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The Pitch: Debt Relief. The Reality: Borrowers May Pay More.

14–18 minutes

Rick Cibelli, earning minimum wage and with $10,000 in student-loan debt, signed up with a debt-relief company. After learning that the federal loan-forgiveness program it pitched does not exist, he managed to get the upfront fee back, a step that puts him among the more fortunate clients of the growing businesses. Kristen Schmid for The Chronicle

When Rick Cibelli heard a radio ad last year promising to slash his student-loan payment, he called right away. As a caregiver in a group home for developmentally disabled adults, he was making minimum wage and struggling to repay the $10,000 he'd borrowed for a paralegal certificate more than a decade earlier.

When he called the toll-free number, the sales rep said the company, First American Tax Defense, was a contractor for the Education Department. He said that he could enroll Mr. Cibelli in the "Obama Forgiveness Program" and cut his monthly payment in half, but that Mr. Cibelli would have to pay $700 upfront.

Though somewhat suspicious, Mr. Cibelli signed up, and the company immediately charged $175 to his credit card. Later that day, he called the Department of Education to verify that the company was working on its behalf. The government representative said no and informed him that there was no federal "Obama Forgiveness Program."

The next day, Mr. Cibelli tried to cancel the contract but was told he couldn't. Furious, he filed complaints with federal regulators, the Better Business Bureau, and the Illinois attorney general. Eventually he persuaded his credit-card company to overturn the charge.

Mr. Cibelli's experience is not unusual. As more borrowers struggle to repay their student-loan debt, a growing number are turning to "debt relief" firms for help. The companies, which advertise heavily on the Internet, radio, and TV, promise to cut borrowers' monthly payments, stop wage garnishments, and secure loan forgiveness. Some even claim they can clear up customers' bad credit.

In reality most of the companies specialize in consolidation, filling out federal forms for borrowers and charging hundreds, sometimes thousands, of dollars for the service.

Richard Neapolitan, who worked for a debt-relief firm for three months this year, says he and other sales reps would not mention the downsides of consolidation, including the fact that a longer repayment term can mean higher costs over time. He said he was trained to quote payments based on a borrower's current income but wouldn't tell callers that their payments would increase if their salaries did.

"The people they are ripping off are the poor or middle class," he says.

Last month Illinois's attorney general, Lisa Madigan, sued First American Tax Defense LLC, accusing it of violating consumer-protection laws. According to the complaint, the company duped struggling borrowers into paying as much as $1,200 for help in applying for free federal repayment plans.

That lawsuit, and another filed by Ms. Madigan against Broadsword Student Advantage LLC, are the first state actions against the growing debt-relief industry for student borrowers. The cases could serve as precedents for lawsuits by other states.

Already this year, a watchdog group established by New York's governor, Andrew M. Cuomo, has sent subpoenas to 13 such companies as part of an investigation into misleading advertising and improper fees. Attorneys general in Arkansas and Minnesota have issued warnings about such businesses.

First American Tax Defense could not be reached for comment. None of the telephone numbers listed for the company were working and its website was down. Broadsword representatives did not respond to telephone and online requests for comment.

No official statistics are kept on the industry, but clearly the firms are multiplying. Many of the new companies have roots in the troubled mortgage- and credit-card-relief sectors, including

Broadsword, which was founded by the head of a company that operates call centers for debt-relief firms.

Deanne Loonin, a lawyer with the National Consumer Law Center who has investigated the companies, says they have “shifted from one scam to another.”

“They are moving into this space because they see it as a growth opportunity,” she says.

Misleading Claims

With student debt topping $1-trillion and default rates at their highest level in two decades, debt relief has become a big business. Google “Obama student loan relief” and you’ll get lots of ads for companies pitching help with student loans. Some have names that sound much like the names of federal systems and programs, such as Direct Student Aid (think direct student loans), and National Direct Student Loan Solutions, whose initialism, NDSLS, is an anagram of NSLDS, the federal database where students can review their aid. Many have logos with images of government buildings or American flags. Some show trees, resembling the U.S. Department of Education’s logo.

