enrollment is often greater than the debt amount at the time of enrollment because the debt continues to accrue interest and fees until a settlement is reached.[152]

Consumers enrolled with Freedom Debt Relief have complained that they were still charged a fee, usually in the thousands of dollars, even when they settled a debt on their own, when Freedom Debt Relief had not directly negotiated with the creditor.[153]

Because consumers are often required to enter another contract with a payment processor for their settlement account, consumers are charged a monthly "service fee" on those settlement accounts even when they exit the program before any debts are settled.[154] A client who sued Freedom Debt Relief alleged that he was charged a

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[146] CFPB Complaint Database Results for California Complaints About Debt Settlement, *supra* note 20.

[147] *CFPB v. DMB, supra* note 61, ¶ *22.*

[148] *Id.* ¶ 23.

[149] *Id.* ¶ 24.

[150] *Id.* ¶ 25.

[151] *Id.* ¶ 26.

[152] *Id.* ¶ 27.

[153] *CFPB v. FDR*, *supra* note 66, ¶ 27.

[154] *Moore v. Freedom Debt Relief, LLC,* No. 18CV0453LNLS (S.D. Cal. Mar. 1, 2018).

phone payment fee and $7.25 in monthly fees, although the company provided no services.[155] Other consumers report that they are charged $12 per month in "legal fees" to be paid to National Litigation Law Group.[156]

> *"Freedom Debt Relief is now requiring us to provide an additional payment to them in order to complete the amount needed to pay off the debt and because it takes 30 days to process when you do an extra deposit, they will charge additional service fees again for the next month. I authorized to make an extra deposit for {$45.00} so that there is enough money for the remaining of the debt plus additional fees that are accruing because of their negligence. If they do not do the deposit this time, again I will not have enough money to pay off the debt in full and will need to deposit even more money on fees for work that they are not doing.[157]"*

Litigation Against Consumers: Debtors Sued by Creditors

As described in the myriad of complaints filed about debt settlement with federal and state agencies, and affirmative lawsuits filed in state, federal, and bankruptcy courts against debt settlement companies, a common complaint of consumers is that they were sued by creditors while enrolled in a debt settlement plan.[158] In 2019, California debt collectors filed over 200,000 lawsuits against California consumers. Consumers who are enrolled in debt settlement plans are not exempt from being sued for the enrolled debts.[159] Consumers who are encouraged to default on their credit card debts by debt settlement companies[160] are more likely to find themselves in a difficult position of paying into a debt settlement plan and defending a debt collection lawsuit—all for the same debt.

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155 *Id.*3

156 Complaint for Plaintiff ¶ 113, *Aganon v. Freedom Debt Relief, LLC,* No. 19CV2377WQHMSB (S.D. Cal. Dec. 11, 2019) [hereinafter *Aganon Complaint*]; *see also infra* Appendix A for a further discussion of National Litigation Law Group, LLP, a company with which Freedom Debt Relief partners in an attempt to mitigate the harm of debt collection lawsuits.

157 Consumer Fin. Prot. Bureau, *Consumer Complaint 3379566,* Complaint in *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3379566 (last visited Mar. 15, 2021).

158 Aganon Complaint, *supra,* note 156; Consumer Fin. Prot. Bureau, *CFPB Consumer Complaints Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/api/v1/?date_received_max=2021-02-09&date_received_min=2011-12-01&field=all&format=csv&no_aggs=true&search_term=%22debt%20settlement%22&size=135&state=CA (last visited Mar. 15, 2021). Californians have filed 135 complaints with the CFPB where they identified the issue as "debt settlement," describing their frustrating about false and deceptive advertising and promises not kept.

159 Freedom Debt Relief, FAQ, https://www.freedomdebtrelief.com/faq/ (last visited Mar. 11, 2021). Debt collection filing data on file with authors. "In a debt resolution program, you voluntarily stop making payments to your creditors, so your accounts go past due. As a result, there's a chance they may choose to use a law firm to collect on the debt."

160 *Id.*(stating that part of a debt settlement plan requires defaulting on accounts that are current).

