More trouble for debtors

A Namaria Segura, an attorney in New York City, represents low-income consumers who face lawsuits from debt collectors. One man who came to MFY Legal Services, the nonprofit law firm where Segura works, had signed up with a debt-settlement company that said it would reduce his $15,000 credit-card debt to 40 cents on the dollar.

In the first three months, the debt-settlement company pulled $724 from his checking account; it then took in fees most of the next 14 months for a total of $2,017. But the man's debts weren't reduced; worse, two of the creditors sued him for nonpayment. MFY was able to recover $900 of the fees he had paid.

MFY sees some 1,000 clients a year with debt problems. "I've never seen a client benefit from debt settlement," Segura says, "other than the initial peace of mind they experience before everything goes sour."

Waylaid payments

Debt-settlement companies are supposed to arrange for consumers to put aside money each month until there is enough to pay off a portion of their debt, then negotiate with creditors to accept less than the consumer owes. The companies advertise low monthly payments, but the money doesn't go directly to creditors; it goes into an account from which the debt-settlement company takes its fee—typically 14 to 20 percent of the debt, including high setup costs of 2 to 4 percent of the debt. So savings can be drained before there's enough to pay for any settlements. Meanwhile, interest and penalties from unpaid creditors may continue to add up.

Some states have good consumer protections. Eight restrict debt settlement to nonprofit groups; Maine limits fees to $75 up front and then at most 15 percent of any savings from completed settlements. But some trade associations are hoping to expand other states' harmful laws. They want to authorize high fees that don't depend on results, though they also propose licensing or registering debt-settlement companies, disclosures, and a brief cancellation period. In the next two years, dozens of state legislatures will be presented with that "solution."

Consumers Union believes that states should instead aim for true reform, including a ban on collecting fees until settlements reduce the debt. Fees should be limited to a percentage of the amount of the real savings from the initial debt, and states should forbid claims about results.

UNSETTLED Attorney Namaria Segura helps clients who lost money to debt-settlement companies.