MARKETS

That Offer to Make You Debt-Free? It Can Make You Worse Off

Debt-settlement firms seek out struggling consumers to sell them plans that can leave them with high fees, damaged credit and a tax bill

By Jean Eaglesham and AnnaMaria Andriotis

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Early this year, Phoebe Tu was rejected for a $30,000 loan to consolidate her credit-card debt. Within days, the gears were turning in a multibillion-dollar lending machine that enables consumers to borrow and, more recently, has tried to profit as they run into trouble.

The system is powered by the companies that compile credit reports based on consumers' borrowing histories. These credit-reporting companies typically sell the data to financial institutions offering loans, but as consumer debt has risen, another type of offer is being pitched to tens of millions of households.

"You may be completely debt free in only 24-48 months," said a typical mailer from New York-based National Debt Relief, which added that the offer was based on a credit report.

Companies like National Debt Relief seek out heavily indebted consumers with a promise to help them get out from under it. But regulators say these debt-settlement programs can leave customers worse off, facing high fees, damaged credit scores and unexpected income-tax bills.

Steven Boms, an adviser to the American Fair Credit Council, the debt-settlement industry's trade body, said most people who enroll in debt-settlement programs already are behind on payments. "The only real alternative many of these consumers have to debt-settlement is bankruptcy," he said.

Consumer debt, not counting mortgages, hit a record $4.02 trillion this year, a big reversal after Americans aggressively paid down what they owed and lenders wrote off unpaid debts following the financial crisis. As borrowers have fallen deeper into debt, the amount enrolled in debt-settlement programs has risen sevenfold, from $1.7 billion to $12 billion in the five years that ended in March 2017, according to a survey by the debt-settlement industry's trade group.

Data from credit-reporting companies has been used by some debt-settlement firms to solicit consumers as their debt is rising and when many are trying to sort out their financial situation. Other firms flood mailboxes with offers of loans, but when consumers call, the pitch can be very different.

'Get the client's guard down'

Ms. Tu, a 33-year-old business development manager in the San Francisco Bay Area, said that after she was rejected for the personal loan, a mailing from GreenLink Financial LLC arrived offering a loan of about $60,000—twice what she wanted—and at a surprisingly low interest rate. But when she called the firm, it turned her down for the loan and pitched her a debt-settlement program instead, she said.

"They said, 'It's to help you get by because you're in a financial crisis.' I'm not in a financial crisis, just trying for a low interest rate," she told The Wall Street Journal.

Former GreenLink employees said only a small number of people who responded to the company's mailings were offered loans. Instead, they were pitched a debt-settlement program that GreenLink sells on behalf of San Mateo, Calif.-based Freedom Debt Relief, the former employees said.

GreenLink's salespeople were taught to "get the client's guard down," according to a GreenLink telephone sales script reviewed by the Journal. The Journal couldn't determine the date of the script.

Most people who responded to GreenLink mailers were told they would be called back after loan-underwriting checks had been made, the former employees said. On that second call, the salespeople were told to say, "I couldn't stop thinking about your file" and to pledge, "I am going to make YOU my top priority today," according to the script.

Then, the consultants were told to break it to the caller that he or she didn't qualify for the loan offer the company mailed, the script said.

"But this actually turned out to be GREAT NEWS!" the salespeople were instructed to say, according to the script, before pitching the debt-settlement program that offers "a payment which fits perfectly within your budget."

Responding to an online complaint on Yelp by Ms. Tu, GreenLink wrote in May that its agent had "handled the call with utmost respect." It added that Ms. Tu did "not meet the minimum requirements needed to get approved for any loan with our funding source."

In response to a complaint on the Better Business Bureau website, GreenLink wrote that debt-settlement "is only an option for clients that we can't qualify for a loan."

The company didn't respond to requests for further comment.

GreenLink, of Santa Ana, Calif., sent about 27 million mailers last year, according to estimates from data-provider Competiscan, up from about 1.2 million in 2015, the first calendar year after the company was formed.

