From: Robert Zangrilli
Sent: Monday, April 26, 2010 10:49 AM
To: Brill, Julie
Subject: Debt Settlement Rule

Hi Commissioner Brill,

My name is Robert Zangrilli. I am the CEO and founder of Franklin Debt Relief, LLC. I am a Dartmouth College graduate with a BA in History, and I started the company in 2006. So far we've had more than a thousand clients, and we handle the entire customer service and negotiations process for our clients. Since our inception we've had one BBB complaint and none in over a year.

I wanted to forward you a research paper I wrote on the debt settlement industry. The purpose of it is to answer the questions – are consumers benefiting from debt settlement, and what will happen to consumers if there is an advance fee ban?

I understand the position the FTC is in, but I also think it's pretty clear that such a drastic move would cause significant collateral damage when there are other means of achieving consumer protection. My main suggestion is to allow companies who help more than 50% of their clients to become debt free to charge advance fees. My concern is an advance fee ban will cause the quality of services being offered to deteriorate significantly or the number of consumers who are allowed to benefit from debt settlement services will be unnecessarily limited. Another concern is that credit card companies and collection agencies will effectively blockade our industry if they know companies can only charge fees on a contingency basis. That is, by refusing any settlements we offer, banks and collection agencies will be able to cut off our revenue and eliminate our entire industry in a matter of months.

By allowing companies who help more than 50% of their clients to charge advance fees, we solve all of these problems while punishing bad companies and preventing them from selling services that will knowingly fail. This is just one of many ideas I have to resolve the challenges facing the debt settlement industry. Please let me know if you or any FTC staff members would like to discuss anything with me.

Also, I am sorry if this was invasive to email you directly, but I have no other means of communicating with your agency.

Regards,

Robert Zangrilli
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Common Sense

A Report on Debt Settlement

By

Robert Zangrilli

Introduction

Key Findings

-Any fair measurement of the total consumer benefit produced by settlement plans exceeds the costs of these plans to consumers, including the aggregate consumer savings of debt settlement exceeds the fees paid by consumers for these service. In fact, it is likely even just consumers who complete their plans save far more than what all consumers who enroll in debt settlement plans pay in non-refundable fees. Using statistics provided by the National Foundation for Credit Counseling (NFCC), a hypothetical analysis of whether this is the case for Debt Management Plans (DMPs) shows that in all likelihood the aggregate consumer cost exceeds the benefit produced by DMPs.

-By comparing debt settlement programs to other debt relief options such as credit counseling and Chapter 13 bankruptcy, and other endeavors undertaken over an extended period of time such as college and high school graduation, one must conclude that in all likelihood debt settlement is exceeding any reasonable expectations for completion rates given the financial and socio-economic situation of their clients.

-An analysis of what creditors recover in debt settlement relative to bankruptcy shows that settlement companies help banks recover by our estimates three times the unsecured debts they would if a consumer were to file bankruptcy. However, an analysis of what creditors would recover if debt settlement did not exist shows that due to high interest minimum payments, it is still in the interests of credit card companies for the industry to be eliminated, which partly explains why they are outspoken against debt settlement companies.

-Consumers are benefiting by using a third party professional to settle their debts, as evidenced by the fact that in all likelihood additional savings are being procured by settlement companies to offset the fee, more consumers are completing plans managed by third-parties than those who do it on their own, and consumers are being saved the time and perhaps more importantly to them, the stress, of dealing with creditors and collectors.

-Assuming they are properly disclosed, the drawbacks of debt settlement as a solution fall under the category of either widely exaggerated or irrelevant to consumers who are paying high interest on credit card debt, are on the verge of filing bankruptcy, and are seeking an alternative. When these drawbacks are disclosed, consumers who are unfit for debt settlement typically choose other options.

-On a macro-level, debt settlement is an important player in the “debt relief ecosystem” in that it supports a specific niche of consumers and helps to reinforce other debt relief solutions such as DMPs and 60-60 plans by exerting pressure on banks to be competitive in the concessions they offer to consumers who request it. Eliminating the industry will also have the effect of harming many consumers who would otherwise administer their own debt settlement plans.

-The total fees received by debt settlement companies are justified as evidenced by the fact that a) they are largely in line with those received by other debt relief alternatives, such as Chapter 13 bankruptcy

and credit counseling, despite the fact that DMPs are much less labor intensive to administer; and b) there are a great deal of services such as counseling, underwriting, and customer support provided to a consumer <u>especially</u> prior to a settlement is ever received.

-Forcing debt settlement companies to accept contingency-only fee arrangements, as opposed to a conditional fee, which is supported by TASC and where consumers do not pay fees if their program fails (no savings off their balances), is the equivalent to forcing banks to only offer businesses equity financing, where the bank profits only in scenarios where the business succeeds, and not debt financing, where banks profit as long as the business does not fail. This type of mandate would have the effect of limiting the number of businesses who could get financing and the number of consumers who could get debt relief, causing both business and consumers to suffer.

<u>**Part I – Putting Debt Settlement in its Proper Context**</u>

Debt Settlement versus Debt Management Plans

Debt management plans (DMPs) are the oldest and the most widely used debt relief option outside of bankruptcy. Under these plans, a consumer makes one monthly payment to a credit counseling agency, who in turn distributes payments to each of the consumer's participating creditors. Consumers enrolled in these programs typically enjoy reduced interest rates and waived late fees and are usually put on plans to pay off their debts in four to five years. For consumers with the income to subsidize these types of plans, DMPs are usually a preferred option to debt settlement because there is less credit score damage, the outcome *appears* far more certain, and one does not need to deal with the stress of collection calls and potential lawsuits.

That said, there is a sizeable demographic of debtors who cannot afford this option, but still want and in many cases, <u>need</u>, to avoid bankruptcy. In some cases DMP payments are higher than the minimum monthly payments charged by the credit card companies themselves (particularly when the credit card company offers 2% of the balance minimum payments), and programs last for two to three years longer than the typical debt settlement program. In all this means that the total cost of a DMP is potentially twice as much as a debt settlement program or higher in some cases.

The high monthly payment and long time frame for DMPs are especially problematic considering the fact that consumers who miss as little as one payment oftentimes see their interest rates reverted back to the original contractual rates offered by the credit card companies. Considering how long these plans are administered and the strict payment requirements, it is no surprise that the NFCC reported that of the 273,473 DMPs terminated in 2002 only 21% were successful completions.

DMPs – More Harm to Consumers than Benefit?

As TASC statistics show, the debt settlement industry's completion rate is nearly double the completion rate of NFCC DMP clients. Furthermore, this sheds light on a fundamental problem in the logic of lawmakers and regulators in terms of how they compare debt settlement to credit counseling. Unfortunately, too many of the conclusions drawn by regulators are based on abstract comparisons of the *appearances* of the two options that fail to account for the implications of statistics showing that more than 50% of consumers who enroll in a DMP stop payments or file bankruptcy after six months.[1]

From this and other statistics in Hunt's report, one can easily deduce that the chief criticism of debt settlement programs being levied by regulators and driving the proposed legislation – that too many consumers who eventually file bankruptcy are losing thousands in non-refundable money – is far more pervasive in DMPs. Although only a fraction of these payments is for fees, from the standpoint for consumers' financial bottom line all that matters is the magnitude of the losses incurred is far greater in DMPs. In fact, the enormity of losses incurred by consumers in DMPs is such that when one analyzes its benefit to consumers in aggregate it calls into question whether DMPs should even be allowed at all under legislation that *purports* to be protecting consumers.

The fairest measurement of the total consumer benefit produced by any debt relief option would compare the total non-refundable money paid in the plan by consumers who did not succeed versus the total savings received by those consumers who did complete the plan. After all, even if a consumer receives the benefit of interest rate concessions or settlements on one or more accounts but files bankruptcy on the others, the consumer still suffered by enrolling in the plan and making non-refundable payments instead of filing bankruptcy immediately. Therefore, if the savings realized by clients who do complete their plans does not exceed the non-refundable money paid by consumers who fail, it can be concluded that the debt relief service results in more harm than benefit for consumers as a whole.