The companies pitch themselves as experts in the “complex” world of student-loan consolidation, with years of experience helping borrowers navigate the “bureaucracy” and “red tape” of federal repayment programs. Many imply a federal affiliation or endorsement, saying they “work closely” or “hand in hand” with the Department of Education.

But few disclose their fees, and most fail to mention that borrowers can fill out the three-page federal loan-consolidation form on their own, free of charge.

Figuring out who is behind the similar-sounding sites isn't easy. Most give just a 1-888 phone number, with no information about the owners or employees; some are simply lead generators for anonymous companies. Some don't register with the states where they are based. Some hide even their web-domain ownership, says Steve Rhode, who tracks the firms for his blog, getoutofdebt.org.

Mr. Rhode, who calls himself the "Get Out of Debt Guy," says the companies change their names and phone numbers frequently to make it harder for customers to cancel their contracts.

The Chronicle reviewed dozens of debt-relief websites and found that many promised significant payment reductions, 60 percent or more. Most also advertised loan forgiveness.

What they often failed to mention was that the size of payments depends on borrowers' income, and that not everyone qualifies for a payment reduction, much less loan forgiveness. And they rarely acknowledged the drawbacks of consolidation or the fact that loan rehabilitation may be a better option for some borrowers in default.

Many of the companies played up the complexity of the federal repayment programs and exaggerated their own expertise. One firm, Action Administrative Services LLC, offered to "complete in a few days what may take you a week of Internet researching, calls to your commonly unhelpful and unresponsive lender, and paperwork." Student Loan Relief Inc. claimed to have combed through 233 state and federal bills and identified more than 300 programs which, "properly applied," could lower its clients' payments.

"We serve those who do not wish to spend thousands of hours researching previous federal and state congressional bills," its website stated. "We believe your time would be better spent pursuing the things you value most in life."

The company went so far as to rename government programs for itself. "Public Service Loan Forgiveness" became "Student Loan Relief Angel Plan," and income-based repayment became "Student Loan Relief Rescue Plan."

In fact, a majority of the companies entered the student-loan market only recently, and their "experts" are typically commissioned sales agents, consumer advocates say.

Several sites contained outdated or inaccurate information about federal repayment programs or referred vaguely to "Obama bailout programs" or "Obama Loan Forgiveness."

The website of Krasker Law, which recently added a student-loan division, credited the Department of Education with "finally" making loan repayment affordable by "passing new laws, including the William D. Ford Act," that it said allowed borrowers to consolidate and pay what they could afford. Never mind that the department doesn't pass laws—Congress does—or that there is no Ford Act, only the William D. Ford Federal Direct Loan Program, which was created in the early 1990s, along with the first income-based repayment plan. The government has been consolidating student loans since the 1980s.

Other companies promoted themselves as honest brokers, disclaiming any relationship with the Department of Education and even acknowledging that federal programs can be accessed free. Student Loan Relief Organization claimed to be "unique" among "student loan institutions," with "deep, abiding human values." Student Consulting Group Inc. pledged "fast, honest solutions," and "No Games, No Gimmicks, Just Results."

"Don't be fooled by the others," warned Student Remedy. "We face it together."

Only one company reviewed by *The Chronicle,* Campus Debt Solutions, named its employees online, posting them under the link "Real People … No, Really." What the company—like most of its competitors—didn't post was its fees.

Feds Take Notice

For borrowers who sign on with a debt-relief company, the fees range from a few hundred dollars upfront to thousands of dollars over the repayment term. Some companies charge monthly "maintenance fees," although it's unclear what those fees cover.

In a report released last year, the National Consumer Law Center documented initial fees as high as $1,600 and monthly maintenance fees of up to $50. The center's investigation, which relied on secret-shopper calls and a review of websites and contracts, concluded that the companies were "routinely violating" consumer-protection laws but that "this issue has not hit the federal or state regulatory radar yet."