Recent analysis of case filings from 2014-2020 shows a dramatic increase in debt collection lawsuit filings in California, back up to the numbers of filings not seen since before the Great Recession.[161] The two largest third-party debt collectors in the nation, Encore Capital (and its subsidiary Midland Funding LLC) and Portfolio Recovery Associates, reported record profits during the COVID-19 pandemic and recession[162]. Despite court closures to the public, these debt collectors continued to file lawsuits against struggling California consumers.[163] In addition to thousands of cases filed annually by the two largest debt collectors in California superior court, original creditors also sue in their own names with great frequency and volume.[164]

Debt settlement companies give consumers a false sense of security and fail to properly disclose the potential for lawsuits. Claims that the debt settlement companies will take care of everything and a business model that asks consumers to stop communicating with their creditors mean that consumers don't have any advance notice before they get sued.[165] Even though the small print in the debt settlement company contracts disavow any responsibility for lawsuits, the dockets of state courts, and the experiences of legal aid clinics and clients, say differently. In 2016, Freedom Debt Relief, engaged in a third-party arrangement with a company called National Litigation Law Group (NLLG) in order to refer consumers sued on debts enrolled with Freedom Debt Relief. CFPB complaints support consumer allegations that NLLG charges consumers separately for an attorney affiliated with NLLG to avoid a default in the state court case.[166] This allows Freedom Debt Relief the opportunity to step in and try to settle the case after a lawsuit was filed, for which it then charges its usual percentage-of-enrolled-debt fee. State court dockets show that NLLG has been the attorney of record in 646 cases in California Superior Court since 2016.[167]

Notably, among the filings with representation by NLLG, only 13.7% (89 cases) were filed by third-party debt collectors, with the vast majority of the filings by original creditors (557 cases, or 86%). The chart below shows California cases in which NLLG appears as counsel for the defendants against creditors who filed 10 or more cases between 2016-2021.

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161 Adam Racusin, *Thousands of People in California are Facing Collection Lawsuits*, 10 News ABC San Diego KGTV (July 2, 2020), https://www.10news.com/rebound/coronavirus-stress/thousands-of-people-in-california-are-facing-collection-lawsuits; *see also Court System Overload: The State of Debt Collection in California after the Fair Debt Buyer Protection Act*, Center for Responsible Lending (Oct. 13, 2020), https://www.responsiblelending.org/research-publication/court-system-overload-state-debt-collection-california-after-fair-debt-buyer.

162 *Encore Capital Group Announces Second Quarter 2020 Financial Results*, Glob. Newswire (Aug. 5, 2020) (discussing record profits), https://www.globenewswire.com/news-release/2020/08/05/2073629/0/en/Encore-Capital-Group-Announces-Second-Quarter-2020-Financial-Results.html; *PRA Group (PRAA) Q1 2020 Earnings Call Transcript*, The Motley Fool (May 9, 2020), https://www.fool.com/earnings/call-transcripts/2020/05/09/pra-group-praa-q1-2020-earnings-call-transcript.aspx. Portfolio is the most prolific filer of debt collection cases in California.

