NEW JERSEY STATE BAR ASSOCIATION

The New Jersey State Bar Association Shares Concerns With
A1739 (McKeon)/S2989 (Pou) Regarding For-Profit Debt Adjusters

The New Jersey State Bar Association has concerns with A1739 (McKeon)/S2989 (Pou), which makes certain for-profit debt adjusters eligible for licensing to conduct business in the State. We thank you for the opportunity to share these concerns with you today.

We are aware that these entities are permitted to obtain licenses in 34 states, but we urge consideration of the fact that by not permitting for profit debt adjusters in this state, New Jersey remains a consumer-friendly state because the entities helping those most vulnerable are non-profits driven to assist – and not profit from – individuals already in dire straits. As currently written, this legislation would change New Jersey's existing laws governing debt management and debt settlement to permit for-profit entities to engage in debt adjustment, while exempting for-profit debt adjusters from the requirements of nonprofit ones (bond, fee limitation, audits). The NJSBA opposes this bill because it would open the door to abuses that are widespread in the states that permit for-profit debt adjustment.

As practitioners in this area of the law, it may be helpful to provide some context to the operations of debt management and debt settlement companies. The most widespread problems in today's debt adjustment marketplace arise from the practices of for-profit debt settlement companies. Debt settlement companies advertise heavily on television, radio and the internet, marketing plans that they claim will allow consumers to repay only a fraction of their debts in a fairly short period of time. This marketing is targeted to – and impacts – the most vulnerable people in our communities and these marketing campaigns prey on this audience.

The reality is that these debt settlement plans involve storing up a consumer's payments in a reserve account – or instructing the consumer to deposit money in an account monitored by the company but belonging to the consumer. Meanwhile, consumers are instructed not to pay their creditors, which further ruin their credit and drives up their account balances with additional late fees and default interest/costs. Only when the debt settlement company believes there is enough money in a consumer's account – above and beyond the hundreds or thousands of dollars in fees it claims already to have "earned" – will the company take any action. Even if this point is reached – and it often is not – the services provided by the company consist simply of contacting a creditor to try to negotiate a payoff of the account for less than the full amount the creditor claims is owed. This is a step that most consumers can easily take for themselves. Once one case is settled, the debt adjuster is free to withdraw its fees, which fees are based on an estimate as

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though the entire case or plan has been completed, even though the remainder of the debts have not been negotiated or paid.

The Consumer Financial Protection Bureau (CFPB) just recently issued a notice on the risks associated with debt settlement companies. In its August 24, 2022 statement[1] the CFPB cautioned people to consider all available options including working with a nonprofit credit counselor before engaging the services of debt settlement companies. The CFPB issues the same warnings to avoid the very concerns the NJSBA has pointed out here including high fees, the potential inability of the debt settlement company to resolve all of the debts leaving the consumer with even more debt due to late fees and penalties, and exposure to collection actions if settlement does not occur.

The unfortunate bottom line is that the promise of debt settlement operators is almost never realized, despite the high fees they charge. The Better Business Bureau has determined that for-profit settlement is an inherently problematic type of business and the United States General Accountability Office completed an investigation finding that "debt settlement companies engaged in fraudulent, deceptive, and abuse practices pose a risk to consumers already in difficult financial situations."[2] Another report by the National Consumer Law Center described also concluded that for-profit debt settlement is "a business model that is inherently harmful to consumers," riddled with abuse practices including:

- Targeting consumers that are least likely to benefit;
- Imposing fees so high that consumers end up saving only a small fraction of their payments in the "reserve account" available to pay creditors;
- Knowing – and failing to disclose – that most consumers will never complete a debt settlement program. Consumers continue to face debt collection efforts, including lawsuits, and their debts will continue to grow as creditors pile on penalty fees and interest accrues and penalty rates; and
- Failing in many cases to provide any professional services to consumers.[3]

The Federal Trade Commission (FTC) has expressed its own concern about the issue after an extensive rulemaking proceeding, which resulted in findings including:

- That "a large proportion of consumers who enter into a debt settlement plan do not attain results close to those commonly represented";
- Deception is "widespread" among for-profit debt settlement companies; and
- "in a large percentage of cases, consumers are unable to continue making payments while their debts remain undiminished and drop out of the program, usually forfeiting all the payments they made towards the provider's fees."

[1] The full statement can be fond at https://www.consumerfinance.gov/ask-cfpb/what-are-debt-settlementdebt-relief-services-and-should-i-use-them-en-1457/

[2] A copy of the investigation summary may be found at https://www.gao.gov/products/gao-10-593t.

[3] A full copy of this report may be found at https://www.nclc.org/images/pdf/debt_settlement/report_investigation_debt_settle_co.pdf.

The FTC amended its Telemarketing Sales Rule both to expand the scope of the rule with respect to debt relief services, and to implement substantial new consumer protections in such transactions. More specifically, it prohibits advanced fees. State law protections remain important, however, because efforts to evade the prohibition on advance fees have proliferated.

On the other side of the coin, reputable non-profit agencies (and attorneys providing ancillary services for clients) already provide all of the crucial services in this arena to New Jersey consumers, legally and effectively. New Jersey has long had an accessible and effective network of non-profit credit counseling agencies that offer debt management plans in accordance with the existing New Jersey Debt Adjusters Act. These agencies have generally performed well, and largely avoided the abuses found in the for-profit sector.

In addition, lawyers provide debt adjustment services to New Jersey consumers as an ancillary service. See generally, Ferguson v. Skrupa, 372 U.S. 726, 732 (1963) (a "debt adjuster's client may need advice as to the legality of the various claims against him, remedies existing under state laws governing debtor-creditor relationships, or provisions of the Bankruptcy Act – advice which a nonlawyer cannot lawfully give him"); accord N.J.U.P.L. Op. 36, 136 N.J.L.J. 221 (Jan. 15, 2001). New Jersey's most vulnerable consumers do not need for-profit companies to make their difficult roads even more fraught with danger, while inducing them to pay money they do not have to spare for the privilege. Current state and federal laws already offer protections to those who face financial difficulties.

Under federal law, the United States already has a debt adjuster statute – the US Bankruptcy Code – which allows individuals facing financial difficulty in most cases to eliminate most common debts, such as credit cards and medical bills. For-profit debt adjustment companies often rely on misleading the customer to disregard the benefits of bankruptcy (no tax liability, immediate relief and rapid conclusion, usually the complete discharge of debts, relatively low cost) to sell a multi-year debt adjustment scheme thus ensuring high fees. Bankruptcy services, on the other hand, are provided by licensed attorneys that have ethical obligations to review the individual client's needs and recommend alternatives.

Current New Jersey law includes provisions to ensure consumers seeking debt adjustment services are protected, including:

- Limits fees for debt adjustment services to one percent of a consumer's monthly income, with a maximum of $25 per month, N.J.A.C. 3:25-1.2(a)(1);
- Requires any nonprofit social service agency of a nonprofit consumer credit counseling agency to post a bond and have its financial records audited annually and file the report. N.J.A.C. 3:25-2.2.

Violations of the Act can result in criminal and civil penalties. See N.J.S.A. 2C:21-19(f); see also N.J.S.A. 56:8-1, *et seq*. These protections would be lost under the current proposed legislation. At the same time, this proposal would allow for-profit debt settlement to operate legally in New

Jersey for the first time in many decades. This would be a grave mistake from the perspective of New Jersey consumers facing severe debt burdens.

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