

# The American way of debt: Turning a profit by preying on the poor

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The increasingly desperate financial crisis facing large sections of the American working class has been writ large in statistics. In September, 15.1 million people were unemployed, with over 5.4 million out of work for six months or more. Counting discouraged and involuntary part-time workers, the unemployment figure in America is now 17 percent, while those still holding a job are down to an average of 33 hours a week, a record low.

Millions in the US are facing impossible levels of personal debt, rising credit card delinquencies, utility shutoffs, foreclosures and homelessness.

But a section of business has turned the growth of poverty into a gold mine. Standing behind the big banks are several layers of an increasingly complex and parasitic finance industry. In the middle of this food chain are the professional debt buyers and securitized investors. At the bottom are the collection agencies, the scavengers who relentlessly pursue individual workers.

Revolving household debt has soared since 2006. Once those falling behind the cost of living could no longer tap into home equity, they turned to credit cards, a much more expensive form of credit. Revolving debt is now estimated to be over \$970 billion, with average credit card indebtedness per household now \$10,678, up 30 percent from 2000, according to CardWeb.com, a research firm.

*US News and World Report* puts average total household consumer debt at \$22,231, not including other debt, such as student loans, which adds another \$10,208, according to a May 2009 report. This debt load has provided fodder for the explosive growth of collection agencies.

Collection agency profits have grown between four and six times over the past several years, according to Securities and Exchange Commission (SEC) statistics. All indications are that tactics have become increasingly aggressive, and sometimes criminal.

One story behind these statistics was related last year on *Credit and Collection World's* Web site. This industry source states, "Emilio Saladiages, 62, of Newark, New Jersey, asked to speak to a manager at Rent A Center about the incessant collection letters and calls he had been receiving regarding missed payments on furniture rentals.

"When no one would speak with him, he doused himself with lighter fluid and lit the fluid with a cigarette lighter, self-immolating in front of customers and employees of the store," the Web site reported.

*Credit and Collection World* went on to state that Rent A Center, ubiquitous in poor neighborhoods, is notorious for its collection tactics. The state of California reached a \$7.75 million settlement with the company for violations of the Fair Debt Collection Act.

While this is a particularly horrendous example, the size and scope as well as the brutality of the collection business has dramatically expanded. This business (known by the acronym ARM, for accounts receivable management) has grown nationally from 47,000 agencies to over 430,000 in the last 10 years, and is expected to swell an additional 23 percent by 2016. The Labor Department's Bureau of Labor Statistics puts this industry's growth rate at the number one position.

Much of this business borders on illegality, employing a policy of deliberate harassment and abuse. As an industry, it has long garnered the most business practice complaints by the Federal Trade Commission (FTC), but the past few years have seen violations skyrocket. "We're sitting on the largest volume of complaints for any single industry—at more than 100,000 a year," said Peggy Twohig, associate director of the financial practices division at the FTC.

There is a vast edifice of debt in place in American finance. Every form of debt is securitized, sliced and diced in the now-notorious manner of subprime mortgages. The banks have created these subsidiary industries and are dependent upon them. Not only have they spun off securities in the accounts receivable industry we examine here, but they trade in virtually every kind of debt: motorcycle loans, recreational vehicle loans, franchise loans, boat loans, non-performing loans, equipment leases, home equity loans, trade receivables and student loans. These are all sources of speculative profit.

At bottom, all of this debt represents a claim on surplus value extracted from the labor of the working class. The working class must be made to pay—hence the abhorrent policies and tactics of the debt collection industry. These abuses are not excesses of a few cowboy entities, but reflect the parasitic character of capitalism and the specific requirements of the banking industry.

## The ARM industry

What is this business and how did it develop? Of course, debt collection has a long and notorious history, judged by its "pound of flesh" literary association. A hundred years ago, the *Chicago Tribune* ran a headline that still sounds topical: "New Evidence of Extortion and Lawlessness by Many Collection Offices. Will Go to Grand Jury."

But the ARM industry has evolved in recent years. Until the 1990s, credit card firms and other creditors rarely sold off unpaid debt. Instead, they hired third-party firms or lawyers to collect the bills, usually on a commission basis. This changed with the elephantine growth of credit card debt.

The first general-purpose credit card was issued in 1958 by the Bank of America. With it, the revolving credit line was born (as opposed to the installment payment plan). The credit card business was not immediately profitable, however, because of the restrictions imposed by states.

## Enter the Supreme Court

State laws against usury prohibited banks from charging more than nominal interest until a 1978 Supreme Court ruling. The Marquette Bank opinion permitted national banks to extend interest rates on consumer loans from the state where credit decisions were made to apply to borrowers nationwide.