A quick calculation of the aggregate consumer benefit of DMPs suggests more harm is being done to consumers than good. To get a better understanding, consider the following: assume that 21% of consumers complete their DMPs, another 22% go on to self-administer their plans (pay off their debts on their own), and the rest (57%) file bankruptcy or stop making payments altogether. Assume the average consumer is paying $550 per month at 22% interest on $22,000 at the time he or she enrolls in a DMP, which is supposed to help them pay off this debt over 60 months on a reduced interest rate of 12% with $15 monthly maintenance fees, which amounts to a $520 monthly payment.[2] Assuming this is all true, a random sample of 100 consumers would show that the consumers who completed the program save roughly $206,640 through their DMPs versus making fixed payments to their creditors,

[1] Hunt, Robert M., "Whither Consumer Credit Counseling," Federal Reserve Bank of Philadelphia, 2005, p. 13

[2] The completion rate here is higher than NFCC statistics show and the NFCC counselors may have a higher completion rate than most agencies since they are considered the most consumer-friendly in the industry, as evidenced by the fact that Attorney General Madigan specifically refers consumers in debt to the NFCC on her own website, for example. The self-administering percentage is one cited by the NFCC in Hunt (2005).

whereas consumers who did not complete the program would lose approximately $255,840 in non-refundable payments to their creditors. [3] [4]

As shown, consumers would lose approximately $49,200 more than consumers who completed their plans would save by enrolling in DMPs. Not only are these organizations tax exempt and receiving government subsidies, but many trusted third-parties also continue to urge consumers to seek out their advice when the statistics they provide show that 35% of consumers whom they counsel are being enrolled in DMPs versus the meager 6% who they refer to legal assistance for bankruptcy. This is despite the fact that in all likelihood the typical DMP client will lose $5522, or 10% of their gross income, because of this advice.[5]

Now let's compare this with the results of debt settlement programs. Based on TASC data, debt settlement clients who complete their programs are saving more than $170,000 off their balances than what consumers pay in total fees and in non-refundable payments made by those who do not complete the program. When comparing the savings of clients who graduate to what they would have paid in their next least expensive option, DMPs, they save over $403,000, or nearly *10 times more than what consumers lose in DMPs*.[6]

Why Some Consumers Want to Avoid Bankruptcy

Bankruptcy is considered by lenders to be one of the worst marks possible that one can have on their credit, and in the case of Chapter 7, it stays there for up to 10 years. On top of this, many consumers hope to avoid the intrusiveness of the experience itself, not to mention the sense of guilt or failure they associate with filing. In a Chapter 7 bankruptcy, it is also possible that the debtor will have to sell some or all of their assets, including their home or car depending on their state.

Chapter 13 bankruptcy, much like credit counseling, involves paying off some or all of a consumer's debts over a three to five year period and a low success rate (statistics show only 33% are ever

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[3] It is assumed that the effect of DMPs on consumers who self-administer is neutral because some of self-administered programs are likely due to consumers not receiving interest concessions and many may end up filing bankruptcy and others are self-administering because they came into additional funds and paid off their debts in full.

[4] The average is based on Hunt (2005) where he states that 50% of DMPs are cancelled in the first six months and assumes that 28% of these cancellations are consumers who self-administer. So for the consumers who enroll in DMPs who file bankruptcy, the following assumptions are used: 6 consumers quit after one month, 15 consumers quit after three months, 15 consumers quit after six months, 7 quit after 9 months, 6 quit after 12 months, 3 quit after 18 months, 2 quit after 24 months, 1 quit after 30 months, 1 quit after 36 months, and 1 consumer quit after 48 months. Under this assumption the 57 clients who did not complete the plan made a total 492 payments for an average 8.63 payments.

[5] Hunt, 2005. In this report he says the average consumer's debt-to-income ratio is 40% (p. 13). Working backward from statistics about the typical debt enrolled in a DMP being reported is currently $22,000, ($16,000 according to Hunt in 2005), one gets an average annual income of $55,000 for the average DMP client. The statistics in regards to enrollment in DMP and referral to bankruptcy are also from this report (p. 11).

[6] These figures are calculated before any taxes on settlements, which is unlikely for many consumers who contact settlement companies because they can be exempt due to their insolvency, although it is certainly possible.

successfully completed), but also has a severe impact on one's credit. With the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which was largely lobbied for by the credit card companies, more consumers are being forced to file Chapter 13, despite its long history of not helping the majority of debtors who choose it, and the average fee for filing it is more than $4,000.[7] A final reason why debtors prefer debt settlement over bankruptcy is that many are not eligible to file it altogether. This includes people who owe more than $337,000 in unsecured debt, the nearly 2.5% of Chapter 7 bankruptcy cases that are dismissed, or consumers who filed too recently (eight years in the case of Chapter 7) to qualify. [8]

Evidence of the Niche –Six Case Studies of Real Graduates of Debt Settlement Programs

As stated throughout this report, debt settlement serves a large but specific niche of consumers with heavy debt burdens that want to avoid bankruptcy. Detailed below are six case studies of consumers who successfully completed their program that could not have achieved their goals without debt settlement.

Mr. Sam – This client had a lot of equity in his home and would have lost it if he filed bankruptcy. He had a lump sum of money he saved over the years that totaled about 60% of his outstanding balances, but he had no other income to speak of because his consulting business was not bringing in any revenue. This being the case, even if he paid down his debts with the lump sum, he still would not have been able to pay them off in full. He looked into getting a low interest consolidation loan using the equity in his home, but could not qualify because he lacked the income to do this. With limited funds, nervous by nature, and easily intimidated by his creditors, if this client agreed to just one settlement for substantially more than what was necessary or affordable, he would have been forced to file bankruptcy and possibly lost his home. Instead he saved around $40,000 and managed to pay off his debts in the only manner in which he could.

Ms. Adriana – This was a 28 year old woman who could not afford credit counseling, but did not want the stain of a bankruptcy on her credit as she prepared to start a family and hopefully get a mortgage. Since she was intent on avoiding bankruptcy, the only option she could afford other than debt settlement would have been to make the minimum payments and pay at least $50,000, or more than one year's salary before taxes, to get out of $30,000 of credit card debt. Instead she settled her debts in two years and saved $15,000 off her balances alone, including fees paid.

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[7] The average attorney fee in Northern Illinois District is $3500, plus $274 in filing fees, $100 for credit counseling, and trustee fees paid in the plan, which typically amounts to at least 5% of the monthly payment. See "Bankruptcy Reform: Dollar Costs Associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2008," The Government Accountability Office. Ironically, a quick perusal of the websites of attorneys in Northern Illinois' District showed that some were charging 40% of the fees up front ($1500), and most attorneys acknowledge that a portion is charged up front. See Cathleen Cooper Moran, *Chapter 13 Explained*, 2009, http://www.moranlaw.net/13workings.htm

[8] "Bankruptcy Reform: Dollar Costs Associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2008." The Government Accountability Office, 2008, p. 43. Of a random sample of 500 cases, 12 are dismissed (2.4%).

Mr. Steven – A contractor who was affected by the housing crisis that fell behind on $50,000 of credit card debt before he finally got another project and started earning enough money to pay off his debt. Unfortunately, he was already at least 5 to 7 months past due on most of his accounts, so his credit had already been affected negatively by "charge offs" and his accounts being in collections. Due to this fact, the client decided it was in his best interests to save as much money as possible and get back on his feet quickly. By settling his debts he saved $17,000 off his balances, which includes fees paid.

Mr. Donald – Owed $105,000 and tried to file Chapter 7 bankruptcy, but his income was too high and he would have been forced to pay off a large portion of his debt over five years in a Chapter 13 bankruptcy plan. This client saved over $65,000 off his balances alone by settling his debts.

Ms. Elaine – A teacher who owed $70,000 in credit card debt when the credit card companies raised her minimum payments. Deeply religious, this client was extremely conflicted about the fact that our program did not involve making payments to creditors, but she understood that this was the only option she could afford besides bankruptcy, which she saw as an immoral choice since she had income and an ability to pay off at least a portion of her debts. Detailed below is an email she sent to the employee who counseled her throughout the process:

"I'll never be able to thank you enough, Steven. You have helped me so much. As well as getting me out of financial hot water, you enabled me to work through self-loathing and feeling like I was an unredeemable, terrible person and you listened patiently when I cried during our first phone conversation. I will never forget your kindness to me. I think you are an extraordinary human being as well as a consummate business professional. You are permanently on my "sending good thoughts your way" list! I think it's going to feel a little weird after this last payment is deducted, but it makes me light-hearted at the same time. I keep close track of my expenses in a notebook now and my goal is to save, save, save and pay for things with cash, cash, cash!"

