Spotlight

DEBTORS' HELL

PART 4: NATIONAL CRISIS, OFFICIAL SILENCE

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Regulators, policy makers seldom intervene

This story was reported by Spotlight team members Michael Rezendes, Beth Healy, Francie Latour, Heather Allen, and editor Walter V. Robinson. It was written by Robinson and Healy.

Last of four parts | August 2, 2006

The debt business, as Donald Friedman, the chief operating officer of debt-buyer Liberty Point Corp., told hundreds of his assembled peers at their March 2005 gathering, is "one of the sexiest, one of the most financially lucrative businesses you can get into."

Boastful? Yes. Overstated? Hardly.

That year, businesses that specialize in debt for collection would purchase $66 billion in delinquent bank credit card accounts alone, paying just pennies on the dollar for the right to press consumers to pay up. That $66 billion represented a golden opportunity for them, and sudden vulnerability for an estimated 8 million card holders - all of them earmarked for repeated phone calls, dunning letters, lawsuits, wage garnishment, property seizure, and sometimes even arrest.

They generally owe the money, but seldom anticipate the consequences. A Spotlight Team investigation, which concludes today, found a system where debt collectors have a lopsided advantage; where debtors frequently face high-handed treatment; and where excessive fees can swiftly turn a small delinquency into a life-upending financial crisis.

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Yet, in spite of all this, there is an eerie silence among regulators, policy makers, and legislators. Those who could intervene to right the balance between collectors and consumers are either unaware of the debt collection free-for-all, and the tens of millions of consumers caught up in it. Or they are simply unwilling to act.

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In Massachusetts, for example, almost 800 complaints about debt collectors flow each year into the office of Attorney General Thomas F. Reilly, whose state website declares that he is "on the front line working for consumers." Yet since Reilly took office in 1999, he has initiated legal action against just one collection agency, a Danvers company that paid a $100,000 fine two years ago.

When Reilly's office announced that settlement with Schreiber & Associates, it called it just the start. "This investigation is part of a larger initiative aimed at protecting consumers from unfair debt collecting practices."

No legal actions have been announced since then, though a spokesman for Reilly said last night that five investigations of debt collectors are underway.

Similarly passive is the Massachusetts Division of Banks, which also has regulatory authority over collectors. The banking regulators do little more than warehouse required annual filings by 410 debt collection companies - haphazardly, as the Globe discovered when it sought access to the division's records.

Meanwhile, the Federal Trade Commission, which is charged with enforcing a federal law that regulates the behavior of debt collectors, has done little in the face of an explosion of consumer outrage. From 1998 to 2005, the number of consumer complaints about debt collectors soared tenfold, from 6,678 to 66,627. Yet, in the last six years, the FTC has taken enforcement action against just 10 companies.

This year, an estimated 20 million Americans are three months or more past due on credit card accounts alone, according to data given to the Globe by Experian, one of three national credit reporting agencies. Yet it appears no one in government is keeping track of this alarming trend, not even the Federal Reserve Board, which in June assured Congress that bank credit card delinquency rates are "not high by historical standards." But omitted from that calculation are the tens of billions of dollars that are "written off" the books by the credit card giants and sold to debt buyers for collection.

Court administrators who are most likely to be aware of the tidal wave of lawsuits against debtors have not, for the most part, raised concerns about credit caseloads that have turned many courtrooms into de facto subsidiaries of the collection business.

Meanwhile, Congress and many state legislatures have acquiesced to the politically powerful banking industry, which issues much of the credit that goes sour. The laws regulating debt collection predate, by a generation, the current boom for debt collectors. Their ranks have doubled in the last decade.

Frustrated regulators say the result is that many of the roughhouse tactics employed by collectors are legal.

When a collector sued her for a credit card debt she said she had settled, Roberta Andresen of Raynham contacted Attorney General Thomas F. Reilly's office. "They said they couldn't do anything for me," Andresen said. (Globe Staff Photo / Michele McDonald)

Jesse Caplan, the chief of Reilly's Consumer Protection and Antitrust Division, said the vast bulk of complaints to his office about debt collectors are "not actionable," but amount to a misunderstanding of what consumer laws protect against. Caplan said his office informs consumers of their rights, and sometimes mediates disputes between consumers and debt collectors.

That would come as a surprise to Roberta Andresen of Raynham.

