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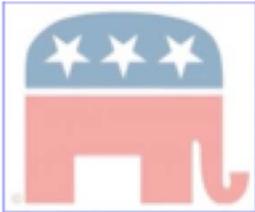
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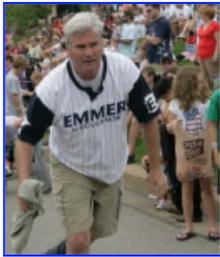
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Debt settlement companies evade state restrictions

Seven firms are licensed in Minnesota, but many more operate here

By [Jon Collins](#) 8/5/10 9:14 AM





Photo: Dan Simpson, Flickr

Bill Gustafson worked at his family's bakery on Minnesota's North Shore for 40 years. After his rheumatoid arthritis knocked him out of the workforce, he racked up debt, at one time spreading it across six credit cards. When the phone rang about a year ago, it was a representative of an outfit insiders refer to as a debt settlement company. "They said I could lower what I was paying every month," Gustafson recalls. "It sounded like a good deal to me, so I went into it."

Each month, Gustafson paid \$519 of his Social Security stipend to the company, the name of which he prefers not appear in print. When unexpected medical expenses made even those payments more difficult, he contacted financial counselors at non-profit Lutheran Social Services (LSS) of Minnesota. That's when Gustafson discovered that, despite the monthly payments he'd been making for almost a year, the debt settlement company hadn't given a dime to his creditors. Almost three-quarters of his monthly payments to the company were being eaten up by fees, with the small remainder being deposited in an account the company said they were only planning use to negotiate a settlement to his debts after 22 months.

In Minnesota, a [law](#) that went into effect last August was designed to limit the worst practices of these companies. But of the estimated 2,000 debt settlement companies operating in the country — many that advertise on the radio or telemarket in the state — [only seven](#) companies have voluntarily [registered](#) for licenses with the Minnesota Department of Commerce, leaving Minnesotans like Gustafson at the mercy of people whose only aim, consumer advocates say, is to squeeze profit from those already in desperate financial straits.

Squeezing the middle class

Debt settlement companies really emerged as a product of the economic downturn. They cover the spectrum of respectability, from fly-by-night outright scams to multimillion-dollar businesses. But what they have in common is that they tell consumers they'll settle their debts, but often just leave them in worse shape, says Dan Williams, Director of Lutheran Social Services Financial Counseling.

"All of the data around debt settlement companies says that they don't ultimately do debt settlement and put a person in a more stable financial situation," he says. "While there's exceptions to that, the vast majority of clients that enter a relationship with a debt settlement company ultimately do not pay off their debts."

Instead, consumers are told to avoid contact with creditors while the debt settlement company purportedly negotiates a settlement. Often, it takes months for a consumer to realize, as Gustafson did, that payments weren't being made to their

creditors at all. By that time, Williams says, their credit is shot and they're even deeper in debt than before, plus out the money they paid the debt settler.

"They'll just be devastated. Their entire financial situation is devastated over \$2,000 or \$2,500 in fees these places collect," Williams says "Getting sucked into a debt settlement scam, it's only \$2,000 in revenue to the scammer, but to the person, to the family, it might just mean moving away from their family; losing their home; having their car dispossessed; filing for bankruptcy."

Debt settlement companies have a hand in knocking people off the cliff of stability, contributing to a string of broader problems, from the foreclosure crisis to growing patient debts at hospitals. Many who end up in debt settlement plans are formerly middle-class people, pinched by the economy, for the simple fact that these companies want to enroll those who can afford to pay their fees, Williams says, instead of desperately poor people, who can't.

"Part of what they tell people is, 'Everyone else you talk to is a scam,'" Williams says of a common lure. "The consumer will still be like, 'No, Bob's great, I know he wouldn't send me in the wrong direction.'"

Even when people do figure out that the company isn't helping them pay their debts, many are embarrassed to report the incident, or just plain overwhelmed by the financial hole they find themselves in: "Everyone thinks, 'That won't happen to me,'" Williams says, "so when it does, I'm not going to shout from the rooftops," which leads to fewer complaints to state agencies.