Ms Jessica – Her partner left her and she was left paying the entire mortgage on her condo. No longer able to split the mortgage and other household expenses, Jessica eventually fell behind on her credit card payments but she was determined to avoid bankruptcy. In the end she saved more than $7000 off her balances, including our fees, and accomplished her goal of becoming debt free without bankruptcy.

These are just a small sample of all the types of situations that lead people to decide that debt settlement was their best option, and there are thousands of other cases where people *have to* settle their debts, such as people who owe too much or filed too recently to qualify for bankruptcy, not to mention the thousands of people who are kicked out of debt management plans because they could not afford the monthly payments. Assuming the risks and effects are properly disclosed and as illustrated by the above cases, debt settlement is very rarely something that people *want* to do, but more something that they are *forced to* do by their situation. Taking away a solution that consumers *need*, which is what would happen if the proposed legislation were to pass, would be a mistake.

Why Consumers Benefit from Paying a Professional

One simple but essential advantage of using a third party is having a partner to keep you disciplined and to support you in the process. Much like fitness trainers provide a tangible benefit to people hoping to get in shape, clients of debt settlement companies benefit from having the emotional support, structure

and accountability provided by a third-party. This is especially true for a portion of our demographic that have shown a tendency to lack the discipline to budget or are beating themselves up psychologically about their predicament (see the Elaine's testimonial on page 12). Along the same lines, another implicit advantage of using a professional is that third-parties help people save time and avoid the stress of managing their own settlement programs.

More importantly, the fact that settlement companies deal with thousands of accounts and gain significant insight into the collection policies of major banks and collection agencies, we are able to appropriately time and prioritize settlements so that our clients can save the most amount of money. Certainly the typical consumer doing this on their own would not have the knowledge or resources necessary to achieve the optimal settlements that professionals routinely accomplish.

Moreover, banks themselves admit that some consumers feel distrust toward their card issuing bank while they are experiencing financial trouble and do not feel comfortable dealing with them directly.[9] This is usually for good reason as many debtors who are forced to negotiate without third-party help find the resolutions offered are largely for the benefit of the creditor and not based on the repayment capacity of the debtor. Consumers are also uncomfortable because the collectors representing billion-dollar banks are experienced in these types of negotiations and experts in using threats to intimidate consumers into payment, usually beyond what a consumer can actually afford. As evidenced by the number of complaints lodged against collection agencies with the Federal Trade Commission (FTC), neither the volume of false threats made by collectors, nor the confusion and stress those threats cause past due debtors can be understated. Using a third-party advocate relieves consumers of the stress and time associated with dealing with aggressive collectors, as professionals are able to use past experience with particular creditors and collectors to discern empty threats from legitimate ones and resolve accounts quicker and at more favorable rates than a consumer can do on their own.

An Attempt to Quantify the Benefit of Using a Professional to Settle

In the above section we enumerate the three main benefits consumers receive from using a professional to settle, which are (1) the expertise and knowledge of a professional means that in all likelihood consumers save more money, (2) the structure and accountability offered by settlement companies helps more consumers avoid bankruptcy than they would on their own, and (3) using a third-party saves consumers a tremendous amount of time and much of the stress of negotiations with creditors and collectors. In the following section, we <u>attempt</u> to quantify these benefits, and for the sake of simplicity, it is assumed that consumers value each of these benefits equally and are paying the standard 15% of debt owed as a fee, so in essence they are paying 5% to receive each of the three benefits.

The value of expertise - Do consumers save more than 5% of the amount owed versus what they would settle on their own?

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[9] Furletti, Mark J, "Consumer Credit Counseling: Credit Card Issuers' Perspectives", September 2003, Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper, No. 03-13, p. 5

Since TASC shows that debt settlement companies average a 42% settlement rate, in essence the question is whether consumers on their own would settle for 47% or higher. Based on the lengths that credit card companies and collectors go to in order to negotiate with consumers directly, (which they do because it is in the self-interest financially, not because debt settlement companies "get in the way" as media sources suggest), not to mention anecdotal evidence of cases where our own clients have negotiated settlements directly with their creditors, it is doubtful that consumers are not receiving a benefit that offsets the 5% fee, and it is highly possible that there is enough of a benefit here to offset the 15% fee altogether.[10] For example, if the balance increases 11.5% because of late charges and a consumer accepts a 50% settlement on that balance, which for most is a great deal, then the consumer has in essence accepted a settlement for 37% more than TASC's settlement average, or more than 15% of the original debt owed, which again is the industry standard fee.

There are countless strategies that negotiators routinely employ to settle debts for less than 5% of the debt. In fact, it is likely the mere act of settling at the end of the month, a strategy consistently used by settlement companies, is enough to discount the settlements by 5% of the amount owed, or from 47% to 42% of what is owed. Perhaps the simplest but most effective technique used by debt settlement companies to get lower settlement percentages is just waiting. As simple as it sounds (and is), this act is far more difficult for worried and confused consumers who are dealing with creditors and collectors that are setting artificial deadlines for when settlements can be accepted "before they move forward."[11] The following are just a few of the other techniques used by negotiators to reduce settlement percentages:

- the act of settling accounts with historically litigious creditors before they are forwarded to attorneys, where settlement demands will increase to 60-80% of the amount owed
- contacting banks between the 150 and 180 day stage of delinquency, a time when specific banks are particularly generous in the offers they will extend to settle
- settling consumer accounts in bulk, which in some cases affords deeper discounts in the same manner as buying something in bulk does

Also, keep in mind that there are countless industries with statistics proving that consumers are better off doing it on their own instead of paying fees to a professional (even hedge funds, an investment vehicle limited to arguably the most sophisticated segments in the marketplace), and even if debt

[10] "Debt Settlers Offer Promises But Little Help", NY Times, April 29, 2009. David Streitfield reports, "Even debt collectors are upset, saying settlement companies prevent them from collecting."

[11] This threat, which is understood by consumers that the creditor intends to pursue legal action against them if the debt is not resolved, is tremendously effective from a collections standpoint because it takes advantage of the fact that most consumers have no idea what legal recourse is even available to creditors in this situation. Among some of the misconceptions of our current and former clients: that they could go to jail or lose their child. Those are extreme examples of the misconceptions, but some fairly common ones include they could garnish their social security, seize their property without first filing suit, and once an account goes to an attorney it cannot be resolved outside of court.

settlement companies were not offsetting their fees with lower settlements, which in all likelihood they are, this is surely not justification for eliminating an industry.[12]

The value of structure and accountability - Are consumers who enroll in debt settlement programs more likely to avoid bankruptcy than those who do it on their own?

In order to answer this question, one must first determine the value of "avoiding bankruptcy." For the average client, the value of "avoiding bankruptcy" is $19,500, which is the typical amount consumers agree to pay approximately in order to "avoid bankruptcy."[13] Assuming consumers are paying 5% of their debt to have the added insurance of knowing they are doing what is in their best interest to achieve this goal, then if 8 consumers out of 100 who would otherwise file bankruptcy are able to complete their programs, then the aggregate benefit received is greater than the aggregate fee paid for this benefit. Assuming 100 consumers are pay 5% of the debt, or $1500, for this benefit, which amounts to $150,000, if eight consumers are able to avoid bankruptcy, the aggregate benefit they receive is $156,000, or $6,000 more than what they paid to receive that value.

