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# FTC Issues Final Rules for Debt Relief Services: Landmark Changes for Service Providers, Advertisers and Marketers of Debt Relief Services


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On July 29, 2010 at the White House, with Vice President Biden at the podium, the Federal Trade Commission (the "FTC" or "Commission") announced its long-awaited amendments to the Telemarketing Sales Rule ("TSR") targeting the sale of "debt relief services" (the "Final Rule" or the "rule"). Under the Final Rule, virtually all debt relief service providers that promote their services through inbound or outbound telephone calls, including in response to inquiries arising from lead generators, will be subject to a ban on advance fees before services are provided, as well as new and existing requirements, and other provisions, of the TSR.

Although the TSR does not apply to *bona fide* nonprofit credit counseling agencies, the new rule potentially may impact such agencies because they now fall under the jurisdiction of the new Bureau of Consumer Financial Protection, which shares enforcement authority with the FTC for violations of the TSR.

The Final Rule will be published in the *Federal Register* shortly, and is available now on the FTC's website. The provisions of the Final Rule will take effect on September 27, 2010, with the exception of the advance fee ban provision, which will take effect on October 27, 2010. Importantly, the advance fee ban does not apply retroactively, so it does not apply to contracts with consumers executed prior to October 27, 2010. The FTC has issued guidelines for complying with the TSR, including the new debt relief rules.

The FTC's stated goals of the new rule to curb deceptive and abusive practices in the telemarketing of debt relief services. The rule defines the term "debt relief service;" ensures that, regardless of the medium through which such services are initially advertised, telemarketing transactions involving debt relief services will be subject to the TSR; mandates certain disclosures and prohibits misrepresentations in the telemarketing of debt relief services; and, most significantly, prohibits any entity from requesting or receiving payment for debt relief services until such services have been fully performed, accepted and documented to the consumer.

A few other highlights of the rule: (1) it will now be illegal to provide "substantial assistance" to another company if you know they are violating the rule or if you remain deliberately ignorant of their actions (this expressly applies to lead generators, back-office processors, and "dedicated account" providers, among others); (2) strict parameters are established regarding "dedicated accounts" utilized to set aside funds for settlement and settlement company fees; (3) there are very specific and strict guidelines for the types of substantiation necessary before certain marketing claims can be made; and (4) the rule can be enforced by the FTC, the new Bureau of Consumer Financial Protection, state Attorneys General, and through private litigation, including class actions.

The Final Rule is likely to cause debt relief providers – primarily for-profit debt settlement companies – to have to transition to new business models and to develop compliance programs that reflect strict advertising and marketing requirements. It also will impact the activities of lead generators, affiliate marketers, back-office service providers, payment processors, banks, and others that provide substantial assistance to debt relief providers, even if they do not sell or provide debt relief services directly to consumers. In short, according to the FTC, those who provide such "substantial assistance" will now be required to review the policies, procedures and operations of debt relief companies to ensure they are complying with the Final Rule, or risk violating the law themselves.

The Commission adopted the rule by a 4-1 vote, with Commissioner J. Thomas Rosch voting "no." In the announcement, Chairman Jon Leibowitz said that the "rule will stop companies who offer consumers false promises of reducing credit card debts by half or more in exchange for large, up-front

fees. Too many of these companies pick the last dollar out of consumers' pockets – and far from leaving them better off, push them deeper into debt, even bankruptcy."

Below we provide a summary of the key provisions of the Final Rule, the FTC's Statement of Basis and Purpose ("SBP"), and the newly issued business guidance for debt relief services. The focus is intended to be broad to cover a range of industry participants and issues. Nevertheless, please note that the discussion is general in nature and how the Final Rule may impact your activities and relationships may differ. In addition, we note that this is not a discussion of all of the requirements under the TSR, which include provisions concerning the Do-Not-Call Registry and other telemarketing practices.

**I. Background.**

While the FTC's debt relief services rule has its technical origins in the TSR, which is promulgated under the *Telemarketing and Consumer Fraud and Abuse Prevention Act* (the "Telemarketing Act"), the FTC has long been active in bringing enforcement actions to stamp out deceptive debt relief practices. In the last seven years, the FTC has brought over 20 lawsuits against sham nonprofit credit counseling agencies, debt settlement companies, and debt negotiators. These cases involved allegations of violations of Section 5 of the Federal Trade Commission Act (the "FTC Act"), which prohibits unfair and deceptive trade practices, and some of these cases involved TSR violations.