Freedom Debt Relief in July agreed to pay $25 million to settle a civil lawsuit filed by the federal Consumer Financial Protection Bureau that claimed it charged consumers without settling their debts as promised, and misled them about fees. Freedom didn't admit or deny the allegations.

A representative of Freedom Debt Relief, which describes itself as the nation's biggest debt-settlement company, didn't respond to requests to comment. National Debt Relief also didn't respond.

Consumers who sign up for these programs are often told to stop paying their credit-card bills and other debts and instead put the payments in a special bank account, regulators say. Then the debt-settlement company negotiates with creditors to try to get them to reduce the consumer's debt.

Halting payments, though, can trigger big penalties and potentially lawsuits by creditors and can hurt a person's credit score. Even if the company persuades a creditor to reduce the debt—and there is no guarantee of this—the customer may owe income taxes on the amount of debt forgiven.

Taxes combined with fees these firms charge of as much as 25% of enrolled debt could wipe out any savings from a reduced debt balance. And a lower credit score that the strategy can trigger could make future borrowing more expensive.

The trade group's Mr. Boms said companies marketing loans often discover information during the loan-underwriting process, such as additional debts, that wasn't known when a mailer was sent. The group said last year that a survey of its members found debt-settlement plans reduced consumers' debts by an average of $2.64 for every dollar they paid the firms in fees.

Alternatives to debt-settlement companies include nonprofit credit counseling services, which attempt to work with the borrower and creditors to agree on a debt-management plan. These plans usually don't reduce the amounts owed; instead, creditors may agree to lower interest rates or waive fees. Credit counselors may charge fees for some of their services.

Legal gray area

At least some debt-settlement firms have used information from credit-reporting companies to pounce on troubled borrowers. The federal Fair Credit Reporting Act allows the companies, including TransUnion , TRU **-1.94%** ▼ Equifax Inc. EFX **-1.60%** ▼ and Experian EXPGY **-1.57%** ▼ PLC, to sell the data from credit reports only for certain uses, such as firm offers of credit. Debt settlement isn't specified in the law as a permitted use of this sensitive financial information to solicit consumers, and some experts consider it a gray area.

SHARE YOUR THOUGHTS

Have you ever worked with a debt-settlement company? How was your experience? Share your story below.

Some firms use the data to pitch debt-settlement plans, according to mailings reviewed by the Journal and lawsuits filed by consumers. The lawsuits reviewed by the Journal all were settled confidentially by the firms.

Other firms first offer loans and then shift their sales pitches to debt settlement, according to former employees of the companies and telephone sales scripts reviewed by the Journal.

Jeff Sovern, a law professor at St. John's University in New York, said that, based on his reading of the Fair Credit Reporting Act, it isn't legal to use consumer-credit reports for debt-settlement solicitations since "that's not a firm offer of credit." He added that the law requires credit-reporting companies to obtain certification from the entities with which they share such information that it will be used for a lawful purpose.

Credit-reporting companies that sell data used to solicit debt-settlement services "bear some responsibility" for the practices of some in that industry because they should be vetting the firms they sell the information to and how those firms use it, said Chi Chi Wu, staff attorney at the National Consumer Law Center, a nonprofit consumer-advocacy group.

TransUnion told the Journal it no longer supplies credit-report data to the debt-settlement industry. A spokesman said the company "historically...has sold prescreen data" to some debt-settlement companies, adding that this complied with federal law because these firms allowed consumers to delay payments for their services—which TransUnion said was a form of credit—or because they actually offered loans.

An Equifax spokeswoman said the company "does not, as a matter of policy, provide consumer-report information to companies who it knows to be charging advance fees for debt or mortgage-assistance relief." The spokeswoman didn't respond to questions about whether Equifax sells information to debt-settlement companies that don't charge advance fees, a group that includes the biggest players in the industry. By law, for-profit companies that sell debt-settlement services over the phone are barred from charging advance fees.