That decision allowed the banks issuing cards to circumvent state laws. All they needed was one state where rates were unregulated. In an arrangement to purportedly bring jobs to the state, South Dakota's state government allowed Citibank to draft the necessary legislation and, with bipartisan support, the bill was introduced and passed into law in one day.

Usury law was eliminated in South Dakota and Citibank's credit card division moved in. The previously unheard-of interest rate of 18 percent was established for all of Citibank's customers, and the credit card industry as a whole entered a decade of enormous profits.

The percentage of US families using revolving consumer credit increased from 16 percent in 1977 to 37 percent in 1995, in tandem with the stagnation of wages and a dramatic rise of social inequality. Large swathes of American society attempted to offset the rising cost of living by borrowing.

In 1996, the Supreme Court made another decision that significantly increased profits for the credit card companies, allowing penalty fees, calculated at even higher rates, to be tacked on to consumers' bills. Penalties would account for \$18.1 billion in revenues in 2007. As inflation continued to mount and incomes to fall, the amount of credit card debt carried by Americans grew to \$937 billion by 2008.

But it was not just the tremendous growth of credit card debt and usurious fees alone that created the debt-buying industry. It was the government's bailout of the savings and loan industry in the early 1990s, under the elder George Bush, that created the impetus for the emergence of the industry.

Purchasing \$125 billion in worthless S&L securities, the administration bailed out the wealthy speculators, then empowered the Resolution Trust Corporation, an agency of the Federal Deposit Insurance Corporation (FDIC), to sell large portfolios of the S&Ls' delinquent credit card debt. These were purchased by new entities, which were to become the largest publicly traded ARM firms.

## Securitization of credit card debt

In 1986, Bank One helped pioneer credit card securitization, packaging \$50 million in debt and issuing securities linked to them. Because securitization pools the assets (the debt) and sells fractions of interests in the pool to investors, it reduces immediate risk to individual investors and promotes riskier lending models. Other banks followed, selling card-backed securities to hedge funds, pension funds and other investors. Outstanding card debt securitized by the major banks and credit card companies hit \$400 billion in 2007.

As in the subprime mortgage industry, securitization was a financial boon to the banks at the direct expense of the working class. As securitization boomed in the 2000s, banks sent out card offers to households with incomes below \$50,000, a relatively new market. *USA Today* reported on October 6 that this initiative, which peaked in 2001 at a record 2.1 billion offers, became a source of dramatically increased revenue.

According to a 2006 study cited by *USA Today*, those with incomes below \$25,000 are twice as likely to pay interest rates of more than 20 percent than those earning \$50,000, and five times more likely to pay such rates than those making over \$100,000. Those who pay late or exceed their credit limit, even once, can be hit with rates up to 32 percent.

Securitization was a mechanism to drive up debt and dramatically increase profits, by collecting from the poorest layers.

The banks had to find a way to pressure workers into payment. In 1993, only \$1.3 billion in debt was sold to third-party collectors, but this would skyrocket to \$110 billion by 2005, with most of the debt from credit cards. The market capitalization of publicly traded ARM stocks more than tripled, from \$878 million in January 2000 to \$3.1 billion in May 2006.

Unlike mortgage debt, revolving debt did not result in losing one's home. Aside from a punitive use of credit scoring and escalating fees, the banks had no direct way to pressure customers. After initial collection, the remaining debt would be "charged off" and sold. Collection hardball had to be outsourced.

Debt buyers typically pay between 3 percent and 16 percent of the face value of the debt, and then own the entire amount actually collected. Most debt sold is credit card debt, but this field has now expanded to telephone debt, water bills, car loans and the fastest growing field—medical debt. The big players buy million-dollar portfolios from banks, utility companies, auto financiers, hospitals and municipalities.

## Debt buyers

Most debt buyers will work an account for a set period, then resell the remaining uncollected assets to another debt buyer. The next buyer will similarly attempt the collection for a certain time frame, and then resell again. This cycle continues until the legal statute of limitations for collections is reached. (This varies by state from 2 to 10 years).

This aptly named "zombie debt" became an industry in itself during the 1990s, *Forbes* magazine explained in an October 2008 feature article. As credit card companies targeted those sections of the working class who couldn't pay off their balances, a ballooning volume of debt was created. This debt was laundered among collection agencies for dwindling pennies on the dollar, depending on its age.

According a May, 2009, report in the *Baltimore Sun*, sums targeted for collection can often be based on entirely bogus debts. The newspaper described an identity theft victim who was contacted repeatedly by a series of debt collectors about a \$5,045 bill that was not hers. Even after she sued and won a \$40,000 settlement, the debt was sold again and she had to begin the battle anew.

