



OFFICE OF
THE CHAIRMAN

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

May 11, 1987

The Honorable Frank Annunzio
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Annunzio:

Thank you for your recent letter forwarding a copy of H.R. 458, the Credit Repair Organizations Act, to the Federal Trade Commission. We appreciate the opportunity to comment on the proposed legislation.

The credit repair business appears to be a relatively recent phenomenon. It involves the marketing of credit repair services to consumers whose credit bureau reports contain negative information that interferes with their ability to obtain credit. The principal method such businesses rely upon to improve consumers' credit bureau reports is the dispute procedure available to consumers under Section 611 of the Fair Credit Reporting Act (FCRA). Section 611 is designed to provide consumers with a self-help mechanism to correct credit reports that contain inaccurate or incomplete information. Correcting and updating such information benefits creditors as well as consumers by helping to ensure that credit-granting decisions are made on the basis of complete and accurate information reflecting the probable creditworthiness of the consumer.

It does not appear, however, that most consumers who employ the services of a credit repair organization seek to correct inaccurate information. Based on the monitoring experience of Commission staff, it appears instead that many of those who turn to credit repair organizations have experienced significant credit problems in the past, which they hope to minimize.¹ Although minor inaccuracies may appear in their credit reports, by and large the adverse information that is reported about them fairly reflects what actually occurred. Utilization of FCRA dispute procedures is, therefore, unlikely to aid these consumers. Nonetheless, through advertisements and oral representations, credit repair organizations often lead consumers to

¹ The Commission brought an enforcement action against six credit repair practitioners in 1986 (see Federal Trade Commission docket numbers C-3185 through C-3190) and presently is monitoring the activities of several others.

believe that adverse information in their credit reports can be deleted or modified regardless of its accuracy. In fact, however, if adverse information reported by the credit bureau is accurate, under the FCRA it may be reported for at least seven years. Bankruptcy may be reported for ten years. Although the FCRA does not require credit bureaus to report adverse information for this period of time, it explicitly authorizes them to do so. Credit bureaus, which are in the business of selling credit history information to creditors, ordinarily report such information for as long as is legally permissible.

It appears that credit repair organizations occasionally improve consumers' credit bureau reports, but fail to do so in most instances -- principally because most of the information they dispute is accurate and within the permissible reporting period. Their services are frequently sold on a money-back guarantee basis, but consumers have reported difficulties in obtaining refunds. The company may be out of business, lack the funds to pay by the time consumers seek refunds, or simply refuse to honor the guarantee. Credit repair organizations have caused economic injury to credit bureaus as well as to consumers by generating large numbers of groundless disputes that credit bureaus must process. To the extent that a credit repair organization does succeed in deleting accurate adverse information from a consumer's credit history, creditors are deprived of information that might otherwise have been a decisive factor in the credit-granting decision. Creditors have expressed concern to the Commission that deletion of accurate information may result in increased lending risk.²

The Commission's staff believes that a substantial segment of the credit repair industry presently engages in practices that injure both the general public and individual consumers. Whether

² Credit bureaus are required by Section 611 of the FCRA to reinvestigate disputed information within a reasonable period of time and to delete information that they cannot verify. A credit bureau may delete accurate information from a consumer's credit bureau report because, for example, it is overwhelmed by disputes generated by credit repair organizations or because creditors fail to respond promptly to verification requests.

the potential scope of this problem justifies enactment of federal legislation is an issue for Congress to decide.³ As the primary law enforcement agency, however, the Commission believes that it has a unique perspective to contribute if Congress chooses to enact such legislation. In our view, the proposed legislation would be strengthened by changing its focus somewhat.

H.R. 458 would impose a bonding requirement on credit repair organizations. It also would provide consumers with the right to sue and to obtain payment from a surety when a credit repair organization violates the terms of the statute. The Commission opposes this approach because we have serious reservations about how well it would work in practice. The way that the bond is intended to function is far from clear. In addition, administration of a bonding requirement involves oversight and enforcement responsibilities that are better undertaken by the states than the federal government, in our view.