Now that we know the cost and benefit of avoiding bankruptcy and we know the likelihood of completion according to TASC (35%), the next step is to determine *how likely it is for a consumer to successfully resolve their debts on their own*, which will be difficult but there are certain indicators one can analyze to get a good idea. Perhaps the best judge of this likelihood is the credit card companies themselves. After all, they observe these cases more than anyone and part of their profits is dependent on their ability to predict and properly handle situations where a cardholder is delinquent. Statistics show recently charged off debt portfolios are being sold for 4 to 9 cents on the dollar. While one cannot deduce that credit card companies expect to recover less than 4 to 9 percent of their debts because there are other considerations, the fact remains that credit card companies understand that consumers missing payments are highly unlikely to pay them back much, if anything at all.[14]

Quite simply the mere act of setting up a third-party trust account for the client to make payments to fund their settlements is probably enough to help eight consumers avoid bankruptcy that would other file bankruptcy doing it on their own. Anecdotal evidence shows that consumers who save on their own are 76% more likely to terminate their plans than consumers who save in a third-party trust or savings account. Based on this statistic and since many companies in TASC are in fact using some type of third-party mechanism to monitor their clients' savings, one would expect TASC to have a 20% completion rate instead of the 35% that it is currently reporting. In other words, 15 consumers out of 100 may be completing their programs on account of perhaps the most elementary part of what debt settlement companies do, making the aggregate benefit received for "avoiding bankruptcy" $292,500 ($19,500, the

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[12] The Credit Suisse First Boston Hedge Fund Index reported that between 1994 and 2000, an investor would have beaten the performance of every major hedge fund by 6% annually by simply investing in an S&P 500 fund, for example.

[13] This assumes a 50% settlement and 15% fee charged to consumers who owe $30,000 in debt.

[14] Some of the considerations include not all debts are sold and that the demographic of consumers who use debt settlement companies is self-selected in that presumably they all have income or savings in order to fund their programs, among other factors.

value of “avoiding bankruptcy” times 15 consumers) versus the $150,000 paid to receive it (100 consumers pay $1,500 to try to “avoid bankruptcy”).

Further, one can gauge the value of superior qualification, counseling, customer support, and negotiation services to a client’s success by comparing the variance of completion rates within the industry. TASC reports completion rates between 30-60% depending on the company. If debt negotiation was simply a matter of having the funds to settle, as is the popular myth promoted by its critics, and had little to do with the efforts of a company to provide structure, support, and expertise for a consumer during this process, there probably would not be cases where some companies were effectively doubling the completion rates of their competitors. Therefore, one can deduce that without any of these services, the likelihood that consumers will effectively avoid bankruptcy would be lower as well.

To see the benefit of added structure and support, consider the graduation rates of University of Phoenix-campus, which an overall graduation rate of 16%, and University of Phoenix-online, where the graduation rate is 4%.[15] Both programs have the same standards, curriculum and deal with a similar demographic – many are older, working full-time, and are more likely to get sidetracked by other issues during the course of their studies than a student at a typical 4-year college. However, the simple fact that one has a campus, a classroom, specific times when the class meets every week, professors with office hours, and other elements that add structure and support to a student’s education, it helps a significant number of students graduate that would not if they pursued their education more independently. Taking this further, if it were possible for one to obtain a degree without any support whatsoever and consumers were forced to establish the curriculum, Power Point notes for the lecture, quizzes to gauge their progress, and all the other support offered even by the University of Phoenix-online, one would expect the graduation rate to be even lower. So while it is impossible to determine what success rate consumers would enjoy on their own, all signs point to the fact that the industry is no different than other services administered by a third-party and consumers are in all likelihood benefiting significantly.

The value of time saved and stress avoided – How much time does it take to successfully settle all of your debts?

Proving the time it takes to resolve a consumer’s accounts is difficult to gauge and varies by company and client, but as a starting point, let’s use TASC’s example of 500 employees are needed to sustain settlement programs for 30,000 consumers. Of the 500 employees, let’s assume that 10%, or 50 employees, are in executives-level positions, marketing, accounting, business development, technical support and other areas which are necessary for a company to function but are not directly related to the services provided to consumers. This being the case, 450 employees are directly involved and working on behalf of consumers to resolve their debts, which on average takes 30 months to do. Assuming that these employees are all full-time and they work 40 hours per week and get two weeks of vacation a year, one can deduce that they collectively work 900,000 hours per year, making the total

[15] “A Trouble Grows for a University Built on Profits,” NY Times, February 11, 2007

hours logged over the course of the 30 month programs for these 30,000 clients to be 2.25 million hours. Using these figures one deduces that the average time spent per client over this time period is 75 hours. By discounting this amount by 33% to account for the fact that there's never 100% efficiency in the workplace and companies intentionally over-staff so that there are no missed calls, one concludes that in all it takes 50 hours in order to settle the accounts of the typical consumer.[16]

So if that's the time it would take, then the question becomes *would the consumer pay $30 an hour (5% of the debt, or $1500, divided by 50 hours) to save the time and avoid the stress of dealing with creditors*?

While this too is difficult to gauge, one can assume the answer is "yes" based on four reasons: (1) the sheer fact that consumers have chosen to use a company, it is an indication that the fees charged to receive this benefit is worth it to them, particularly since many consumers have already attempted negotiations with their creditors and chosen to use a service for exactly this reason; (2) the fees charged seem to be very reasonable and are in line with or lower than many professional services;[17] (3) the reasonableness of the fee becomes even more clear when one considers the fact that debt settlement companies extensively train employees and have streamlined the negotiations process such that it would require more hours of work for a consumer to resolve their debts than a professional; (4) the rate of $30 an hour closely resembles the average salary of consumers who are seeking debt relief, which we deduced earlier is around $55,000. That is, if the consumer were to request 50 hours of unpaid leave, or the more than a week of work necessary to settle their debts, they would lose an amount in wages that is approximately the fee they would pay to enjoy this benefit.

Admittedly this exercise to quantify the benefit of paying a professional does not prove that consumers are making the correct choice, but it does show that it is reasonable to assume they are, which certainly means that eliminating the industry on the grounds that consumers can do it on their own is suspect, especially since their enrollment with a debt settlement company alludes to the fact that they prefer to use a third-party.

Debt Settlement in the Big Picture – Debt Relief & the System of Checks & Balances on Banks

Banks have shown that they want a strong hand in how debt relief is granted to consumers. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is a testament to this fact, as credit card companies spent millions in lobbying efforts to get Congress overhaul the bankruptcy code and make it more difficult to discharge debts in Chapter 7 bankruptcy.

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[16] It should also be noted that debt settlement companies have no incentive whatsoever to overstaff, and therefore the hourly figures determined deductively are probably an accurate indication of the workload that typically goes into servicing consumers.

[17] According to the Laffey Matrix, paralegal fees are $120 / hour. According to the Institute of Management and Administration, junior accountants without CPAs are billed at $91 / hour. Web programming firms bill at $190 / hour. The hourly rates for web designers are between $65 and $110 / hour (see www.mountevansdesigns.com/web_design_rates.html), copywriters charge $100 / hour (see http://www.greatstuff.com/rates.html), and web marketers charge between $50 and $350 / hour (see http://www.seomoz.org/blog/in-seo-do-you-get-what-you-pay-for).

It's also true that banks have long targeted debt relief industries that threaten to cut into their profits. In the 2003 Philadelphia Reserve Bank's report on debt management plans, "Consumer Credit Counseling: Credit Card Issuers' Perspectives", representatives from Juniper and Chase complained of changes in marketing where credit counselors were targeting "consumer(s) who believes he or she is paying too much in interest" for debt management plans, which causes credit card company revenues from fees and interest to drop more than 70%. As a result, these banks openly admitted to not working "with agencies who do not meet certain standards" and partnering with specific credit counseling agencies and referring card holders who ask for lower interest rates or are past due directly to these agencies.[18] Therefore, not only is this agency dependent on the bank for "Fair Share" but also as its main source for clients. This being true, it is unreasonable to think that these agencies serve the interests of consumers when they are largely, if not entirely, subsidized by the bank.