The Commission also has issued numerous publications to consumers warning of debt relief scams and has sent warning letters to media outlets. In addition, the FTC has authority to challenge credit repair companies under the Credit Repair Organizations Act and has a pending rulemaking to address Mortgage Assistance Relief Services.

The state Attorneys General and other state regulators also have been very active in bringing law enforcement actions against debt relief companies, having filed over 200 cases in the last several years. Nearly every state has laws that regulate debt adjusting to some degree, including debt settlement, debt management, and credit counseling, and have used these laws to regulate debt relief service providers.

In light of all of this ongoing activity and the growing number of consumers in financial distress because of the state of the U.S. economy, the FTC held a public workshop in September of 2008 entitled, "Consumer Protection and the Debt Settlement Industry."

On July 30, 2009, the FTC issued a notice of proposed rulemaking that sought comments on the proposed debt relief amendments to the TSR. The comment period, as extended, closed on October 26, 2009. The FTC received 321 comments from interested parties. The FTC held a public forum on November 4, 2009, where Commission staff and interested parties discussed the proposed amendments and issues raised in the comments.

**II. Types of Entities Subject to the Rule.**

The new rule applies to for-profit sellers of debt relief services and telemarketers for debt relief companies. The TSR defines "telemarketing" as a "plan, program, or campaign . . . to induce the purchase of goods or services" involving more than one interstate telephone call.

In addition, under the TSR, it is illegal for a person to provide "substantial assistance" to another seller or telemarketer when that person knows or consciously avoids knowing that the seller or telemarketer is engaged in any act or practice that violates the rule.

Although the TSR generally exempts inbound calls placed by consumers in response to direct mail or general media advertising, there is no such exemption in the Final Rule. The Final Rule, consistent with the proposed rule, carves out inbound calls made to debt relief services from that exemption. As a result, virtually all debt relief transactions involving interstate telephone calls are now subject to the TSR.

**A. Definition of Debt Relief Services.**

The Final Rule defines "debt relief service" as "any service or program represented, directly or by implication, to renegotiate, settle, or in any way alter the terms of payment or other terms of the debt between a person and one or more unsecured creditors or debt collectors, including, but not limited to, a reduction in the balance, interest rate, or fees owed by a person to an unsecured creditor or debt collector."

The FTC's SBP makes clear that the use of the term "service" is not intended to be limiting in any way. As a result, the Commission states that "regardless of its form, anything sold to consumers that

consists [sic] of a specific group of procedures to renegotiate, settle, or in any way alter the terms of a consumer debt, is covered by the definition." Further, "[t]he Commission believes that this definition appropriately covers all current and reasonably foreseeable forms of debt relief services, including debt settlement, debt negotiation, and debt management, as well as lead generators for these services."

Although the Final Rule does not include "products" in the definition of "debt relief services," the Commission notes in the SBP that this limitation should not be "used to circumvent the rule by calling a service – in which a provider undertakes certain actions to provide assistance to the purchaser – a 'product.' Nor can a provider evade the rule by including a 'product,' such as educational material on how to manage debt, as part of the service it offers."

**B. Coverage of Attorneys.**

The FTC is concerned with attorneys in connection with debt relief services. Based on the record in the rulemaking, the Commission decided that an exemption from the amended rule for attorneys engaged in the telemarketing of debt relief services "is not warranted." The FTC offers several reasons for its decision, including that:

> [I]n general, attorneys who provide *bona fide* legal services do not utilize a plan, program, or campaign of interstate telephonic communications in order to solicit potential clients to purchase debt relief services. Thus, an attorney who makes telephone calls to clients on an individual basis to provide assistance and legal advice generally would not be engaged in "telemarketing."