Or as Minneapolis consumer attorney Todd Murray hears from clients who previously contracted with debt settlers: "I was skeptical. I wasn't sure about this — in hindsight it seems a really stupid thing to do — but I was desperate."

Slippery when debt

Minnesota has been a leader in aggressively countering debt settlers. The office of the Minnesota Attorney General has taken nine companies to [court](#) since September 2009, according to spokesman Benjamin Wogsland. (Of five of those companies contacted about a prospective debt settlement in Minnesota, only one responded, and their representative admitted they're unable to work in the state at this time.)

And the state has had a law on the books since August 2009 that Williams calls "one of the best in the country." But that law requires that debt settlement companies register for licenses through the Minnesota Department of Commerce, and despite airwaves bombarded with advertisements for debt settlers, only seven companies are legally licensed to practice in the state.

Wogsland says the attorney general's office will absolutely pursue cases where it appears debt settlement companies are showing a "pattern of fraud." But the primary regulator is the Department of Commerce, which has taken action against three debt settlement companies since the new law went into effect a year ago, all of which were prompted by consumer [complaints](#), says Rochelle Barnhart, the department's spokesperson. The department plans to maintain its current approach.

"Some issues we attempt to resolve informally. Other problems rise to a higher level and we would open a formal investigation of the company with the intent of taking some sort of action against it," Barnhart says. "We are limited to taking civil actions. In very serious cases we might share our investigative results and work with authorities which could take criminal action."

The problem is that the fines leveraged against companies that violate the rules are piddly compared to the potential profits the companies can earn. If a company applies for a license, it costs \$1,000 and the deposit of a \$5,000 Surety Bond, and they're required to follow a number of business practice restrictions imposed by the state law. The statutory base penalty is \$5,000, although the Minnesota Department of Commerce can leverage much higher fines. For many companies, it could come down to the cost of doing business.

"If there's legislation that says, 'Hey, you can't earn any money until you've actually stabilized a person's financial situation and the debts are paid off,' why would they even bother getting registered," Williams asks. "All of the history of debt settlement companies and Congress' report on debt settlement really would tell us that's not a business model that works."

But it's also a problem rooted in the nature of the industry, where companies pop up under multiple names and can quickly shift how they describe themselves, using euphemisms from "debt management" to "debt counseling" while maintaining essentially the same business model. Although the Federal Trade Commission ruled last week that collecting upfront fees for debt settlement is against the law, debt settlement companies already appear to be making adjustments, Williams says.

There are few actual studies of debt settlement, making it difficult to even peg down the number of companies that are operating in the country, although the New York Times put the number at 2,000. Of the nine companies sued by the Office of the Attorney General, none were from Minnesota, says Wogsland. The company Bill Gustafson dealt with eventually claimed to be two companies, one dedicated to advertising and one to settlement. Each insisted it had little knowledge of the other's activities. This sieve-like nature makes it difficult to get a grip on debt settlement as an industry.

There are some areas where legislators could potentially tighten the industry's access to consumers. In Duluth, as across the state, Williams says, radio and television stations are regularly broadcasting paid advertising from unlicensed debt settlers. Advertising is an area where the industry's top group, [The Association of Settlement Companies](#), which opposes most regulation, has pushed [voluntary standards](#).

"Local radio stations all over Minnesota are getting money from debt settlement companies that aren't licensed by the Department of Commerce," Williams says. "If people really understood the consequences that these scams cause to families and communities, I think that radio stations and TV stations might even think twice about taking the advertising revenues from these places."

In the end, Gustafson, with the help of financial counselors at LSS, was able to cancel his debt settlement program. And after a complaint to the state attorney general's office, the debt settlement company, which was unlicensed, returned much of the money he'd paid them. He spoke to the Minnesota Independent to warn others away from making the same financial misstep.

"It turned out that most of what I was paying was fees and just a little bit was going towards settlement, when I found that out it was a little bit disgusting," Gustafson says. "When you first get into it, it sounds good, but then you have to really explore what the whole thing is about."

[Freedom Fidelity Management](#) One example of a Minnesota Department of Commerce action against an unlicensed debt settlement company

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