From the perspective of public law enforcement, the Commission believes that requiring disclosures about the FCRA's limited basis for changing credit reports would protect consumers more simply and effectively. Their right to sue a credit repair organization that engages in deception should also be disclosed. Moreover, although we believe that the proposed private right of action for consumers may aid in enforcing the law, we think that enforcement of the Credit Repair Organizations Act would be enhanced considerably if Congress were to grant the Commission authority to seek civil penalties for violations of its provisions. The ensuing comments discuss these issues in more detail. They also suggest narrowing the definition of a credit repair organization and eliminating one of Section 404's prohibited practices.

Disclosure Requirements: Section 405

The Commission supports the inclusion of effective disclosure requirements in this legislation. Despite educational efforts,

³ Although we are aware of a few large credit repair organizations, a great many others appear to be small and relatively unstable. We have no basis for estimating the number of customers they currently attract or predicting whether their clientele may diminish in the near future as a result of consumer education and unfavorable publicity.

many consumers continue to be unaware of the FCRA's rules governing the reporting of information by credit bureaus. As a result, these consumers are easily misled by credit repair organizations that offer to repair or improve their credit histories. Requiring credit repair organizations to disclose information about the FCRA prior to execution of a sales contract should reduce their ability to misrepresent what the credit repair process is likely to achieve. The Commission believes that the focus of the disclosures required under Section 405(b) of the proposed legislation should be shifted, however. Section 405(b)(1) requires a credit repair organization, prior to the execution of a contract, to disclose to consumers their right to review their own credit files and to dispute the completeness or accuracy of information contained therein. The effect of this section is to bar a credit repair organization that only sells information about consumers' rights to correct information concerning their credit record, credit history, or credit rating from charging a fee for making this information available to consumers.⁴ There is no apparent reason for a prohibition of this sort. Other businesses and professions routinely charge for the disclosure of information about rights and opportunities provided by law; indeed, this is a key component in the provision of many professional services.

Moreover, the disclosures required by Section 405(b)(1) do not address what appears to be the principal cause of injury to consumers in their dealings with credit repair organizations. Injury does not arise because credit repair organizations, for a fee, exercise rights that consumers could exercise themselves at little or no cost. Instead, consumers are injured when they pay money to an organization to do something that neither that organization nor they themselves can accomplish. We think that disclosures explaining instead the limited circumstances under which credit history information must be altered by credit bureaus would provide consumers with an informed basis for evaluating a credit repair organization's claims and that this is their best protection. It may also be worthwhile to require disclosures that consumers may sue a credit repair organization if it engages in deception and that they may rescind any contract within three days of signing it. Finally, we think it would be helpful to identify the Federal Trade Commission as the relevant law enforcement authority, so that consumers with questions will know whom to contact.

⁴ Of course, this concern is less significant to credit repair organizations that also sell services for the purpose of improving a consumer's credit record, credit history, or credit rating.

There are two additional sets of disclosures that Section 405 presently requires. Section 405(b)(2) requires a complete and detailed disclosure of the services to be performed and the total amount to be paid for these services, disclosures which are duplicated in Section 406 governing the content of contracts. We question the utility of requiring a detailed description of services to be performed. Even a minutely detailed description could easily avoid conveying clear and definitive information about what will be done in the case of an individual consumer. Section 405(b)(3) requires disclosure of the consumer's right to proceed against a bond and identifies the surety. Information about the right to proceed against a bond clearly would be significant to consumers if Congress should decide to retain the bond requirement. However, for reasons discussed in the ensuing section, we do not endorse a bond requirement.

We suggest that, to be most effective, any required disclosures be conveyed on a separate sheet of paper, in simple, non-technical language, before the consumer signs a contract or the credit repair organization receives any payment. So as to avoid possible obfuscation, we recommend that credit repair organizations be required to follow language that is identical or substantially similar to model language proposed by Congress.