In addition, the FTC states that "it is important to retain [TSR] coverage for attorneys, and those partnering with attorneys, who principally rely on telemarketing to obtain debt relief service clients, because they have engaged in the same types of deceptive and abusive practices as those committed by non-attorneys." The FTC also states that its decision to not grant an exemption to attorneys from the Final Rule is consistent with the existing scope of the TSR and several other statutes and FTC rules designed to "curb deception, abuse and fraud."

**C. Coverage of Sham Nonprofits.**

The Final Rule does not cover *bona fide* nonprofit organizations, but does cover companies that falsely claim nonprofit status. Over the years, the FTC has brought enforcement actions against companies that it has alleged are sham nonprofits in order to curb perceived unfair and deceptive conduct.

**D. Persons Providing Substantial Assistance.**

The FTC is concerned about those that work with debt relief companies and telemarketers. As mentioned above, the TSR makes it illegal to provide "substantial assistance" to a provider if that person knows that the primary actor is violating the rule or if the person remains deliberately ignorant of their actions. In particular, the FTC provides examples in its business guidance that, in the context of debt relief services, substantial assistance may include: obtaining leads, helping a debt relief provider with its back-room operations, and offering dedicated accounts (as explained below). The FTC warns businesses, "[i]f you work with debt relief companies, review their policies, procedures and operations to make sure they're complying with the Rule. Willful ignorance isn't a defense."

**III. Scope of Prohibitions and Disclosure Requirements.**

The Final Rule cites a number of practices that it views as deceptive or abusive under the TSR, thus making them illegal. While the Final Rule contains provisions similar to the proposed rule, it differs in a number of critical respects. Below we provide a brief summary of these provisions.

**A. Advance Fee Ban.**

*1. Overview*

The FTC rule will make charging an advance fee before providing any debt relief services illegal throughout the United States, effective October 27, 2010. As mentioned above, several states already have laws regulating debt relief services, outlawing advance-fee debt relief services, and establishing maximum fees that may be charged.

As explained in the SBP, the Commission believes that regulating the timing of fee collection constitutes a reasonable exercise of authority under the Telemarketing Act in light of the record and its own observations. In the Final Rule, the FTC takes the position that charging an advance fee for debt

relief services is abusive. The TSR already bans the abusive practice of collecting advance fees for three other services – credit repair services, recovery services, and offers of a loan or other extension of credit, the granting of which is represented as "guaranteed" or having a high likelihood of success. In reaching its decision, the SBP goes into significant detail to address comments both in support of and against the advance fee ban.

Specifically, the Final Rule includes an advance fee ban, but in a form modified from the proposed rule. In short, the Final Rule sets forth three conditions before a debt relief provider may collect a fee for resolving a particular debt:

> (1) the consumer must execute a debt relief agreement with the creditor or debt collector;
>
> (2) the consumer must make at least one payment pursuant to that agreement; and
>
> (3) the fee must be proportional, i.e., the fee must bear the same proportional relationship to the total fee for settling the entire debt balance as the individual debt amount bears to the entire debt amount (the "individual debt amount" and the "entire debt amount" refer to what the consumer owed at the time her or she enrolled the debt in the program); in other words, if the provider settles a proportion of a consumer's total debt enrolled in the program, it may get that same proportion of the total fee. Alternatively, if the provider bases its fee on the percentage of what the consumer saves as result of using its services, the percentage charged must be the same for each of the consumer's debts.

As a result, front-loaded payments – charged by a number of debt settlement companies and the lifeblood of many advertisers and marketers – will be prohibited.

*2. Dedicated Account for Fees and Savings*

Notably, the Final Rule allows the provider to require customers to place funds in a "dedicated bank account" for provider fees and payments to their creditor(s) or debt collector(s) in advance of securing the debt relief, provided that certain conditions set out in the Final Rule are met. This is a significant change from the proposed rule – as it recognizes the risk of non-payment by consumers for services provided – and bears careful study by debt relief providers who choose to take advantage of this optional provision. There are significant restrictions on how these dedicated accounts may be set up and operated, which serve to safeguard the customer's funds.

*3. Limitation on Setup Fees for DMPs*

Of particular importance to credit counseling agencies and debt management plan ("DMP") providers, the Final Rule prohibits them from charging a set-up or other fee before the customer has enrolled in a DMP and made the first payment under the DMP, but it would not prevent the provider from collecting subsequent periodic (*e.g.,* monthly) fees for servicing the account. For *bona fide* nonprofit credit counseling agencies, this is a requirement that bears careful scrutiny, even though the FTC does not have the jurisdiction to enforce the Final Rule against such agencies.