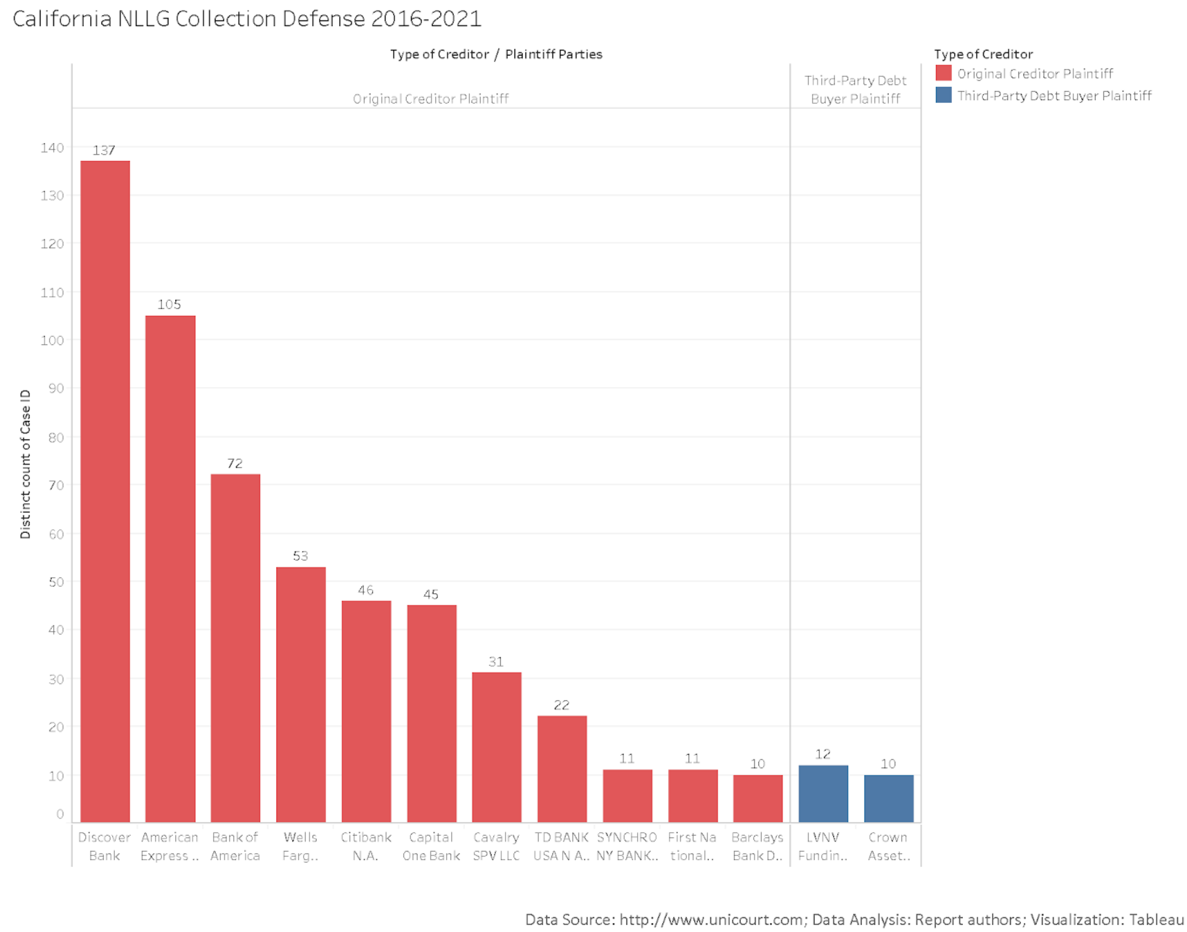
163 Data on file with authors.

164 *Id.*; Ctr. for Responsible Lending, *supra* note 161 (noting that a reduction in filings in 2014-2015 may be a attributed in part to the passage of the 2014 Fair Debt Buyer Protection Act (FDBPA)) Judith Fox, *Do We Have a Debt Collection Crisis? - Some Cautionary Tales of Debt Collection in Indiana*, 24 Loy. Consumer L. Rev. 355, 373 (2012), https://lawecommons.luc.edu/lclr/vol24/iss3/3. Evidence in Indiana reflects a reduction in filings upon the implementation of a law similar to the FDBPA.

165 *See* Freedom Debt Relief, *FAQ*, https://www.freedomdebtrelief.com/faq/ (last viewed Mar. 11, 2021)

166 See *infra* Appendix A.

167 California Superior Court Docket Search for Attorney of Record "National Litigation Law Group" Within the 15 Largest Counties in California, http://www.unicourt.com (search conducted Jan. 23, 2021).