For example, the required disclosure might begin with a warning not to sign a contract or pay money for credit repair services before reading the notice. It might then state:

1. You have no legal right to have accurate information removed from your credit bureau report. Under the Fair Credit Reporting Act, the credit bureau must remove accurate negative information from your report only if it is over 7 years old. Bankruptcy can be reported for 10 years. Even when a debt has been completely repaid, your report can show that it was paid late if that is accurate.
2. You have the right to sue a credit repair or credit improvement company that violates the Credit Repair Organizations Act. This law prohibits deceptive practices by credit repair companies.
3. The Credit Repair Organizations Act also gives you the right to cancel your contract for any reason within 3 working days from the date you sign it.

4. The Federal Trade Commission enforces these federal laws. For more information, call or write:

Division of Credit Practices
Federal Trade Commission
Washington, D.C. 20580
(202) 326-3225

For enforcement purposes, each disclosure statement should be signed by the consumer as an acknowledgement of having read it before entering into the contract. The consumer's name, address, and telephone number should be included, as should the sales agent's signature and the company's name, address, and telephone number. The statement should be signed in duplicate, so that the consumer may retain one copy and the credit repair organization may retain the other for the two-year period that, we assume, Section 405(c) would require.⁵

We believe that these disclosures would effectively warn consumers against contracting with credit repair organizations whose businesses are based on explicit or implicit misrepresentations of what the law permits. However, these disclosures should not adversely affect the activities of credit improvement counselors who do not rely on consumers' ignorance of the credit reporting laws or otherwise attempt to mislead them.

Bonding Requirements: Section 404(a)

The proposed legislation requires a credit repair organization to obtain a \$50,000 surety bond if it wishes to obtain payment for services in advance of performance. A surety is a third-party guarantor who promises to pay if the principal does not and requires a percentage of the bond amount for providing this assurance.⁶ The percentage is often small because the

⁵ It would facilitate both compliance and enforcement if the evidence that a credit repair organization should retain to demonstrate compliance under Section 405(c) were set forth in greater detail.

⁶ We assume that indemnification of this sort is what the legislation is intended to produce. It is our understanding that surety agreements take many different forms, however, and are designed to achieve many different purposes.

surety retains the right to recover the amount paid from the principal. In order to obtain a bond a company must persuade the surety that it is a good risk. In the case of a credit repair organization, we assume that a surety would want some assurance that the organization's practices will conform to the law and that, as a result, the organization is not likely to be held liable for violating the law. Prior business experiences, business and personal credit history, income, assets, and other indicia of reliability may be factors in determining whether an organization is able to obtain a bond. A business that does not appear to be sufficiently risk-free ordinarily would be required by the surety to put up collateral corresponding to the amount of the bond. Under the proposed legislation, a company that cannot or does not wish to obtain a surety bond is not barred from the credit repair business. Although it would be prohibited from receiving fees prior to performing the services it sold, it could obligate consumers in advance to pay for services upon completion of performance.

The purpose of the proposed bond requirement, we assume, is to make funds available for the payment of consumers' claims. The Commission is concerned that it may not serve this purpose in practice, however. Businesses that are engaged in deliberate consumer fraud may well ignore the bonding requirement. Moreover, the requirement may be too amorphous to achieve its intended purpose. The legislation does not outline in any detail how the bond is to function or who is to administer payments from it. It does not explain what procedures are to be followed in the event of competing claims that exceed the bond amount or whether the bond amount of \$50,000 must be continuously maintained. It is not clear from the statutory language whether an organization that does business in more than one state must provide for a \$50,000 bond in each state or whether, alternatively, a single \$50,000 bond issued by a surety licensed to do business in each of those states would suffice.⁷ It also is unclear whether residents of one state may make claims against a bond issued in another state when the bond funds in their state of residence have been paid out. Nor is it clear whether consumers are intended to name the surety as a defendant in an

⁷ Credit repair organizations vary considerably in operational structure (franchises are becoming more common), size, and business volume. If Congress should decide to include a bond requirement in this legislation, we suggest that it examine ways to link the value and number of bonds required to variables such as these.

action or to seek payment from the surety only if conventional efforts to satisfy a judgment from the credit repair organization have been exhausted.