Experian said it has never sold information from credit reports to the debt-settlement industry for solicitation purposes.

CreditAssociates LLC, a Dallas-based debt-settlement company, said it stopped receiving data from TransUnion last year, but sent offers to consumers based on the company's information as recently as last month.

"You are preapproved for a debt relief program that can save you thousands of dollars," said a mailer sent earlier this year by CreditAssociates. "This 'pre-screened' offer of credit is based on information in your credit report."

Rick Burton, a co-founder of CreditAssociates, said its debt-settlement offer in the mailer qualified as credit because clients can pay the fees it charges in installments, rather than a lump sum. This approach was approved by TransUnion compliance personnel, he said.

A TransUnion spokesman said it doesn't provide legal or compliance advice to its customers and doesn't approve customers' mailers.

Prof. Sovern called the practice of letting customers pay fees in installments a "quite imaginative" way of using the fair-credit law's provision allowing the use of credit-report data for loan offers "for a completely different purpose of debt-settlement offers."

Amanda Ricchio said she knew that a debt-settlement offer she was pitched would damage her credit rating, despite the promoter's claim that it would cause only 'a slight hit at first.' PHOTO: SARA STATHAS FOR THE WALL STREET JOURNAL

Concern about credit score

In some cases, sales pitches for debt-settlement programs appear to minimize the risk to a consumer's credit score. Amanda Ricchio, a 34-year-old accounting student in Racine, Wis., was mailed offers for loans after she put a few thousand dollars of college costs on her credit cards. The offers said they were based on credit reports.

Ms. Ricchio called Simple Path Financial LLC, of Irvine, Calif., but was refused the 4.99% loan she had been pitched. Instead, she said she was offered a debt-settlement program, which she was told would cause only a "slight hit at first" to her credit score.

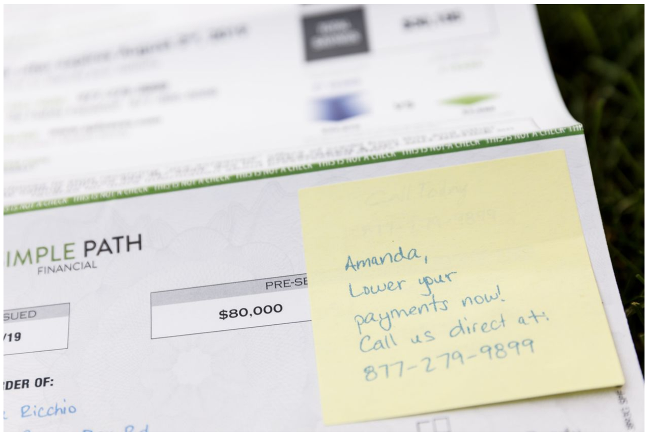
Ms. Ricchio, who had worked for a credit union where her father was chairman, said she didn't believe the claim. "I know this kind of program would actually cause serious damage to my credit score," Ms. Ricchio said.

Mr. Boms, the adviser to the debt-settlement industry trade group, said the credit scores of the "vast majority" of people who enroll in the programs would fall due to their existing financial problems, whether or not they go this route.

Simple Path was founded in 2016 by Bradley Smith and Branden Millstone and sells debt-settlement plans from another firm founded by the two men, public records show.

Mr. Millstone in an interview said a “very large number of people” who respond to Simple Path mailers are offered a loan, adding that he didn’t have the exact numbers.

People who do qualify for a loan may choose debt-settlement as a better option than “putting a Band-Aid on their situation” by taking on more debt, he added.



One of many mailers Amanda Ricchio said she received from debt-relief companies. PHOTO: SARA STATHAS FOR THE WALL STREET JOURNAL

—Lisa Schwartz
contributed to this article.

Write to Jean Eaglesham at jean.eaglesham@wsj.com and AnnaMaria Andriotis at annamaria.andriotis@wsj.com