As one of the industry's leading debt-buyers, Unifund, put it, "[we] popularized the concept that long-delinquent distressed debt is regenerative."

As household debt hit stratospheric levels, the US Congress made another major government policy decision at the behest of the credit card industry. In 2005, Congress revised the bankruptcy law, making it much harder for households to escape the grasp of bill collectors. The new law made most people ineligible for debt relief and instead forced them into 3-5 year repayment plans on auto, credit card, medical and other bills that previously were discharged in the bankruptcy process. Additionally, it drove up the cost of bankruptcy from \$800 on average to between \$1,400 and \$2,400.

## The mechanics of collection

The collection process itself is highly automated, utilizing, in the industry lingo, "appropriate diagnostics and analytics." Forecasting

models are used, scoring individuals based on zip codes, credit agency information and as much investigative fact-finding as possible.

Having been deemed a good mark, the individual is uploaded in the computer for predictive dialing. Literally billions of collection calls are made through computer-generated phone banks. At the collection agency level, each collector is auto-generated a series of non-stop calls based on when the computer predicts he or she has completed the last call.

If a debtor is not reached on the first attempt, the agency will begin the skip tracing process. One agency advertises its expertise as follows: "First thing we should do is 'Categorize the Skip.'... An Intentional Skip [is not likely to leave] behind the typical 'trails' that skip tracers look for. Many Intentional Skips are aware of what is necessary, what they must do, to avoid being found...but usually are not willing to make an entire identity change and will frequently leave a trail that can be followed.

"If the person is an Intentional Skip, and they know how to hide, you just have to hope that person 'slips up' somewhere. It gets difficult if the person [is] aware of how to avoid paper trails, they do not stay in touch with old friends, family and relatives, they work under the table for cash only, they change their occupations frequently, they dropped all their old hobbies, they took on a new look, and they adopted new behavior patterns."

The site goes on to elaborate the policy of searching every source of data: hunting and fishing license applications, divorce records, workmen's compensation data, amateur radio records, etc. It gives a sense of the ruthlessness with which the unfortunate debtor is pursued.

For the younger generation, collection agencies are now creating Facebook accounts, a technique called "facebait." Once they have been "friended," the collectors identify themselves to all the debtor's friends as a debt collector in an attempt to embarrass and harass the victim.

### **The fraud of debt settlement**

Another relatively new player in the collection field is the "debt settlement" specialist. This scam is, if possible, even more parasitic and vicious. The service is widely sold to the most desperate individuals. Marketing themselves as customer advocates who will sympathetically assist the debtor and negotiate his liabilities down, these firms are profit-making entities that take charge of a family's entire finances.

With "debt settlement," the payments go to the settlement firm, not to the client's debt—a point often not mentioned to clients. Usually there is an up-front premium.

Monthly payments are sent to the firm to be aggregated until a sufficient amount can be used to negotiate a payoff. Meanwhile, a worker's credit score will continue to deteriorate. The firms count on the fact that most people drop out before the payoff. Even should he successfully complete the program, the individual is liable for taxes on the reduction! Victims of these schemes have few ways to retrieve their money.

In many states, once a creditor obtains a judgment, it can immediately restrain a bank account. As a result, workers are unable to pay rent, utilities or other expenses. Such policies are deliberately used to bully people into turning over large sums of money. A common complaint of consumers is that, having authorized a debt collector to make a single, specific withdrawal from their bank account, they find that all the funds are withdrawn or multiple withdrawals are made.

Accounts Receivable Management is an industry that was reinvented and became a major economic player as the American working class sank under a growing burden of debt in recent decades. It was established under the protection of the Supreme Court and shielded by links with government officials. Today, despite the systematic and well known

nature of abuse, it remains well protected politically and highly profitable, poised to take full advantage of the growing misery of millions of Americans.

### **Case histories**

The following reports and personal stories are gleaned from the legal record and ARM industry news reports. They paint a picture of the brutality with which the poorest sections of the population are being victimized. Not only are workers who are behind in their payments abused, harassed and fleeced, once they have fallen into substantial debt they are burdened with exorbitant fees and penalties that make it virtually impossible to get out of debt. The elderly, college students, the unemployed and even the dead are special targets.

\* Last week, New York Attorney General Andrew Cuomo announced charges of grand larceny against 12 debt collectors in Buffalo. A chain of companies, owned by Tobias Boyland, had employees pose as police and threaten consumers with jail time unless they paid alleged debts on the spot.