Insurers who issue surety bonds, such as government performance bonds or indemnity guarantees, may well be reluctant to issue any bond pursuant to this legislation, regardless of the character of the credit repair organization at issue. Sureties ordinarily want to know that their obligations and liabilities are fixed and clear before agreeing to act in this capacity. Under the law as presently drafted, few if any insurers may be willing to act as sureties for credit repair organizations. Even if the bonding requirement and consumers' access to it were spelled out in more detail, however, we are not persuaded that it should be included in federal legislation. The equitable distribution of bond funds may be difficult or impossible without the intervention of a disinterested third party, such as a state administrative agency. On balance, the Commission believes that the bonding of credit repair organizations should be left to the states to legislate and administer.

Enforcement: Sections 409 and 411

Section 409 of the Act provides consumers with the right to sue for a violation of any of its provisions. It provides for actual damages, additional damages, costs of bringing the action, and attorney's fees. By providing consumers with a mechanism for recovering, at a minimum, the fees paid to a violative organization, this right of private action should help to make the statute self-enforcing.

Nonetheless, the Commission believes that enforcement of any credit repair organization legislation Congress might enact would be strengthened considerably if Congress were to grant the Commission civil penalty enforcement authority for violations of its terms.⁸ At present, Section 411 of the proposed legislation

⁸ Congress typically accords the Commission civil penalty authority by authorizing enforcement of statutory violations as if they were violations of a Commission trade regulation rule, i.e., through Section 5(m)(1)(A) of the Federal Trade Commission Act, which empowers the Commission to seek civil penalties. See Section 704(c) of the Equal Credit Opportunity Act, 15 U.S.C. § 1691c; Section 814(a) of the Fair Debt Collection Practices Act, 15 U.S.C. § 1692l.

accords only administrative enforcement authority to the Commission. It provides that a violation of its terms constitutes an unfair or deceptive act or practice in violation of Section 5(a) of the Federal Trade Commission Act and is enforceable through the Commission's administrative adjudication procedures under Section 5(b). The Commission currently possesses Section 5 enforcement authority over credit repair organizations.⁹ Thus, as proposed, the grant of authority to enforce the credit repair statute would not expand the Commission's powers, although the affirmative requirements of the law would simplify enforcement to some extent.

By including civil penalty authority in the Act, Congress would accord the Commission greater flexibility in selecting enforcement alternatives and would also, we believe, promote more vigorous enforcement. Particularly in cases involving deliberate fraud, the power to require a company to disgorge its profits through imposition of a civil fine may be the only way to address adequately the violative conduct.¹⁰ Because civil penalty actions are brought and resolved in federal court, the final order -- whether it involves injunctive relief, a civil fine, or more -- is directly enforceable by the court. The contempt powers available to the court are a potent tool if compliance problems arise.

Precedent exists in the federal consumer credit protection field for establishing a range of enforcement mechanisms. Congress has accorded the Commission the authority to seek civil penalties for violations of the Equal Credit Opportunity Act and the Fair Debt Collection Practices Act under sections providing for administrative enforcement. Other sections of these statutes provide for the imposition of civil liability by authorizing consumers to bring private damage suits. The Commission's enforcement experience with these laws indicates that different enforcement approaches can serve different but often complementary enforcement goals. As a result, we believe that allowing the Commission to seek civil penalties for violations of this Act would assist enforcement efforts.

⁹ The enforcement activity referred to in footnote 1 above was based on that Section 5 authority.

¹⁰ The credit repair business is often a transient one. When a company moves from state to state, the likelihood that individual consumers or local law enforcement authorities will succeed in bringing an action against it is substantially reduced.

