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Debt-Relief Firms Attract Complaints

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By ELEANOR LAISE

Wally Bowman, a part-time security guard in Miamisburg, Ohio, had roughly \$15,000 in credit-card debt when he signed up with a "debt settlement" firm last year. The company said it could resolve his debts for far less than the amount he owed and advised the 63-year-old to stop making payments to his creditors, according to Mr. Bowman.

Podcast

John Ulzheimer, president of consumer education for Credit.com, talks with Eleanor Laise about the growth in debt settlement companies and whether they deliver on their promises.

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As the market continues its month-long hula, banks are tightening up credit limits. And this could lead to another credit crunch, especially for those with less-than-sterling credit scores. Read The Wallet blog.

"I'd have been much better off."

As the economy weakens, a growing number of consumers are paying big money for services from debt-settlement companies that purport to help them settle their debts for a fraction of what they owe. But as Mr. Bowman's experience shows, customers can end up wishing they hadn't sought such help.

At financial-services Web site Credit.com, the number of complaints about debt-settlement companies received so far this year is already double the number received in all of 2007, says John Ulzheimer, the site's president of consumer education. The Federal Trade Commission, which has also seen an increase in consumer complaints, was concerned enough about the issue that it held a workshop late last month to examine debt-settlement business practices.

Dealing With Debt

Some tips for consumers who are buried in bills:

Consumers who can't pay their bills on time should contact creditors immediately to try to work out a payment plan.

If you can't manage your debt on your own, consider working with a nonprofit credit-counseling organization.

But beware: Some nonprofits have been linked to for-profit companies and offer little educational value to consumers.

Some major creditors, including American Express Co., say they won't even work with debt-settlement companies, though the companies dispute this. "There's no service or benefit that a debt-settlement company can offer our card members that they don't receive from working with us directly," says Lisa Gonzalez, a spokeswoman for American Express.

Regulators, consumer advocates and industry groups are taking a closer look at debt-settlement firms. But even some nonprofit organizations that offer alternatives, such as credit counseling and education, have come under scrutiny, with the Internal Revenue Service examining their ties to for-profit outfits.

Hess Kennedy, the firm hired by Mr. Bowman, was sued by the Florida attorney general earlier this year for allegedly violating the state's laws on unfair and deceptive trade practices. The firm was placed in receivership in July, and on Monday, a Florida Circuit Court judge entered an order to wind down the firm and approved a process for consumers to apply to get their money back. The firm referred questions to an attorney, who didn't respond to requests for comment.

Hefty Up-Front Fees

Debt-settlement companies generally advise clients to make monthly payments into a special account instead of paying creditors. The firm promises to use the accumulated cash to settle debts for pennies on the dollar. They often charge hefty up-front fees, and their tactics can trash customers' credit scores, boost their tax bills and leave them in greater debt than when they started.

Rules governing these firms vary by state, but a number of states have recently passed laws allowing for-profit credit-counseling and debt-settlement firms to do business within their borders. Membership in the Association of Settlement Companies, a debt-settlement industry trade group, has roughly doubled in the past year, to more than 150.

Because the industry has so many new people, "there's a lot of misunderstanding about how a company should be run,

Mr. Bowman paid hundreds of dollars in up-front fees and made regular monthly payments of \$249 to Hess Kennedy, but the Coral Springs, Fla., firm never settled any of his debts, he says. By the time he dropped out of the program this summer, Mr. Bowman says, his debt had ballooned to about \$20,000, due to interest and late fees, and creditors were threatening to garnish his wages. Finally, he filed for bankruptcy last month.

"I wish I had done that to begin with," Mr. Bowman says.

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many debt-settlement companies are set up to look like legal services, usually it's a sham, says Norman Siegel, an assistant attorney general in West Virginia. Consumers often don't receive any legitimate legal services, "and the lawyer is like the Wizard of Oz back there behind the curtain," Mr. Google says.

The high fees charged by debt-settlement firms can prolong the process of paying off debts. The companies often charge an up-front fee of 10% or 15% of the total amount owed. They may also charge monthly fees of about \$50, and a back-end fee of about 20% or 30% of the amount "saved" for clients in a settlement.

Credit-Card Lawsuits

Meanwhile, creditors aren't getting any payment, so interest and late fees accrue, debt rises and clients get a steady stream of calls from creditors and collection agencies. They may even be sued and have their wages garnished. Lawsuits against credit-card holders are becoming more common as card issuers increasingly sell delinquent accounts to debt purchasers, regulators say.

Debt-settlement companies often refuse refund requests, says West Virginia's Mr. Google. And though regulators may try to get money returned to customers, these companies are generally not well-capitalized, "and often the consumer harm vastly outstrips whatever assets the company would have," says the FTC's Ms. Hrdy.

Consumers in debt-settlement plans often see their credit scores tank. While they're not making payments, of course, their scores will drop. But settling a debt for less than the amount owed is also "a serious negative on your credit score" and stays on your credit report for seven years, says Barry Paperno, consumer operations manager at Fair Isaac Corp., which developed the widely used FICO credit score. Debt settlement can also boost consumers' tax bills, since they generally must pay income tax on the amount of debt forgiven in a settlement.

Even when companies deliver, many customers drop out of the programs early. David Gillson of Sherwood, Ark., a 38-year-old quality-control manager at a construction firm, signed up with debt-settlement firm Elite Financial Solutions of Fort Lauderdale, Fla., in 2006. He owed more than \$71,000 in seven different credit-card accounts. Elite helped him reach two settlements within the first year or so.

'Just Horrendous'

But the collection-agency calls were "just horrendous," Mr. Gillson says, and his credit score was plummeting, two creditors sued him, and his wages were garnished. Given his reduced wages, he couldn't afford to put anything in the debt-settlement account, and he dropped out of the program in June.

Elite's contracts "clearly explain all the negatives, such as garnishment, that interest rates will accrue and that late fees will apply," says a supervisor at the firm.

Consumers who can't work out debt problems on their own do have alternatives. Many nonprofit credit-counseling organizations offer "debt-management plans," in which consumers steadily pay the full balance owed but often get concessions from creditors such as lower interest charges and waived fees. Such nonprofit programs come with some consumer protections. For example, they must provide services tailored to the needs of individual clients and charge reasonable fees.

But even here, consumers must tread carefully. The IRS began examining nonprofit credit-counseling organizations several years ago and found that many were funneling fees to for-profit companies, or doing little or nothing to educate consumers. In its initial examination, the IRS looked at 63 organizations, and in 49 of those cases either the IRS issued proposed or final revocations of nonprofit status, or the organization went out of business or became a for-profit firm on its own.

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