Consumers are being warned to exercise extreme caution in dealing with companies that offer to reduce credit card debts. The warning follows a little-noticed rule announced by the Federal Trade Commission which is likely to put many put of these firms out of business in the next few months, but only after they have collected millions of dollars in fees without providing any service.

"There's 9 million customers in these plans who are going to be hung out to dry basically," says consumer advocate Jordan E. Goodman, author of *Master Your Debt: Slash Your Monthly Payments and Become Debt Free.* "These firms have collected millions of dollars from people and they are going to lose the money; it's just going to be a complete disaster."

Heavy on Ads, Light on Results

Everyone has seen the ads that predominate on the Internet and on late night cable television: We can help you settle your credit card debt for 50 cents on the dollar and you can be debt free in 12 months. Some even invoke President Obama's name and say the administration included the reduction of credit card debt in the 2009 stimulus. But there wasn't any credit card bailout.

By the industry's own accounting, which it made public during hearings on the FTC rule, as few as 30% of consumers ever achieve a settlement of any kind. But they still have to pay thousands of dollars in upfront fees to the debt settlement companies.

In an effort to halt this abuse, the FTC adopted a rule on July 28 that prohibits firms from collecting upfront fees from consumers in debt settlement cases. Instead, they will have to wait until at least a partial settlement is made before collecting their fee. They will also be forced to disclose how long the process will take and the possible negative consequences of using a debt relief service.

But the new rule does not take effect until Oct. 27, and the debt settlement companies are still feverishly advertising their services and may legally continue to collect these fees until the cutoff date.

Goodman says that there is real concern that many firms will simply go bankrupt or close down because their business models depend on getting upfront fees, not waiting three or four years for a settlement.

"These firms can't make it if they are only going to live on success fees and they are going to fold like crazy," Goodman says.

Jenna Keehnen, executive director of the United States Organizations for Bankruptcy Alternatives, a debt settlement trade association, says that 12 of the association's members have already gone out of business in August, two months before the deadline, and "I do expect to lose quite a few more."

Disappearing in a Cloud of Fees

What happens to the consumer when the company goes under? Under the typical contract with debt settlement companies, consumers stop paying their lenders and instead pay into an escrow account for both the fees and the balance on their credit card debt. The escrow accounts are usually at third party institutions, but there is nothing in the current law to prevent a company from closing on Oct. 27 and taking its fees without performing any service.

Andrew Pizor, an attorney with the National Consumer Law Center in Washington, D.C., says that past practice has shown that if there is no settlement, most consumers end up losing their money.

"Most of these firms are not providing much of a valid service and I think they are susceptible to going belly up in the first place," Pizor says "The new rules are forcing companies to either change their models or stop operations so that could cause an increase in that."

Legally, the debt collection firms cannot touch the consumer's money in the escrow accounts except for their fees, but what will happen to those accounts when the firms disappear remains unclear. Goodman says that in the case of Ameridebt, a debt modification firm, tens of thousands of consumers lost their money after the FTC closed the firm down in 2005.

Pizor says the new rule is a major improvement because it prevents a company from taking any fee until they at least partially settle a consumer's debts, which wasn't legally required in the past.

"On the flip side, it's far from perfect because the size of the fee is not tied to the amount saved," Pizor says. "Someone can get the creditor to knock five bucks off the original debt and the debt settlement company can charge you a fortune in fees. Without a definition of settlement or tying the size of the fee to the amount saved there is still room for a lot of abuse."

Many credit experts say consumers would be better off with debt counseling, which helps them restructure their budgets to pay off their debts in full over time without suffering drastic consequences to their credit ratings caused by debt settlement and bankruptcy.

See full article from DailyFinance: http://www.dailyfinance.com/story/consumers-face-huge-losses-with-debt-settlement-firms/19613606/?icid=main%7Cmain%7Cdl4%7Csec1_lnk3%7C167577&icid=sphere_copyright