She felt she had nowhere to turn but the attorney general after a debt collector sued her in 2003 for a credit card debt she says she had long since settled. Reilly's office, she said, seemed uninterested in her complaint:

"They said they couldn't do anything for me, and told me to post a complaint on the Internet," Andresen said.

At the Division of Banks, the authority to audit debt collection firms is infrequently used because the law doesn't require it. "We're not under any statutory requirement to examine debt collectors," David J. Cotney, chief operating officer for the division of banks, said.

And at the Federal Trade Commission, the senior enforcement official acknowledged that the agency has not kept pace with consumer complaints, even though debt collection generates far more complaints than any other activity in the marketplace. "Clearly, the trend is not good, and we're quite concerned about that," said Peggy Twohig, the associate director of the Federal Trade Commission's Division of Financial Practices.

Twohig said her agency is planning to increase its enforcement of federal debt collection laws. Asked about the tenfold increase in complaints, and the tiny number of FTC enforcement actions, Twohig replied, "It's a fair point. The record is what it is."

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Becoming a target

This government inaction has left millions of people feeling they have nowhere to turn, and no one on their side, when debt collectors come calling.

Manuela Cormier is one among the millions. Waiting with 100 other forlorn debtors in a three-hour queue at the New Bedford District Court last Nov. 30, Cormier stood convicted of misfortune: Five years ago, the 45-year-old single mother lost her job, and had no money to make payments on a $1,000 credit card bill. The combination of a 29 percent interest rate, penalty fees, and court-imposed costs have since pushed the bill close to $4,000. Cormier was told she would be jailed if she did not pay.

She agreed to pay $25 a month from her $10.25-an-hour salary as a home health aide - not even enough to cover the $38 monthly interest on the debt. "I'll be paying until the day I die," Cormier lamented.

Hers is the grim face of a growing crisis for America's middle- and working-class families - a crisis that has hardly entered the national conversation.

The 20 million consumers seriously behind on credit card payments were delinquent on some 36 million individual accounts, as of January. And there were an estimated 40 million people three months or more behind on other kinds of accounts, according to Samah Haggag, manager of analytics at Experian. Those include home, car, and student loans, utility and medical bills, and, increasingly, bills from cell phone carriers and health clubs.

People with accounts that far in arrears almost always end up in default and become potential targets for debt collectors.

And they feel like targets. A survey of 1,300 consumers released last December by the National Opinion Research Center at the University of Chicago found that 15.8 percent say they had "been pressured" during the prior 12 months by stores, creditors, and debt collectors to pay past due bills.

"The great American middle class is fighting a battle for survival - and losing," said Elizabeth Warren, a Harvard Law professor who specializes in consumer law. "Millions are in financial free fall, wondering whether every ring of the phone or knock on the door will bring more bad news."

Even leaders in the debt collection industry find it remarkable that the scope of the problem remains largely unseen. Rozanne Andersen, the general counsel for ACA International, the trade association for most debt collectors, says reliable information on the number of consumers in serious debt "is horribly deficient."

Often what follows for debtors in such straits is a date in court. The Spotlight investigation found that between 2000 and 2005, there was one debt collection lawsuit for every five Massachusetts households. Numbers provided to the Globe by debt collectors show that eight of the busiest firms file 90,000 debt collection lawsuits a year in Massachusetts district courts - most of those in small-claims sessions, where consumers are pitted against collection lawyers.


Attorney Martin Odstrchel (left) talks with a man waiting in line with others at New Bedford District Court trying to take care of their debts. (Globe Staff Photo / John Tlumacki)

Even in some affluent counties, court dockets are crowded with debt collection lawsuits.

In Montgomery County, Maryland, where per capita income is among the highest in the nation, the courts are swamped with such cases. In 2005, debt collection firms filed about 21,000 lawsuits, according to Bonnie Bell, the county court's civil clerk. Bell said her court grants debt collectors attachments on wages or bank accounts at the rate of 1,000 a month. To keep the caseload under control, Bell segregates mass filings by debt collectors for hearings in a separate court session, where judges speedily process the claims. They call that session the "rocket docket" - for the way it speeds judgments against debtors.

Thanks to the proliferation of debt collection cases, Bell said wryly, "We'll never be out of a job here."

In next-door Prince Georges County, the courts have been so inundated with suits against debtors that it also channels large volume debt collectors into one special court session. "We handle 600 cases in one court in one day," Kathleen Schnobrich, the civil clerk, said.