*4. Relationship with State Law*

State laws can impose additional requirements as long as they do not directly conflict with the TSR. However, providers may not charge initial or monthly fees in advance of providing the specified services, even if state laws specifically authorize such fees.

*5. No Retroactivity*

According to the FTC's SBP, "[t]he Final Rule does not apply retroactively; thus, the advance fee ban does not apply to contracts with consumers executed prior to October 27, 2010."

**B. Disclosures.**

Under the Final Rule, providers will have to make several disclosures when telemarketing their services to customers. These requirements will take effect on September 27, 2010.

The FTC Rule mandates four debt relief-specific disclosures that must be made before a customer consents to pay for the goods or services offered. These are in addition to the existing, generally applicable disclosures currently in the TSR (not discussed within this article in detail). Before the customer consents to pay, the Final Rule requires debt relief service providers to disclose to the customer, clearly and conspicuously:

(1) the amount of time necessary to achieve the represented results;

(2) the amount of savings needed before the settlement of a debt;

(3) if the debt relief program includes advice or instruction to consumers not to make timely payments to creditors, that the program may affect the consumer's creditworthiness, result in collection efforts, and increase the amount the consumer owes due to late fees and interest; and

(4) if the debt relief service provider requests or requires the customer to place funds in a dedicated bank account at an insured financial institution, that the customer owns the funds held in the account, may withdraw from the debt relief service at any time without penalty, and then may receive all of the funds in the account.

According to the SBP, the above disclosures are required "to the extent that any aspect of the debt relief service relies upon or results in the customer failing to make timely payments to creditors or debt collectors."

The proposed rule contained three additional debt relief-specific disclosures that have been omitted from the Final Rule:

(1) that creditors may pursue collection efforts pending the completion of the debt relief service (which has been combined with another required disclosure);

(2) that any savings from the debt relief program may be taxable income; and

(3) that not all creditors will accept a reduction in the amount owed.

The Commission decided the above omitted disclosures were "largely duplicative or likely to detract from the efficacy of the required disclosures." In addition, the Commission acknowledged that "even those creditors that claim not to work with debt relief providers may do so in certain situations."

**C. Misrepresentations.**

The Final Rule supplements the existing TSR prohibitions against misrepresentations with a provision specifically intended to target deceptive practices by debt relief service providers. Under FTC precedent, an act or practice is deceptive if: (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that representation or omission is material to consumers.

*1. Debt Relief-Specific Illustrative Examples*

The Final Rule prohibits sellers or telemarketers of debt relief services from making misrepresentations regarding any material aspect of any debt relief service and it provides several illustrative examples, including misrepresentations of:

- the amount of money or the percentage of the debt amount that a customer may save by using such service;
- the amount of time necessary to achieve the represented results;
- the amount of money or the percentage of each outstanding debt that the customer must accumulate before the provider will initiate settlement attempts with the customer's creditors or debt collectors or make a *bona fide* offer to negotiate, settle or modify the terms of the customer's debt;
- the effect of the service on a customer's creditworthiness;
- the effect of the service on the collection efforts of the customer's creditors or debt collectors;
- the percentage or number of customers who attain the represented results; and
- whether a service is offered or provided by a nonprofit entity.

*2. Debt Relief Savings Claims*

The FTC requires that representations promising specific savings or other results be truthful, and that the provider have a reasonable basis to substantiate the claims. In this regard, the SBP contains extensive guidance about the specific evidence required to make various representations regarding debt relief services. For example, the SBP states when a debt relief service provider represents that it will save the consumer money, the savings claims should reflect the experiences of the provider's own past customers and must account for several key pieces of information. Although this is consistent

with the FTC's longstanding policy statement on advertising substantiation, the Commission provides detailed guidance on the proper methodology for conducting this historical experience analysis. This guidance should be studied carefully by anyone making debt relief savings claims or other representations concerning debt relief services.