While the chart of California debt filings is not an exhaustive list of consumers in debt settlement plans who have been sued over the last four years, this data for Freedom Debt Relief cases starting in 2016 for consumers who utilized (and paid for) the third-party services of National Litigation Law Group, supports the anecdotal evidence of legal aid clinics who have observed an increase in original creditor lawsuits overlapping with clients enrolled in debt settlement plans. Across California from 2016-2021, the five largest debt collectors were, in order: Portfolio Recovery Associates; Midland Funding LLC; Discover Bank; Capital One; and Cavalry Portfolio Services.[168] Of these, the three leading third party debt collectors on this list file about half of all of the debt collection cases annually in California. The data from cases filed against Freedom Debt Relief clients sharply diverges from this pattern.

The data does not demonstrate a causal relationship between original creditor filings and enrollment in a debt settlement plan, but it does show a correlation. This analysis of cases filed in California courts shows that Californians enrolled in Freedom Debt Relief debt settlement plans risk being sued by original creditors and require the assistance of an attorney to avoid a default judgment and attempt to get their debt settled. Without additional data from AFCC or other entities in the debt settlement industry showing the number of people

[168] California Superior Court Filings Analysis (on file with authors).

current on their accounts at the time of enrollment, it is not possible to ascertain with certainty, but this trajectory may be related to the initiation in the debt settlement plan. It is possible that the consumers who have enrolled in the Freedom Debt Relief debt settlement plan are recently defaulted on their previously current credit card bills — as part of the debt settlement model — making it more likely that the original creditor has not yet sold the debt to a third party. The CFPB complaint from a consumer residing in Nevada describes the relationship between National Litigation Law Group and Freedom Debt Relief:

"I am working with a debt settlement company called Freedom Debt Relief and I am really questioning their practices. From my experience thus far, they seem to not attempt to negotiate any settlements once a Debt (sic) gets transferred to a Creditor 's Attorney. They just let those accounts sit there until I get sued and the buck gets passed on to a Litigation (sic) service that Freedom Debt Relief provides called XXXX XXXX XXXX XXXX XXXX XXXX XXXX which I pay for separately.

> *My problem is not the fact that FDR does not lift a finger to try and Negotiate (sic) a Settlement (sic) before the Creditors (sic) Attorney (sic) sues me, but, the fact that FDR still collects a settlement fee, (which is obviously high) for doing absolutely nothing with that account.*

I am investing over {$1200.00} (sic) a month into this program and that is too much for accounts to just sit there until they ALL sue me and FDR will collect settlement fees for doing nothing. . . . Some of the email's (sic) that FDR send to me state that they " Are not Attorney's and Therefore Can not Offer Advice " so that tells me that they DO NOT try and do anything with those accounts fallen to a third party. I do not remember this being explained to me when I first enrolled with FDR that they still collect settlement fees when they are not even touching those accounts. I also believe that there are certain creditors that do not negotiate with FDR even though FDR claims that they have worked with these creditors. . . . They have settled a couple of accounts.. one was a Lawsuit (sic) that [National Litigation Law Group] handled (FDR collected XXXX settlement fee for doing nothing) and one small debt, but, this is irrelevant to all of the money I am investing into this program which is over {$11000.00} (sic) thus far. I believe this company is deceitful and is not completely honest about what they can do. [169]

<u>*Hidden Disclosures*</u>

The Telemarketing Sales Rule (TSR) requires debt settlement companies to provide disclosures of material information before a consumer consents to pay for the services.[170] These disclosures are buried and scattered within the contracts — contracts which are sometimes made available to sign electronically. Few debt settlement companies offer clear disclosures in advance and if any are to be made, it is often in the form of frequently asked questions or in a footer menu[171] on the company's webpage. Still, these disclosures are overshadowed by vague considerations made by the company. For example, the TSR requires: "to the extent

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[169] Consumer Fin. Prot. Bureau, *Consumer Complaint 3475545,* Complaint in *Consumer Complaint Database,* https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3475545 (last visited Mar. 15, 2021).

[170] 16 C.F.R. § 310.3(a)(1)(viii).