To be sure, creditors have the legal right to collect what is due. And consumers generally owe what collectors are after, though they often dispute the exorbitant fees and interest that have been added on. Among the scores of debtors interviewed for this series, all but a handful admitted as much. Often, too, they acknowledged spending beyond their means - out of carelessness, misplaced optimism about how much debt they could carry, or dire need.

But most often, their debts became overwhelming after one of life's unanticipated setbacks: the death of a family member, a divorce, an illness, unanticipated medical bills or the loss of a job. Some debtors paid the rent and heat and ignored the credit card bill. Others used the cards for food and gasoline until their credit was cut off.

"Ninety-nine percent of the debtors I dealt with are good people. They just ran into a spell of bad luck," says Tony Clawson, a Connecticut attorney who pursued credit card collection cases for two years for Lindner & Associates, a debt collection law firm in Needham. "Too many of them got

And the pattern appears to hold nationwide.

In states where records are available, such as Iowa, Michigan, Maryland, Indiana, South Dakota, and Florida, the caseload of debt collection lawsuits is as high or higher. In Allen County, Ind., which includes Fort Wayne, debt collectors filed 20,000 lawsuits in 2004 - one for every six households. In Maryland, judges in the Baltimore City District Court approve an estimated 300 judgments against debtors each day, on the say-so of debt collectors who are almost never asked - in Maryland or any other state - to provide evidence that the debt is owed or that they have the right to collect.

into trouble because they were gullible to offers from credit card companies who give out cards too easily."

Cormier, whose $1,000 debt became a $4,000 millstone, is Exhibit A. Eight years ago, she was a part-time nanny, struggling to support her developmentally disabled daughter with government assistance, and scraping by without a credit card. Then came the enticement from card issuer Discover, which is now owned by Morgan Stanley, the investment banking powerhouse. "I got the [credit card] offer in the mail. It said I was pre-approved," Cormier recalls. "Getting that card was the stupidest thing I ever did."

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Low income, high profits

And Cormier did not get that card by accident. Since the 1990s, credit card vendors have aggressively courted customers among lower-income, higher-risk consumers. It is the industry equivalent of tobacco companies marketing to minors.

In 2005 alone, credit card issuers blanketed the country with 6 billion offers for new credit cards, with most of those aimed at people of modest means and modest credit ratings - people most likely to carry balances at high interest rates that generate enormous profits for banks.

With profits so high, card issuers consider it an acceptable cost of business that about 5 percent of those customers, unable to keep up with minimum payments, will tumble into default.

"The higher-risk customers are actually more profitable, especially if you can get them to pay," said Matthew S. Melius, the former chief of operations at Metris Cos., the former parent company of Direct Merchant Credit Card Bank.

But, speaking at a debt collection conference in Orlando last year, Melius said pushing credit on higher-risk customers can backfire. The granting of credit, he said, is "a drug, if you will. ..... If we give it to them, they're going to use it."

He laid the blame for the practice at the industry's doorstep.

Furthermore, boosting interest rates to 30 percent or more and slapping those who make late payments with hefty penalties is "probably the worst thing you can do to a customer who is struggling," he said.

It is the explosion of credit card availability, combined with the need of companies like Metris to swiftly off-load customers who fall into delinquency, that has fueled the astonishing growth of the debt buying business. Since 1995, bank credit card issuers have sold off $390 billion in past due debt. The annual sales have grown from $4.4 billion in 1995 to $66.4 billion in 2005.

Debt buyers - many of whom also collect debt - work in different ways. The largest purchase huge portfolios of debt written off the books by major credit card companies. They

then break up the debt into smaller blocks for resale. Companies that buy this debt first try to collect the money, then re-sell uncollectible accounts to others further down the collection food chain.

Evidence of the untrammeled nationwide growth of the business is hard to mistake. Recent press releases tout the expanding fortunes of debt collectors across the country: a new 21,000-square-foot facility in Chicago for collectors to make calls demanding payment; 300 new positions in Mobile, Ala.; official congratulations from New York Governor George E. Pataki for the creation of 450 jobs for debt collectors in Batavia, N.Y.

On Wall Street, debt-buying firms have become coveted investment targets. One publicly traded company in Norfolk, Va., Portfolio Recovery Associates Inc., collected $10.9 million from debtors as recently as 1998. Last year, it took in $191.4 million - annual revenue growth of 55 percent. Portfolio Recovery's profits, which were $402,000 in 1998, soared to $36.8 million in 2005.