*3. Existing TSR Provisions Prohibiting Deceptive Representations and Misleading Statements*

In addition to the above debt relief-specific misrepresentations, existing prohibitions found in the TSR will now apply to the inbound or outbound telemarketing of debt relief services. The SBP provides guidance on the meaning of these prohibitions in the context of debt relief services, using claims that are frequently used in the marketing and sale of debt relief services.

**D. Recordkeeping.**

Under the Final Rule, any debt settlement, DMP or other debt resolution plan from a creditor must be in writing. Providers must keep these documents for at least 24 months. Further, the FTC business guidance recognizes that oral agreements for settlements may be needed in isolated cases, but strongly favors written approval for settlements.

**IV. Enforcement and Outlook.**

At the July 29 press conference, Chairman Leibowitz promised "aggressive" enforcement of the new debt relief rules. The TSR and the Final Rule are enforceable both by the FTC and state Attorneys General, and allows either the ability to obtain nationwide injunctive relief and consumer redress. Also, the TSR may be enforced by the Bureau of Consumer Financial Protection, under the Consumer Financial Protection Act, which amended the Telemarketing Law. Finally, the TSR provides for a private right of action, whereby injured consumers can bring private litigation, including potentially as class actions, for violations of the TSR.

As a legal matter, the FTC only has the authority to enforce the rule against debt relief providers within its jurisdiction. The FTC Act exempts banks and other depository institutions and *bona fide* nonprofits, among others, from the Commission's jurisdiction. These exemptions apply to the Telemarketing Act and the TSR as well. As discussed above, this means that the FTC's authority to enforce the new rule would not extend to *bona fide* nonprofit credit counseling agencies.

The new Bureau of Consumer Protection was granted authority to enforce the TSR by amendments to the Telemarketing Act that took effect with the enactment of the *Consumer Financial Protection*, which is part of the comprehensive *Dodd-Frank Wall Street Reform and Consumer Protection Act*. As a result, the Bureau has the ability to enforce the FTC's amendments to the TSR regarding debt relief services against *bona fide* nonprofit credit counseling agencies, even though the FTC itself lacks jurisdiction over such agencies. For instance, if the rule was applied to *bona fide* nonprofit credit counseling agencies by the Bureau, no initial DMP set-up fee would be permitted to be charged. This bears close watching by the nonprofit credit counseling industry and other nonprofit organizations providing debt relief services, especially as new less-than-full balance DMP programs and other settlement-type products gain steam.

**NEW TSR DEBT RELIEF RULES:**
**JURISDICTIONAL AUTHORITY FOR ENFORCEMENT**

| | **For-Profit Debt Relief Service Provider** | ***Bona fide* Nonprofit Credit Counseling Agency** |
|---|---|---|
| **Federal Trade Commission** | Yes | No |
| **Bureau of Consumer Financial Protection** | Yes | Yes |

Although the FTC announced no new enforcement actions at the press conference, we understand that it has a number of pending non-public investigations in response to perceived abuses by debt settlement companies and others, including affiliate marketers and lead generators. We also are aware that several state Attorneys General and other state regulators have open investigations and

pending lawsuits against a number of debt relief providers. In addition, it is not unusual for the FTC to coordinate with state Attorneys General to bring a law enforcement sweep against violators shortly after a new rule becomes effective (this happened after the enactment of the Credit Repair Organizations Act, for instance). Lastly, FTC staff has publicly stated that the Final Rule is in addition to existing compliance obligations under Section 5 of the FTC Act, which would allow the Commission to bring an enforcement action even if the activities in question fall outside of the TSR.

**V. Debt Settlement Industry Legal Challenge Possible.**

The FTC is authorized to conduct rulemaking proceedings under the Telemarketing Act using the Administrative Procedure Act's "notice-and-comment" procedures. The FTC generally does not have rulemaking authority under Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices. Moreover, unlike the FTC's pending rulemaking for mortgage assistance relief services, this rulemaking was not authorized specifically by statute. Rather, the FTC is using the Telemarketing Law's deceptive and abusive practices standard as its basis to issue the Final Rule.