In the same fashion that consumers would never receive the degree of assistance from debt settlement they are enjoying today if there was no threat of bankruptcy, the very existence of a true third-party advocate for consumers in the debt relief industry should help keep credit card companies honest and more accountable for their lending practices and more generous in the types of assistance they offer consumers who ask for help. Considering the fact that one positive and significant determinant of success in DMPs were creditor reductions in finance charges, one could also reason that the availability of debt settlement programs and the pressure it exerts on banks to be competitive in their concessions to overextended consumers who seek out credit counseling may even have a positive effect on the success of DMPs.[19]

Another obvious example of efforts to be more competitive in the assistance offered to consumers is their recent creation of "60-60 plans", a new type of DMP first proposed in 2006 as an off-shoot of a provision in the 2005 bankruptcy laws that would allow debtors to pay off 60% of their debt over a 60 month period. As with most other industries, competition begets innovation and lower prices which ultimately benefits consumers. Although one cannot definitively attribute these positive developments in the types of debt relief being offered to overextended consumers to the emergence of debt settlement companies, it is certainly possible. After all, why else did it take more than 50 years after the advent of the DMP for credit card companies to even attempt to create a program for those who cannot afford to pay off their debts in full, especially considering the number of DMPs that were failing?[20]

This delay in creating a debt relief program for consumers who could not afford to pay their debts back in full also begs the question of whether innovation within debt relief space, long relegated to non-profits thanks to debt adjusting and pro rater laws passed in the 1950s, has suffered because for-profit entities have not been allowed in the space. Considering the amount of credit banks have offered since 1950 and the wide variety of financial needs of consumers, one would expect more positive changes in the debt relief being presented to consumers, but instead, the biggest change undergone in credit counseling arena over the next forty years was that a group of agencies began offering counseling over

[18] Furletti, p. 4-5
[19] Staten, Michael. *The Impact of Waiving Finance Charges on Debt Plans at Consumer Credit Counseling Services*, Credit Research Center, Purdue University, 1993
[20] The OTC rejected 60-60 plans for regulatory purposes.

the phone, which happened in the 1990s or 110 years after Bell invented the telephone.[21] In sum, it is reasonable to assume that due to the fact that the only source of help for consumers has been forced to tip-toe around banks because they are dependent upon them for funding, are stuck in a regulatory strait-jacket since most are non-profit, or quite simply these organizations lack the motivation urged forward by the profit incentive, the progress of debt relief has been glacial, and one can only reasonably assume that the legislation being pushed forward, which will once again effectively eliminate for-profit debt relief as we know it, will set back this progress even further.[22]

Debunking the Myths that Consumers Will Settle on their Own & that Banks Would Be Supportive of Debt Settlement Companies if They Helped Consumers Avoid Bankruptcy

The availability of a consumer-focused option such as debt settlement is causing credit card companies to be more flexible and generous in the types of assistance they are willing to offer consumers. A search of "can I settle my credit card debt" in Google News Archives in the year 2002 (also a recession year) yields no results. Today, however, major news publications are publishing stories where credit card companies are going on record that they offer settlements to qualifying consumers and encouraging past due card holders to explore this option.[23]

The concept of debt settlement is not new, as banks have been settling debts since at least the 1980s (one would assume even long before then). However, prior to the emergence of the debt settlement industry, banks made every effort to keep this option a secret to consumers until they were already behind on their payments. Even in news articles where the credit card industry is going on record about the practice of settling debts, one will typically see hedged statements that this practice is a new development in response to this "one of a kind" recession. If the debt settlement industry is in fact eliminated, one should also expect the option itself to be taken off the table for consumers as well, or so they will be lead to believe. To suspect that credit card companies will not create a new myth that settling is impossible after the elimination of the industry is unrealistic, as evidenced by the following: (a) there is already widespread doubt about the feasibility of debt settlement even among so called experts and consumer advocates;[24] (b) until recently, banks did not publicly acknowledge settlement as an option and only privately offered it to consumers who were past due, and (c) the economics of the credit card interest and minimum payments is so decidedly in favor of credit card companies at the expense of consumers such that keeping settlement a secret is in their self-interest, even if having it public knowledge would prevent a majority of bankruptcies.

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[21] *Credit Counseling*, Wikipedia, 2010,
http://en.wikipedia.org/wiki/Credit_counseling#History_of_credit_counseling

[22] There is much conjecture here and the author is admittedly unfamiliar with the credit counseling industry and would describe his knowledge as cursory at best.

[23] "Credit Card Issuers Settle Accounts for Lower Balances", NY Times, June 16, 2009

[24] See Travis Plunkett's statement in "Don't Fall for Debt Relief Scam Artists", April 17, 2007, http://www.msnbc.msn.com/id/18155301/ns/business-consumer_news/ where in reference to the notion that one can negotiate a one-time settlement with their creditors to reduce their principal balances by 50 to 70 percent, he says: "This is virtually impossible under any circumstances." Plunkett has been asked to testify before Congress a number of times about the debt relief industry and is the Legislative Director of the Consumer Federation of America.

To understand point (c), consider the following:

Let us assume 100 consumers call a bank and explain that they already spoke to a credit counselor and could not afford the monthly payment they required. Then, they explain to the bank representative that their only hope outside of bankruptcy is to settle their debts, which they recall reading about at some point, to which the bank representative says this is no longer an option offered and it was only allowed during the recession. Of those 100 consumers, even if 90% file bankruptcy and only 10% pay their debts off in full on minimum or fixed payments, then banks receive more money than they would under a scenario where each of the 100 consumers settles their debts in full for 36% of the outstanding balance, or twice the typical recovery rate of consumers who choose debt settlement services.[25] In other words, even in a scenario where banks recover 100% more than what is typical in professionally-administered programs, which as shown earlier is in all likelihood significantly more successful than if a consumer does it on their own, banks are still better off forcing 90% of consumers into bankruptcy and crossing their fingers that 10% will pay off their debts in full with minimum or fixed payments.

Not only does this explain why it makes sense for banks to keep the practice of settlement shrouded in secrecy unless a consumer is severely delinquent, but it also explains why banks have advocated so strongly against our industry despite statistics suggesting that banks may recover as much as three times from debt settlement clients than they do from consumers who file Chapter 7 bankruptcy.[26] As a result, although the practice will not be eliminated entirely if the industry is since banks will continue to settle with consumers who are severely delinquent, the elimination of the industry will certainly diminish the number of consumers who benefit from it because banks will ensure that their practice of settling debts remains a secret, just as it was prior to when the industry started.

Although banks may spin that they stand against debt settlement companies because of the harm done to consumers, the fact is credit card companies stand behind and even fund credit counseling organizations, whose track record of helping consumers become debt free is far worse than the debt settlement industry's, because it makes financial sense for them. This is the magic of minimum

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[25]This assumes that the consumers are paying 22% interest on $30,000 of credit card debt at the time they call the banks about the possibility of settling. Of the 90% who file bankruptcy, this assumes they make an average of 4 minimum payments before giving up and filing bankruptcy, which amounts to $270,000 received by the creditors and reduces the average balance to $29,177 of credit card debt before they file and creditors recover 7% of what is owed, or $183,815. Of the remaining ten consumers, three pay the minimums and are debt free 658 months later for a total of $334,011, and the remaining seven consumers make fixed payments of $750 over 73 months for a total of $383,250.

[26] This is an educated guess based on the fact that TASC statistics suggest consumers who use debt settlement services pay back 18% of what they owe to creditors and accounts by bankruptcy attorneys and creditors that that they recover very little in Chapter 7. This being true, it is assumed that creditors recover 6% of the debt in Chapter 7 cases, which is 40% of what they recover in Chapter 13 according to the data collected in this report.

payments and proof that the concept of a win-win for banks and consumers with debt settlement, although certainly possible, is for all intents and purposes an illusion. [27]

More importantly, not only are consumers who are using the services of debt settlement companies benefiting significantly from the existence of the industry, but so too are a great deal of consumers who are doing it on their own that otherwise would not if there was far more uncertainty about whether banks did in fact settle debts. In sum, even though some banks may advocate against this industry, this is partly a reflection of the economics of high interest credit cards, which are heavily lopsided against consumers, and not debt settlement, which is proven to benefit consumers and banks more than bankruptcy.

Additionally, when understood on a macro level, it is clear that the debt settlement industry is an important component of the debt relief ecosystem because not only does it support a specific niche of overextended consumers who cannot afford DMPs and do not want to file bankruptcy, but the existence of debt settlement ultimately reinforces DMPs, 60-60 plans, and even consumers who choose to settle debts on their own. In the same way that biologists have long argued that biodiversity – a greater variation of life forms within an ecosystem – contributes to the strength and resilience of an ecosystem, so too does a greater variation of debt relief options strengthen the debt relief ecosystem as a whole.