The firm's results also illustrate how the industry turns pennies into millions.

In its first decade of operation, Portfolio Recovery purchased 658 debt portfolios with a face value of $16.4 billion - at a cost of only $415.4 million. That's about 2.5 cents for each dollar of debt purchased. It collects, on average, 7.5 cents per dollar.

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The extraordinary expansion of the debt sold off for collection is one powerful force behind some of the collection abuses documented in the Spotlight investigation.

As debt is sold and re-sold, companies that buy the right to collect it often know little about the debtor: name, last known address, card issuer and account number, and amount due. That limited picture can cause problems for everyone involved.

Sean McVity, managing partner at Garnet Capital Advisors, a New York investment banking firm that brokers the sale of debt portfolios, said many large banks selling off debt have a "buy-it-as-is" attitude, providing only minimal data when they sell accounts, and charging buyers hefty fees if they come back for more documentation. He called it a "dangerous" practice.

Sparse data makes for major miscues: Outdated addresses mean that many consumers get no notice that they have been sued. And, with increasing frequency, the wrong person is targeted.

Collectors, too, are disadvantaged. Often, they have little evidence to support their claim on a past-due amount.

Michelle A. Weinberg, a legal aid lawyer in Chicago noted that, in Illinois as in Massachusetts, debt collectors have to file an affidavit with their lawsuits attesting to the legitimacy of their claims. "But the affidavits are plainly false," Weinberg said. "If the plaintiff has anything, it is only a computer printout." In every case she has taken, Weinberg said, she has challenged the veracity of the affidavit, and "in every instance, the debt collector has dropped the case."

Federal banking regulators have set no rules for how much data the banks should provide when they sell a customer's debt.

Some states, however, have moved to fill the void. Maine, West Virginia, and Minnesota, for instance, are developing reputations for aggressively regulating debt collection agencies that mistreat consumers.

And judges in a handful of states, including New Jersey, Maryland and Michigan, have found the imbalance between collectors and debtors so troubling that they are looking for change.

In Michigan, the three justices of the Southfield District Court in suburban Detroit, citing widespread abuses by debt buyers, want to update court rules to curb what they describe as "predatory" practices, "particularly for the majority of defendants who are not familiar with the court system and who cannot afford an attorney."

The judges complain about numerous practices, many of which, the Globe found, are also commonplace in Massachusetts courts. In Michigan, the judges wrote:

- The sale and resale of uncollected debts often leads to cases involving outdated addresses, so debtors receive no notification they have been sued.
- Suits are mistakenly filed against the wrong consumers, or against people who have already repaid a debt.
- Debt collectors seldom have evidence of the original debts they are claiming.
- Debt collectors often misrepresent the amount owed by adding unwarranted interest charges.

Even consumers who pay off their debts have no guarantee the matter ends there. In Massachusetts and other states, collectors who win court judgments are required to notify the court when a judgment is paid. But many do not - leaving consumers powerless to erase black marks on their credit reports when they go to buy a car or refinance a home. They are often forced to take on higher interest rates, and with them larger payments and a greater likelihood they will slip back into financial trouble.

Cheryl Cook, a clerk in civil court in Orange County, Calif., said her court spends a lot of time fielding calls from people who are trying to clear up an old judgment that they paid. "It's just crazy," Cook said. "It's an extremely frustrating thing for anybody to go through."

And among those who collect debts, some express growing unease about the way debtors are treated.

One is Richard S. Daniels Jr., a Boston lawyer whose firm has been collecting debts on behalf of clients for nearly 30 years and files about 20,000 small-claims lawsuits a year - more than any other debt collector in the state. And yet Daniels said the current practices of the credit card industry have left a sour taste in his mouth.

"Any system that puts people's backs up against the wall doesn't work," he said in an interview. Daniels described the penalties and fees that credit card companies tack onto consumer bills as "usurious" and "totally unconscionable," making it impossible for people to get out of debt. Such charges, Daniels declared, amount to "classic abuse I wish to hell Congress would do away with."

"This used to be an honorable business," Daniels said, when discussing collections for credit card companies. "Now, the guys on the other side are thieves."

Contact us

The Spotlight Team would like to hear from readers who have first-hand information about debt collection abuses.
The telephone number is (617) 929-3208. Confidential messages can also be left at (617) 929-7483.
E-mail messages can be sent to **debt@globe.com**.