Businesses Subject to the Act: Section 403(d)

The definition of a credit repair organization in Section 403(d), like most of the provisions of the proposed legislation, focuses on businesses selling credit repair or credit improvement services, i.e., services to remove adverse information from consumers' credit bureau reports. The definition of a credit repair organization appears to be needlessly broad, however. It includes entities that, for a fee, provide services for the purpose of "obtaining an extension of consumer credit for a consumer. . . ." This definition would include, for example, automated mortgage loan shopping services and other businesses that sell information about currently available terms and conditions of credit. Such businesses can provide an important consumer service in a credit-oriented economy and should not be subjected to regulation in the absence of evidence that they cause consumer injury. We therefore recommend that the definition of a credit repair organization be revised to eliminate reference to those who assist in obtaining credit extensions for consumers. Individual businesses that make false claims about their ability to obtain credit for consumers are, we believe, better dealt with on a case-by-case basis under Section 5 of the Federal Trade Commission Act or similar state consumer protection laws.

We note that the proposed legislation presently exempts a number of institutions and professions from the definition of a credit repair organization. Depository institutions, real estate brokers, and broker-dealers appear to be exempted because, in the ordinary course of business, they may assist consumers in obtaining credit. If Congress adopts the foregoing recommendation to redefine a credit repair organization, these exemptions may be unnecessary. The Commission is not aware that such entities ordinarily sell services to consumers for the purpose of improving their credit bureau reports. We suggest that the exemptions for consumer reporting agencies and debt collectors be eliminated as well. Neither of these entities advises or assists consumers in improving credit bureau reports for a fee.¹¹

¹¹ When credit bureaus remove negative information that is inaccurate or obsolete they may improve consumers' credit reports. Because this is not a service that credit bureaus may charge for but a right granted to consumers by the FCRA, credit bureaus would not fall within the definition of a credit repair organization. Services that credit bureaus are permitted to charge for are described in Section 612 of the FCRA.

Under this approach only two exemptions remain -- nonprofit organizations and attorneys. Nonprofit organizations, such as the consumer credit counseling services operated by the National Foundation for Consumer Credit, sometimes charge a small fee for advising consumers about credit history problems. Attorneys may also advise or assist their clients concerning their credit histories and their rights under the Fair Credit Reporting Act.

In the Commission's view it is preferable to avoid exemptions when possible. Exemptions can create enforcement gaps.¹² They give a competitive advantage to one group or profession over another. Regulations necessarily impose some burdens on business and, if regulation is necessary, the underlying rationale ordinarily should be equally applicable to all industry members. We suggest therefore that Congress consider whether the definition of a credit repair organization should provide for any exemptions. Particularly if the bonding requirement is eliminated, as the Commission has proposed, complying with the affirmative requirements of the Act should not be unduly onerous.

Prohibited Practices: Section 404(b)

Section 404(b) of the proposed legislation prohibits charging fees solely for referring a consumer to a retail seller who will or may make credit available to the consumer on substantially the same terms as those available to the general public. If Congress revises the definition of a credit repair organization to exclude those who refer consumers to creditors for possible credit extension, it may wish to delete this provision as well, as it appears to be directed at practices associated with credit referral rather than with credit repair.

In any event, the Commission questions whether the practice that this section addresses necessarily injures consumers.¹³ If, through the assistance of a credit repair organization, a consumer who cannot otherwise obtain credit is able to do so, the consumer

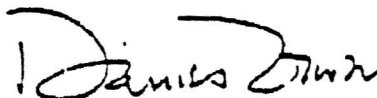
¹² For example, the attorney-at-law exemption to the Fair Debt Collection Practices Act was recently repealed because it had become a haven for attorneys who practiced debt collection rather than law.

¹³ Moreover, if this practice were injurious, the Commission is not certain why the injury would arise only in connection with credit extended by retail sellers as opposed to other categories of creditors.

may well deem this a service worth paying for. The critical issue, in our view, is not whether the credit to be provided is available to others on the same terms or even on more favorable terms, but whether the consumer understands what he or she is paying for. Whether the credit is offered on terms that are desirable to the consumer will depend on the financial circumstances and options available to that consumer.

Thank you again for soliciting the Commission's views on the Credit Repair Organizations Act. We hope that these comments will be useful in your deliberations.

By direction of the Commission,



Daniel Oliver
Chairman