Cuomo charged the companies with stealing "tens of thousands" of dollars by terrifying those unfortunate individuals who picked up the phone. Frightened at the prospect of arrest and humiliation, consumers authorized withdrawals from their checking accounts, wired money or sent money orders to the collection companies.

The Buffalo area, once a center of steel production that has been decimated by plant closures, has become a major debt collection center, with 120 firms employing more than 5,200 people.

\* In September, Ohio Attorney General Richard Cordray described to the *Akron Beacon Journal* instances in which debt collectors called elderly people, "telling them they are worthless and they should get a job and that they have committed a crime and will be arrested." He has filed a lawsuit against National Enterprise Systems, Inc., of Solon, Ohio, on their behalf.

\* New York City Councilman Dan Garodnick said, "We've even heard of cases where debt collectors would threaten to have residents deported," according to a report in the *Village Voice* from last March.

\* Earlier this month, Internet payday lender Cash Today, Ltd, and its network of companies settled with the state of Nevada for \$1 million in damages for unlawful debt collection. Consumers had been led to believe that a one-paycheck loan would cost between \$35 and \$80. However, if a payment was missed, the company would call them at home and at work, threatening them with arrest or imprisonment, cursing and informing co-workers, all violations of the Fair Debt Collection Law.

\* The State of Maryland announced this week that it was issuing a cease-and-desist order against one of the largest debt buyers in the country, Encore Capital, and its subsidiaries. The company faces penalty and restitution demands of more than \$40 million. Encore had made the news in March after awarding its top executives nearly \$1 million in bonuses. The company had reported a 25 percent increase in earnings for 2008 by shifting to credit card debt.

\* In August, California secured a judgment against CashCall, Inc., for infractions including: causing borrowers to incur bank fees by repeatedly presenting checks despite knowing that there were insufficient funds in the account; making excessive and verbally abusive telephone calls at all hours of the day and night; threatening law enforcement proceedings without any basis to do so; charging 139 percent annual interest on loans without disclosing it; improperly discussing private financial information with borrowers' friends, colleagues and neighbors, etc.

\* The Washington State attorney general's office is suing Topco

Financial Services for calling debtors names such as “loser,” “scum,” “blight on society,” “lowlife,” and “terrible parents,” and threatening to “bitch-slap” a debtor. When one debtor said she was undergoing tests for cancer, a Topco representative, according to the suit, replied, “Aren’t you dead yet? I’m going to collect the money from you dead or alive,” and, “Why don’t you just die from cancer because you are a low-life deadbeat?”

The abusive and illegal policies are not just limited to smaller “cowboy” firms. One target of an FTC investigation was Capital Acquisitions and Management Corp. (CAMCO), an industry leader with a \$1.75 billion portfolio of consumer debt.

The FTC received over 2,000 formal complaints against the company. CAMCO harassed thousands of customers to pay old, unenforceable debts or even debts they didn’t owe. It sometimes tried to find people with the same name in the same geographic area and collect the debt from them.

Even if the consumer was not the actual debtor, CAMCO threatened jail, seizure of property or garnishment of wages, the FTC said. CAMCO collected millions every year “and perhaps as much as 80 percent of the money” came from consumers who never owed the original debt, the state government reported in its complaint. When it was closed down, CAMCO auctioned off its receivables to another debt buyer.

In March the *New York Times* reported, “Dead people are the newest frontier in debt collecting and one of the healthiest parts of the industry.” The newspaper explained that since probate records are public, they enable the eagled-eyed debt collector to file a claim. Firms such as DCM Services specialize in “emphatic active listening” when calling the bereaved regarding the deceased’s debt. Playing on the family member’s sense of morality, DCM will ask if anyone in the family is in a position to pay the debt, despite the fact that survivors generally have no legal obligation to do so.

*Inside ARM*, an industry Web site, gives additional details on a recent case, the basis of one of the largest collection awards documented. A California jury awarded Manuel and Luz Fausto \$500,000 in damages over harassment by Credigy Services Corporation. The couple had opened a Wells Fargo credit card in 1992 and made regular payments on the card, but the balance kept increasing. They requested the account be frozen, but a local Wells Fargo branch declined their request.

The Faustos received help in paying the balance from a local business that promised to negotiate a discounted payoff. The couple then thought that two money orders, which they issued in the late 1990s, had paid off the entire debt.

But in 2006, Credigy contacted them demanding almost \$17,000. A Brazilian affiliate of the collection agency made over 90 threatening calls and sent numerous letters to their home, even after a cease-and-desist notice was sent to the company. Only after Luz Fausto recorded the last phone call made by the collectors that threatened the Faustos’ livelihood, and the couple filed suit, did Credigy stop calling.



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