[171] *See e.g.,* ClearOne Advantage, *FAQ*, https://www.clearoneadvantage.com (last visited Mar. 15, 2021).

that any aspect of the debt relief service relies upon or results in the customer's failure to make timely payments to creditors or debt collectors, that the use of the debt relief service will likely adversely affect the customer's creditworthiness, may result in the customer being subject to collections or sued by creditors or debt collectors, and may increase the amount of money the customer owes due to the accrual of fees and interest".[172] In the frequently asked questions page on Freedom Debt Relief's website, the disclosure is addressed in different drop down options. The simple question "How does debt relief affect my credit score" is answered with reassuring but vague claims:

"Our goal is to help you get out of debt as fast as possible by negotiating with your creditors to get them to accept significantly less than face value on your unsecured debts. Depending on the condition of your credit report at the time of enrollment, any debt settlement or debt negotiation program, including ours, could negatively affect your credit. Negative information could remain on your credit report for up to seven years. By engaging in good credit behavior, anyone's credit score could recover over time. Results vary depending on your payment history, credit utilization, length of credit history, and debt-to-income ratio.

If getting out of debt is more important to you than the likelihood that your score will be negatively impacted, our program could help you resolve your debt faster and for less—without declaring bankruptcy."[173]

Taking this example — will debt settlement affect a consumer's credit rating — the answer depends on some factors including the consumers credit history before debt settlement, the consumer's credit behavior while in the program, and the results of the debt settlement service.[174] Freedom Debt Relief's response goes to great lengths to give the consumer just enough information —that debt settlement may negatively affect the credit score—without providing the whole picture in the single answer. Instead, the whole picture is broken into bits of information strategically spaced far apart. Freedom Debt Relief's response only answers part of the second factor as it fails to describe the practice of debt settlement. Eight questions down, with "can you settle credit card debt if you are still current," the rest of the credit impact question is partially answered by hinting more to the fact that enrolling in the program will involve "letting [the consumer's] payments go into default."[175] As for the third factor, no information is provided by the debt settlement company about how settlements are reported and impact a consumer's credit report.

California legal aid attorneys have seen a significant increase in clients over the last five years who are involved in debt settlement plans that they cannot afford, that do not benefit them, and that leave them with no disposable income at the end of the month. EBCLC estimates over half of its debt collection lawsuits by original creditors in the 2019-2020 calendar years resulted from participation in a debt settlement plan.[176] People who are trying to get back on their feet after a financial hardship are least positioned to take the hit to

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[172] 16 C.F.R. § 310.3(a)(1)(viii)(C).

[173] Freedom Debt Relief, *supra* note 159.

[174] Bev O'Shea, *What Factors Affect Your Credit Scores?*, Nerd Wallet (Jan. 28, 2020), https://www.nerdwallet.com/article/finance/what-makes-up-credit-score. ("The two major scoring companies in the U.S., FICO and VantageScore, differ a bit in their approaches, but they agree on the two factors that are most important. Payment history and credit utilization . . . make up more than half of [] credit scores.")

[175] Freedom Debt Relief, *supra* note 159.

[176] E-mail from Kara Acevedo, Staff Att'y and Clinical Supervisor, East Bay Cmty. L. Ctr. (Mar. 10, 2021) (on file with author).

their credit caused by defaulting on all of their credit cards, a consequence rarely understood by clients of debt settlement companies. Consumers like Bay Area Legal Aid client J.W., who saw her credit score drop from over 650 to below 500, will be unable to qualify for new small business loans to restart her business after the pandemic due to involvement with a debt settlement company.[177] Debt settlement companies are not effectively disclosing the risks, obligations, and long-term effects of defaulting on credit card bills and entering into a debt settlement plan.

5. Other States' Movement to Rein in Debt Settlement

While nine states[178] outright ban the practice of for-profit debt settlement, 32 states impose restrictions on the amount of fees that debt settlement companies can charge, and 10 of these states require that debt settlement fees be taken as a percentage of the savings. States with fee limitations are lessening the harm to their consumers though, even under these maximums, consumers can still end up worse off with the monthly fees to maintain their settlement accounts.