Finally, not only is debt settlement an important part of this ecosystem, but it evolved naturally as a response the lending practices of banks in the past decade and was strengthened by bankruptcy reform, providing a solution to hundreds of thousands of consumers who desperately need debt relief but cannot qualify for Chapter 7. The measures proposed in the legislation, specifically those dealing with fees, are a drastic attempt to reign in something that evolved naturally to address a need in the financial environment that was created by the banks themselves.

Understanding Completion Rates for Debt Relief Programs

Many critics of debt relief services fail to understand completion rates in their proper context and are appalled by the fact that a substantial portion of clients do not actually achieve the goal of becoming debt free that they hoped for by enrolling. As mentioned previously and without stating the obvious, a client's ability to make consistent program payments is the single biggest determinant of the success of any debt relief plan, whether it's debt settlement, credit counseling, or even Chapter 13 bankruptcy. Unfortunately, accurately gauging a client's ability to do this is a difficult task, and although it is tempting to blame debt relief companies for not properly qualifying consumers for their programs, the reality is no one is responsible for this problem, including consumers themselves in many cases. Even the largest banks whose profits depend on how well they are able to determine affordability and devote millions of dollars in technology and human resources to this very pursuit continue to fail, as the very existence of the debt settlement industry suggests. The fact that people turn out to not be able to afford debt relief plans is a testament to how difficult predicting affordability is over a three year period for a demographic that is overextended financially, have burned through their savings in an attempt to

[27] Again, if a consumer is already severely delinquent then both banks and consumers stand to benefit from settling.

stay current on their payments, and are one event away (car and home repairs, for example) from missing payments, not the greed of decision-makers in the industry.

In fact, completion of anything that's administered over time is difficult. To appreciate this fact, consider the case of university graduation rates in Illinois. Based on my company's internal statistics, only 11 out of 46 of the largest universities in the state have a higher "graduation" rate than our program. As with our program, many students realize that tuition is no longer affordable, change their mind about their goals or do not fully consider how difficult things can be and become tempted by an easier path. For many their situations may change and perhaps they need to get a job or help a parent with medical problems. For a substantial portion of our clients, like millions of other Americans affected by the housing crisis, the impending foreclosure of their home meant that bankruptcy suddenly made more sense because it could resolve both their secured and unsecured debt problems (unlike debt settlement which only deals with unsecured debts such as credit cards).

Completion rates also tend to reflect the demographics of the clients. Experiencing a financial hardship, many have already started missing payments or have bad credit and a track record of not following through on financial commitments. To appreciate this fact, consider the cases of Chicago State University, which has a 16% graduation rate and Northwestern University, which has a 95% graduation rate. One might argue that the academic performance of each student body in high school would be <u>one</u> factor influencing the wide variance between the two. In the same fashion, the fact that debt settlement companies typically attract people with sub-prime credit explains <u>part</u> of why a portion of our clients do not meet the payment requirements and therefore cannot complete the program. This reality is very much in line with the findings of Staten, Link and Brown (2007) in "An Analysis of Why Debt Management Plans Fail", where they find information "indicating that higher credit scores increase the probability of successfully completing the DMP."[28] One should also note that debt settlement, due to its uncertain nature, the negative press it has received, and the barrage of warnings against it by trusted third-parties is much more likely to attract more risk-tolerant candidates than other debt relief options, such as DMPs, which *appear* more predictable and are encouraged by the trusted third-parties. This certainly affects termination rates as well since risk-tolerant consumers are more likely to being taking risks in other areas of their life, which can have the effect of destabilizing their ability to make payments during the course of the program.[29]

One might also suspect that the socio-economic situation of each university's student bodies is a factor at play in their respective graduation rates. After all, it is reasonable to assume that a student from Chicago State University is far more likely to need to attend to more immediate and basic needs than

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[28] Staten, Michael, Link, Charles, Brown, Daniel. "An Analysis of Why Debt Management Plans Fail," Financial Services Research Program, Working Paper No. 73, 2007

[29] This is in line with John Cawley and Tomas Philpson in "An Empirical Examination of Information Barriers to Trade in Insurance" (1999), which shows that mortality rates of people applying for life insurance is lower than that of the uninsured, even when controlling for income and other factors and the fact that they have much more to lose since they are uninsured. This is true because people who apply for insurance are typically more conservative--- less likely to need it, but more likely to buy it according to David C Webb and David De Meza in "Advantageous Selection in Insurance Markets" (2000).

their education since many are working full-time, or more simply, have problems paying their tuition than the average student at Northwestern University (even though the tuition of Northwestern is significantly higher). In the same fashion, the fact that debt settlement companies are enrolling people who are experiencing financial problems and are at the brink of bankruptcy explains a large part of why a portion of our clients fail to complete the program, not the fact the solution itself does not work or is prohibitively expensively. In sum, not only are the graduation rates of both Chicago State and the debt relief companies largely beyond their control, but it is completely reasonable for both to not achieve high graduation rates.

To further illustrate this point, consider again the completion rates of other debt relief plans, starting with Chapter 13 bankruptcy, which has a 33% completion rate.[30] In a Chapter 13 bankruptcy, the debtor's monthly payment is based on their disposable income which is determined by a judge, who has no financial incentive whatsoever to put debtors on payment plans they cannot afford, and yet, they still encounter a problem where an overwhelming majority of consumers are not completing these plans. In other words, an income and budget analysis, which is the only realistic tool that debt settlement companies can use to qualify consumers, is not sufficient in weeding out those consumers who will not complete the program. This reality is underscored by Evans and Lown (2008) who found that Chapter 13 completion rates was not associated with monthly income and expenses.[31] The same is true for credit counselors who do an income and budget analysis before approving consumers for DMPs, only 21% of which are ever completed.

When it comes to all debt relief plans that involve payment over time (debt settlement, credit counseling, and Chapter 13 bankruptcy), regulators must accept that completion rates are and probably always will be better understood in the context of graduating from high school or college and to be more specific, the graduation rates will look more like the Chicago Public School system's and not New Trier's. When understood in this way, the legislation being advanced is akin to shutting down public schools in Chicago (this is what the net effect would be of the current bill) because 48% of students are not graduating, even though thousands are benefiting on an annual basis.[32]

Understanding the Drawbacks in their Proper Context

The drawbacks of debt settlement are not always understood in the context of the financial situation of our clients, and furthermore, there is an underlying assumption that debt settlement companies do not disclose these drawbacks, which is certainly true for "bad actors" but not for much of the industry. For many, drawbacks are disclosed to clients on our website, in their initial sales consultations, in the contract and once again verbally in a "welcome call", which happens at least several days in advance of

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[30] Bermant, Gordon, Burke, Virginia, Flynn, Ed, "Bankruptcy by the Numbers: Measuring Performance in Chapter 13: Comparisons across States," Executive Office for United States Trustees, 2008. http://www.justice.gov/ust/eo/public_affairs/articles/docs/abi082000ch13.htm

[31] Evans, David, and Lown, Jean, "Predictors of Chapter 13 Completion Rates: The Role of Socioeconomic Variables and Consumer Debt Type", Journal of Family and Economic Issues, Volume 29, June 29, 2008

[32] Chicago Public Schools graduate 52.2% of all students every year. See "Big-city schools struggle with graduation rates." USA Today, June 20, 2006. This number has since increased significantly to around 69%.

any debits to the client's account. This being the case, those with options to avoid debt settlement typically do exactly that.

More importantly, far too many government officials, media members, and other parties that consumers trust to be informed about the subject matter are explaining to the public that debt settlement companies are selling a ponzi-scheme for one's personal finances, where the benefit received from saving off one's balances is paid for subsequently by an increased cost of credit, taxes on the savings realized, and the late fees and interest which will be added to a consumer's account. As the following section will show, there is a sizable but specific demographic of consumers who receive a clear financial benefit by choosing debt settlement, and the solution companies are offering is not a "trick" being played on consumers just to collect a fee.