The report got the attention of Democrats in Congress, including Sen. Tom Harkin of Iowa, chairman of the Senate's education committee. He called on federal regulators to investigate the industry.

"Existing laws should be enforced, and new rules should be considered," Mr. Harkin wrote. "We owe it to student-loan borrowers—and to taxpayers—to ensure that unscrupulous businesses are not taking advantage of the student-loan-debt crisis."

Department of Education officials say that they don't have the authority to take action against debt-relief firms, and that they forward complaints involving the companies to the Federal Trade Commission and the Consumer Financial Protection Bureau.

Those two agencies have taken steps against several debt-relief companies in recent years, but none of those actions have involved student loans.

Last year the financial-protection bureau issued a "consumer advisory" reminding borrowers that "you don't have to pay someone to help with your student loan."

Rohit Chopra, the bureau's student-loan ombudsman, says the agency received complaints about the companies' marketing tactics and lack of transparency.

Some of the complaints "remind us of the worst practices that emerged in the wake of the meltdown of the mortgage market," when dozens of companies cropped up, promising relief to struggling homeowners, Mr. Chopra says. "Too often, this cottage industry was offering high fees with borrowers not getting much in return."

Now, with the housing market rebounding, the debt-relief industry's focus has shifted to the student-loan sector, where an estimated seven million borrowers are in default, according to the bureau. The spinoff companies are concentrated in South Florida and California, the states with the highest number of foreclosures since the start of the housing crisis, in 2007, according to RealtyTrac, which compiles real-estate data.

What's "particularly troubling" this time around, Mr. Chopra said, is that the programs being offered are actually free and widely available, with standard terms. Unlike in the credit-card and mortgage industries, he explained, the businesses pitching student-loan relief cannot negotiate better deals for borrowers of federal loans.

Mr. Chopra and Senator Harkin blame student-loan servicers for fueling the industry's growth, saying the servicers are failing to educate borrowers about affordable repayment options before they fall behind on their loans.

In June, Mr. Harkin introduced legislation to reauthorize the Higher Education Act that would require the loan servicers to take "reasonable steps" to keep borrowers out of default. It would also automatically enroll severely delinquent borrowers in income-based repayment plans, shrinking the market for debt-relief companies.

Meanwhile, an industry effort at self-regulation has apparently fizzled. Last year, in the wake of Ms. Loonin's damning report for the National Consumer Law Center, a group of key players in the debt-relief industry formed a trade association and drafted a code of ethics for its members. It sought advice from Ms. Loonin and Mr. Rhode, the student-loan blogger.

On its website, the Association for Student Loan Relief describes itself as "the leading association of professionals associated with the sole purpose of assisting Americans burdened with student loan debt," formed as a resource for debt-relief firms and "individuals needing assistance and wanting to know they are dealing with a reputable company."

But now, less than a year after the association held its first conference, in Las Vegas, it has stopped accepting new members. Robby H. Birnbaum, a Florida lawyer who represents some of the firms and was one of the group's founders, says only that it now operates as an "education provider."

In July, that group and the International Association of Professional Debt Arbitrators issued a news release announcing a training and certification program for employees of student-loan debt-relief firms. To graduate, participants will have to pass a multiple-choice exam demonstrating an understanding of "all available federal consolidation options," says Laurence Larose, executive director of the association, in an email. The cost is $149.

"Student-loan debtors deserve to work with consolidation professionals who totally understand all the student-loan-relief options available and who can effectively guide them to the best program for their unique situation," the news release said. "Our certification training will ensure their total competence."

Meanwhile, Mr. Cibelli, the long-indebted borrower, has enrolled in the federal government's Public Service Loan Forgiveness plan—on his own. If he stays in a public-service job until 2020, his remaining debt will be forgiven.