Colorado[179], Delaware[180], Florida[181], Georgia[182], and 18 other states have given their consumers the ability to remedy their own debt settlement harms by implementing a private right of action. Review of complaints filed under these statutes is unsurprisingly consistent with complaints filed by consumers with the CFPB. The most consistent theme among the complaints across these states is misrepresentations by the debt settlement company as to the amount of savings the company could obtain and impermissible fees taken by the debt settlement company.

In Delaware, where debt settlement fee amounts are only modestly regulated[183] and a private right of action[184] is available for consumers, the verified class action complaint in the matter Gonzales v. Cornerstone Legal Group, LLC[185] paints a representative picture of the harm consumers across the country face with debt settlement companies. The complaint alleges "Mr. Gonzales is a disabled veteran of the United States Armed Forces who was experiencing difficulties with debt. While looking at websites relating to resources for veterans, Mr. Gonzales saw an advertisement for Defendant's debt-management services. Mr. Gonzales signed a debt-resolution contract with Defendant based on Defendant's representation that it could "resolve [Plaintiff's]

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[177] Interview by Clair Johnson Raba with J.W., *supra* note 129.

[178] Arkansas, Hawaii, Louisiana, Massachusetts, New Jersey, New Mexico, North Carolina, South Dakota, and Wyoming.

[179] Colo. Rev. Stat. Ann. § 5-19-235.

[180] 6 Del. Code § 2435A.

[181] Fla. Stat. § 817.806(1); Fla. Stat. § 501.211(1)-(2).

[182] OCGA § 18-5-4(b)(2).

[183] 6 Del. Code § 2423A(d)(2). Settlement fees are capped at 18% of the total principal amount of the debt.

[184] 6 Del. Code § 2435A.

[185] *Gonzales v. Cornerstone Legal Grp., LLC*, No. 11034-VCG, 2017 WL 2633758 (Del. Ch. June 14, 2017).

unsecured debt." Beginning December 6, 2013, Mr. Gonzales paid Defendant $266.50 per month for eleven months - a total of $2,931.50. Despite the payments made by Mr. Gonzales, Defendant did not help him manage his debt; instead, Mr. Gonzales' credit rating has been damaged due to Defendant's actions or lack thereof. During the eleven months that Defendant was supposed to be resolving Mr. Gonzales' debt issues, Defendant only managed to settle one small credit card debt originally totaling $601.00 for $448.00. Furthermore, of the two other, larger debts that Mr. Gonzales disclosed to Defendant, one was settled by Mr. Gonzales personally using his own funds after a lawsuit was filed against him by the creditor, and the other, which was for $7,443, was transferred to another creditor, Midland Funding, which has issued a demand letter on Mr. Gonzales. In other words, Mr. Gonzales is worse off financially than he would have been had he not engaged Defendant.[186] Defendant was not and is not licensed to provide debt-management services in Delaware and, as such, violated Section 2404A(a) of the Delaware Uniform Debt-Management Services Act."[187]

The allegations in this complaint are a familiar story to legal service providers in California and throughout the country. Giving consumers a private right of action to pursue harms caused by debt settlement companies is necessary given the rise of complaints of injury by consumers.[188]

6. Solutions

The need for regulation over the debt settlement industry in California is urgent. A legislative solution to regulate debt settlement companies and protect consumers must ensure that people who cannot afford to enroll in debt settlement plans are not solicited for this product. Distressed consumers who are at their lowest point in managing their debts should be given a full picture of their options and the potential harms and damages through clear, concise, and accurate disclosures before entering into a debt settlement plan.

Legislation must ban unfair, deceptive, and misleading practices in the advertising of debt settlement plans, including the attorney model of debt settlement. Banning debt settlement companies from taking payments out of public benefits is essential to protecting some of the most vulnerable consumers. An affordable and reasonable fee structure must be based on a percentage of the debt settled—which incentives advocacy for the consumer — and not on a percentage of the debt enrolled — which incentivizes quick nominal settlements in order to access debt settlement service fees. Legislation must prohibit the origination of loans by debt settlement companies as this practice only saddles consumers with a new debt and disincentives low settlements for consumers.