(1) The credit impact

The credit of many debt settlement clients is already suffering when they enroll in a program, and those whose credit is not suffering that have other options typically want to avoid debt settlement for exactly this reason. Those who do not have any other options and choose to enroll are doing so because they understand that their credit is going to be impacted no matter what they do - whether it's missing payments or filing bankruptcy, their credit scores will drop as a result. In these cases debt settlement may be the best option for their credit since Chapter 7 stays on your credit for 10 years and stopping payment on your debts and making no efforts at all to resolve the balances is arguably worse for your credit than bankruptcy.

(2) Potential for lawsuits

As with the credit impact of debt settlement, many consumers with other options who are disclosed about the possibility of legal action choose another solution because the risk, or to be more specific, the *perceive*d risk, is not worth it. The truth is, however, the potential for a lawsuit is relatively low and the likelihood of a wage garnishment is even lower. Even when legal action does occur, it is not a large determinant of program success because the total cost of the typical resolution of these accounts is affordable for the client and is line with a consumer's only other debt relief option outside of bankruptcy- credit counseling.

Only 12% of all of our 2007 clients' accounts were forwarded to attorneys located in the state in which the client resides or attorneys located outside of their state for arbitration (hereafter referred to as "legal accounts"). Of these the majority are set up on payment plans or settled before the client ever receives a summons to appear in court. Even after a summons is received, not a single client from 2007 had their wages garnished because the majority of these accounts are still resolved on a payment plan where the client pays back the full balance at statutory interest with the typical cost amounting to roughly what the consumer would pay on the account in a DMP. Clients who signed up in 2007 paid 137% of the original balance on payment plans we reached with law firms, which includes interest and late fees as well as court costs. In sum, approximately 90% of all our resolved accounts were settled, where the clients saved on average 58% off on these accounts' original balances, and roughly 10% of our resolved accounts were payment plans where clients pay roughly 137% of the original balance.

The above figures show that there is still a clear financial benefit for doing debt settlement even with the risks posed by lawsuit, particularly for those whose only other options are credit counseling or struggling to make minimum payments on high interest credit cards.

(3) Collection calls

For starters, it is worth noting that many consumers are already fielding collection calls when they seek the services of a settlement company, so accusations about the problems the industry "causes" in this regard are misstated for a large portion of its demographic. For consumers that are not receiving calls many will choose another solution, assuming they have one, upon learning that collection calls will continue during the process. Those who do not have other choices, however, find dealing with the nuisance of creditor calls is worth it in order to avoid bankruptcy or save thousands of dollars versus credit counseling, especially since many will simply use caller ID to screen calls, get a new phone number, or rely on a company-supplied script for dealing with harassing creditors. Furthermore, calls can be reduced appreciably once accounts are more than six months past due and are being handled by collection agencies, who are bound by the Fair Debt Collection Practices Act (FDCPA)and required to honor a debt negotiation company's Power of Attorney (POA).

(4) Balances increase from late charges and interest

As shown in section 2, "Potential for lawsuits," the savings from debt settlement programs are significant even when viewed exclusively in terms of dollars saved versus the original balance. As mentioned, TASC statistics show clients have settled their debts at 42% of their original balances. This being the case, the concern over balances increasing while accounts are being negotiated is largely exaggerated and only affects a small demographic of clients - those who choose to terminate their programs and resume payments to their creditors – and a small portion of settled accounts – those with small balances that grow dramatically by percentage because conditional fee late charges have a greater impact proportionally on small balances than large ones.[33]

The truth of the matter is, when properly disclosed about the drawbacks, few if any consumers, have the mindset, "I'll try to settle my debts, and if I don't like it, I'll just resume my payments", and therefore, in light of statistics showing that increased balances rarely impinge on a settlement company's ability to resolve a client's accounts, levying criticism against the solution because balances increase while accounts are being negotiated is mostly superfluous. When a program is not completed, it is typically because the client can no longer afford it, pushing them into bankruptcy, where the fact that balances increased during the program has little bearing because the debts will be wiped out anyway.

(5) Tax implications from settling

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[33] For example, a $50 late fee assessed to a $500 balance would increase the balance by 10%, whereas that same late charge added to a $10,000 balance would only increase the balance by 0.5%. Due to this fact, many debt settlement companies, encourage clients to exclude balances below $1000 from the program.

Although the tax implications of settling are certainly an added cost for some consumers, the number actually affected by this is far fewer than critics contend because clients who are insolvent (owe more in liabilities than the value of their assets) qualify for a partial or total exemption by the IRS from taxes on the forgiven portion of their debts. As one might expect, a large portion of debt settlement clients are not actually solvent because if they were, they would more than likely choose another option that does not affect their credit such as refinancing their mortgage, getting a home-equity loan, or borrowing against a life insurance policy, just to name a few of the countless options that solvent consumers may have at their disposal which most would prefer to debt settlement.

Another exaggeration made by some critics is that clients not only get large tax bills that they cannot possibly afford, but those bills essentially nullify any savings one receives by settling. Since consumers are taxed on a percentage of what they save, even in theory it is difficult to conjure a scenario where this is even possible. Moreover, the tax liabilities are rarely due in an exorbitant lump sum because they are spread out over the tax years of the program, which typically lasts two to three years.[34] Finally, even if the taxes from settling are in fact high, it is the by-product of a successful program where the consumer saved a lot off their balances. Certainly the tax consequences of settling affects the real total cost of the program and makes the savings quotes advertised by some settlement companies inaccurate, but this issue can be addressed by adding marketing provisions to the proposed legislation prohibiting specific percentage savings quotes and is surely not justification for eliminating debt settlement as an option.

Moreover, in light of the fact that the drawbacks of debt settlement are indeed serious and best to be avoided by those who have other options, why then is the proposed legislation putting forth fee requirements that will have the net effect of having more consumers use debt settlement services than less? The reality is up front fees serve as a screen or deterrent from having consumers who are unsure of whether debt settlement is right for them to enroll.

Consumers who are Unfit for Debt Settlement Choose Other Options

As stated previously, debt settlement companies serve a specific niche of consumers who are overextended with credit cards and have no realistic option outside of bankruptcy. The vast majority of consumers do not fit into this category, and as a result, when there is proper disclosure about the consequences and potential risks of debt settlement, they will typically choose another solution if one is available to them. These numbers are also in line with TASC survey statistics that suggest only 6 to 7% of consumers who contact debt settlement companies choose to use their service, which is a fraction of the 30 to 35% of those counseled who enroll in DMPs.[35]

In other words, strict disclosure requirements are the best way to ensure that only well-qualified consumers are enrolling in debt settlement programs, and the notion that a "percentage of savings" fee mandate will accomplish this goal more effectively is both naïve and false. Not only are there examples

[34] Forgiven debt is reported on the tax return of the year in which the settlement occurred.

[35] Hunt, 2005

of debt settlement companies who relied heavily on a "percentage of savings" revenue that have been prosecuted for unfair and deceptive trade practices, but a significant portion of up front fees collected is used to pay the costs associated with verifying that only well-qualified consumers are enrolled (this will be detailed later in the section, "Why some up front fees are necessary, justified, and beneficial to consumers"). [36] In a best case scenario, a "no up front fee" mandate would force companies to scale back qualification services. In a worse but more probable scenario, it will in effect eliminate the industry altogether.

Understanding the Complaints in their Proper Context

The purpose of this report is to put debt settlement in its proper context, not to pretend that problems do not exist within the industry. The complaints regulators *are claiming* to be receiving is a testament to the gravity of harmful practices within the industry, practices that well-conceived legislation can fundamentally correct. Still, before delving into the types of regulation that would protect consumers, it is important to address why regulators are drawing false conclusions, such as Lisa Madigan's that "consumers seldom, if ever, see their debts settled" in debt settlement programs.[37]

For starters, it seems that regulators are drawing conclusions about debt settlement based on information uncovered in investigations of "bad actors" within the industry. One useful analogy for this would be if regulators were to draw conclusions about the legal profession based on investigations of attorneys who have complaints filed against them with the Bar. This is implied by statements such as Treasurer Giannoulias': "We haven't seen many cases in which these companies actually help consumers."[38]

Regulators are drawing conclusions based on the fee structure being up front. For one, many are misinformed about the very premise of this conclusion and believe that debt settlement companies charge all of their fees up front, which is false. Not only are consumers a lot smarter than this premise suggests and would rarely agree to such an arrangement, but collecting fees over a period shorter than the first half of the program is against TASC standards.