As a result, while expedient, the FTC's use of the Telemarketing Act to regulate the debt relief services industry is aggressive since a "debt relief" rule was not specifically authorized by law. Although it is safe to assume the FTC believes it is on firm ground, there are some significant questions about whether the rule is enforceable given its origins. Therefore, debt settlement industry opponents of the rule potentially may attempt to challenge the authority of the FTC to issue the rule under the Telemarketing Act. The prospects for industry success are uncertain in light of the record developed by the FTC during the rulemaking and the discretion granted by courts to government agencies.

**VI. FTC Business Guidance Released and Additional Information.**

As mentioned above, the FTC staff issued a compliance guide to help businesses comply with the new debt relief rules, including detailed examples and best practices. The new rule and the compliance guide are available on the agency's website at **http://www.ftc.gov/opa/2010/07/tsr.shtm**.

In addition, several articles, presentations and alerts are available on this subject on our firm's website, including our articles:

- *Public Forum on Proposed Debt Relief Amendments to the Telemarketing Sales Rule*, available at **http://www.venable.com/ftc-hosts-public-forum-on-proposed-debt-relief-amendments-to-the-telemarketing-sales-rule/**;
- *Federal Trade Commission Issues Notice of Proposed Rulemaking to Amend Telemarketing Sales Rule to Cover Debt Relief Services*, available at **http://www.venable.com/federal-trade-commission-issues-notice-of-proposed-rulemaking-to-amend-telemarketing-sales-rule-to-cover-debt-relief-services-07-31-2009/**; and
- *FTC Commissioner Rosch Calls for More Responsibility and Reforms in the Debt Settlement Industry*, available at **http://www.venable.com/ftc-commissioner-rosch-calls-for-more-responsibility-and-reforms-in-the-debt-settlement-industry-04-06-2009/**.

Lastly, for additional information about the Bureau of Consumer Financial Protection and the Consumer Financial Protection Act, see our article, *The Dodd-Frank Act: What It Means for Credit and Housing Counseling Agencies and Other Debt Relief Service Providers*, available at **http://www.venable.com/the-dodd-frank-act-what-it-means-for-credit-and-housing-counseling-agencies-and-other-debt-relief-service-providers-07-26-2010/**.

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For several years now, many in the debt relief industry and consumer groups had publicly wondered who would be the executioner of the present day for-profit debt settlement business model that relies on advance fees to maintain their business and finance advertising and marketing. The answer to that question now appears clear. With the announcement of the Final Rule, the FTC has taken decisive action to promulgate rules and issue guidance related to debt relief services. Now the questions become: (1) Will the Final Rule be enforceable?; (2) How will the Bureau of Consumer Financial Protection utilize the rule?; (3) How will providers of debt relief services react to and comply with the new requirements?; (4) For those that are not able to or are unwilling to comply, how long they will be

able to continue before the FTC, state Attorneys General, or consumers (acting under a private right of action) catch up to them in a law enforcement action or private lawsuit?; and (5) What will happen to debt settlement company customers if a company chooses to or is forced to close its doors?

In addition, up until just a week ago, for nonprofit credit counseling agencies, the proposed rule had only been a policy matter that was easy to support. Now, however, nonprofit credit counseling agencies will potentially be confronted with new compliance requirements under the Bureau of Consumer Financial Protection that will share enforcement authority under the Telemarketing Law with the FTC. In addition, the new Bureau is likely to look at the FTC for guidance in developing its own rules, including rules to regulate credit counseling, debt management plan services, and other debt relief services. As a result, as nonprofit credit counseling agencies develop new services to address the needs of consumers in financial distress that closely resemble those services regulated under the TSR – such as less-than-full-balance DMP programs – they should be mindful of the baseline requirements established by the FTC.

Lastly, as a practical matter, the Final Rule (and business guidance) may be viewed by many as establishing a new minimum level of standards to which those advertising and engaged in providing debt relief services may be held by regulators and private plaintiffs, irrespective of whether they are organized as nonprofit or for-profit organizations. As a result, all providers of debt relief services – both nonprofit and for-profit – should carefully consider their operations, policies and procedures, including advertising and marketing (*e.g.,* websites, inbound telephone scripts, print, radio, television and Internet advertisements, affiliate relationships, lead generation relationships, back-office provider relationships), in light of the new rule.

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