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[186] *Id.* ¶ 2.

[187] *Id.* ¶ 3.

[188] Consumer Fin. Prot. Bureau, *Consumer Complaint 3108349*, Complaint in *Consumer Complaint Database*, https://www.consumerfinance.gov/data-research/consumer-complaints/search/detail/3108349 (last visited Mar. 15, 2021). Note that a search for "debt settlement" on the CFPB database also produces complaints from consumers enrolled in debt settlement plans making complaints about creditors related to consumer misdirected confusion about the practice of debt settlement. For example, in a complaint about the creditor, the consumer wrote: "Capital One keeps on calling and leaving a voice message nonstop every single day while Im (sic) on my debt Settlement Program."

Finally, Consumers must be able to recoup their financial harms against debt settlement companies that fail to operate fairly. The rapid growth of debt settlement participation in California is resulting in more consumers being harmed by an industry that is customarily opaque in its practice. Californians who endure abusive, deceptive, and harmful acts by a debt settlement company should receive financial restitution especially since nothing can be done to undo the harms to a consumer's credit rating once the debt settlement plan has begun. Similarly, statutory damages against debt settlement companies will help to reduce irresponsible practices by these companies. Collectively, a private right of action that encompasses compensatory damages endured by the consumer, injunctive relief, attorney's fees and costs for the consumer, and statutory damages, would help affected consumers while deterring bad acting debt settlement companies.

Appendix A:
Freedom Financial Network Consolidation Loan Overview

Freedom Financial Network issues two types of consolidation loans, securitized by Freedom Financial Asset Management (FFAM), a subsidiary of parent company Freedom Financial Network.[189] Freedom FinancialAsset Management utilizes Cross River Bank as its "originator for all loans originated through the Freedom program."[190] As of May 20, 2020, Freedom created the FREED 2020-2CP Trust for the purpose of securitizing a series of "ConsolidationPlus" loans and is the sixth such "securitization collateralized by unsecured consumer loans originated through" FFAM.[191] This raises concerns for underwriting standards for these loans, as they are marketed at people who are facing financial struggles as indicated by their enrollment in a debt settlement plan. FFAM offers two debt consolidation products and the terms of these products, the ConsolidationPlus ("C+") and FreedomPlus ("F+") loans, are not a considerable savings on general credit card interest rates, with the C+ loans carrying interest rates of 22.9% over one-six years and the F+ loans ranging from 4.99 to 26.99% over two-five years.[192]

For the C+ loans, the only underwriting guidelines are that the applicant not be in active bankruptcy, enrolled in a Freedom Debt Relief program for six months prior to application, has made three deposits in to the Freedom Debt Relief -associated deposit account, is 18 years old, and has a loan payment to income ratio of 25% and debt-to-income ratio of 70%.[193] It is simply not reasonable that a consumer facing financial hardship should undertake a debt consolidation loan that comprises 25% of her income.[194]

The Financial Crisis of 2008 was brought about in part by the securitization of risky consumer financial products.[195] Making high-risk and high-interest loans to people who sought the services of debt settlement companies because they were unable to pay their debts in the first place sets consumers up to fail. While it is not known how widespread the sale and marketing of consolidation loans is by debt settlement companies in California, legal aid advocates and the CFPB complaint database reflect that this is indeed occurring.

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189 *FREED ABS Trust, supra* note 82.

190 *FREED ABS Trust, supra* note 82, at 19.

191 *FREED ABS Trust, supra* note 82, at 13.

192 *FREED ABS Trust, supra* note 82, at 15.

193 *FREED ABS Trust, supra* note 82, at 16.

194 The KBRA report does not specify if this is 25 percent of net or gross income, or how the DTI ratio is calculated.

195 Jeff Andrews, *10 Years After the Financial Crisis, Is the Housing Market Still at Risk?*, Curbed (Aug. 29, 2018, 11:00 AM), https://archive.curbed.com/2018/8/29/17788844/financial-crisis-2008-cause-housing-mortgage-lending.