Perhaps more widespread is the popular misconception that the standard 5% of total debt up front fee is a reflection of the industry's lack of confidence in the service we provide, as if there is a "mad dash" to collect payments from consumers before they realize that the service really does not work. This false conception is solidified by media coverage from seemingly factual and authoritative sources who continue to claim that debt settlement *rarely* provides a benefit, which TASC statistics show is patently

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[36] See "FTC Charges Better Budget Financial Services with Defrauding Debt-burdened Consumers, " November 9, 2004, http://www.ftc.gov/opa/2004/11/bbfs.shtm. In this case, the company charged fees that were very much in line with what Mr. Giannoulias is purposing – a set up fee, monthly maintenance fees of between $29 and $39 per month and a settlement fee of 25% of the amount saved.

[37] "Lisa Madigan Continues Her Crackdown on Debt Settlement Industry," Illinois Attorney General, September 30, 2009

[38] "Debt Settlement Companies: Illinois Treasurer Alexi Giannoulias has outline to regulate them," Chicago Tribune, October 2, 2009

false.[39] The truth is, however, this up front fee, which is not charged by all companies and accounts for 33% of all the fees collected, is a reflection of the fact that any business has marketing costs, which tend to be high for most financial services, and that roughly 25% of the services consumers benefit from – counseling and underwriting – are rendered before a company ever receives a payment.

Certainly the age of the industry is also a source of many of the issues that have plagued it. Much in the same way every service and product is perfected over time to limit any unwanted complications and improve results, the same is true for the marketing, sales practices, and services provided by settlement companies. A new industry, many mistakes have been made along that way that have harmed consumers and caused complaints, particularly in regards to how people understood the marketing claims being made. Unfortunately, these lessons could only be learned by surveying actual client experiences, long after any unintentional misrepresentations or errors that lead to complaints were already committed. Moreover, in any emerging industry one should expect that bad players will be able to harm consumers far more than in a developed one, where consumers are better informed about the nature of the services and how to distinguish "bad actors" from good ones. As more information emerges about companies over the course of time, this will be even easier to distinguish.

In other words, it would be unwise to make assumptions about debt settlement based on complaints because not only do these complaints represent a very small fraction of what is happening within the industry, but some complaints are a reflection of the fact that the industry is in its infancy, which makes drawing any conclusions about its *inherent* nature and certainly legislation that threatens to permanently eliminate the industry based on these complaints even more problematic.

Since there is such a clear and sizeable demographic benefiting from debt settlement services, a more practical approach would be to create safeguards to ensure that the greatest number of consumers are benefiting from these programs while limiting the number of consumers who suffer. While certainly the legislation attempts to do just this, unfortunately, the simple answer of basing fees on savings will not work because not only is it cost-prohibitive for debt settlement companies, but it will radically alter the industry's relationship with its clients and banks to the point that any consumer benefit previously enjoyed would in all likelihood be eliminated.

Part II - Why up front fees are necessary, justified, and beneficial consumers

Put simply, there is value added and costs in the enrollment of clients that both justify up front fees being charged and are necessary for debt settlement companies to continue operating and providing the best possible service to consumers.

The Value of Counseling

Some of the most critical services provided by a debt settlement company occur before a consumer becomes a client. Statistics suggest debt consultants, who are a consumer's initial contact in the

[39] See "Few Get Major Debt Relief from Settlement Firms," Wall Street Journal. November, 9, 2009

process, counsel roughly 14 to 16 consumers for each one that enrolls, speaking to the typical enrollee for several hours and in a number of exchanges on both the phone and via email in order to help them to completely understand what options are available and how debt settlement works. Not only are consumers who enroll just a small portion of the people who receive assistance from consultants, but the time and quality of the service they provide is essential for ensuring that only well-informed and well-qualified consumers are enrolling in our service. Without *any* up front fees, it would be impossible for a debt settlement company to subsidize a high level of service in this area, which will cause more consumers who are attracted to the low monthly payment promised by debt settlement but with only a cursory understanding of how it actually works to enroll. In other words, even if a company does attempt to operate under the proposed legislation, it is likely that a major mechanism at play today that is causing complaints will not only exist in spite of that legislation, but it will actually proliferate.

The Value of Qualification Services

The services and expertise offered by debt consultants is just a portion of the services debt settlement companies provide before a payment is ever received, which are necessary to reimburse. In addition to that, we have a full-time underwriter who processes potential clients and ensures that consultants are not enrolling someone into our program who is unlikely to see a benefit. This function entails reviewing a consumer's profile by creditor, what they are proposing to pay on a monthly basis to the program, and by the state in which they reside, to safeguard consumers who will be the likely target of legal action from enrolling. In addition, underwriters verify that accounts are not secured or cross-collateralized or do not have recent cash advances, large purchases, or balance transfers, which some creditors interpret as fraudulent if done prior to becoming delinquent, to name just a few of the situations that underwriters are required to review in detail. After a consumer has opted to enroll but before a payment is debited, the underwriter reviews all the paperwork submitted by a client to make sure we have the documentation necessary to negotiate on their behalf, and finally, gives a welcome call to every new client to reiterate important points about the program and ensure they fully understand the nature of debt settlement.

The Value of Customer Service

Just as high quality counseling and underwriting is essential to ensuring that only well-informed and well-qualified consumers are enrolling in settlement programs, high quality customer service is vital to calming the fears of clients throughout the process and making sure those programs are actually completed. The only way companies can combat the threats and intimidation tactics of creditors, not to mention the attacks made against the industry in the media, is by strengthening the bond of trust with their clients, which can only be achieved through intelligent, reliable and incessant customer service, particularly in the earliest stages of the program before a client realizes a settlement and gains confidence that the process works. Customer service, however, is something that companies would be forced to scale back because of the "no up front fee" ban in the proposed legislation, and therefore, unless provisions are added limiting the actions creditors can take against clients in debt settlement plans, the net effect will be that more consumers, not fewer, will terminate their programs.

The Earliest Stages of the Program Are the Most Labor-Intensive (and the Costliest for Companies)

The notion that debt settlement companies will work harder to better qualify consumers and keep clients enrolled because their compensation is tied to it makes sense in theory, but as shown above, it will be nearly impossible to realize in practice because of one of two possibilities: One, it will be too difficult for companies to operate profitably within regulatory requirements that force them to subsidize the most labor intensive portion of the program before they can receive a fee, eliminating the industry as we know it; or two, companies will scale back their services to the point that unqualified consumers continue to enroll in settlement programs where they receive inadequate customer service, are surprised by the nature and effects of the plan, and eventually file bankruptcy. As you know, the negative effect that debt settlement companies can wreak on consumers' financial health extends far beyond the fees that are paid for those services, so it is naïve to believe that complaints will stop as long as the consumer did not pay any up front fees. For example, a consumer losing their home because they unknowingly enrolled a cross-collateralized account is not going to be put at ease because they did not pay any up front fees. As a result, it is the opinion of this report that the proposed legislation needs to put greater emphasis on strict written <u>and</u> verbal disclosures, but tread lightly on changing the way debt settlement companies can charge fees because the unintended consequences of such a change will harm consumers.

Contingency Fees Are More Expensive

Another such way consumers will be harmed, for example, is that a "percentage of savings" fee, while helping those clients who terminate their programs and do not realize settlements, will in all likelihood make it more difficult for clients who would otherwise complete their programs in a conditional fee arrangement to save the money necessary to settle their debts. The reason for this is fee cap proposed in the legislation (35% of savings, not the 5% of savings under Attorney General Madigan's proposal which would be impossible to operate under) will actually be much higher than the 15% conditional fee currently charged by most companies.[40] Not only will the gross cost of debt settlement programs be higher, but because of this it will take longer for consumers to accumulate savings to effect settlement under this arrangement since, as is already the practice of companies in the industry who base their fees off of savings, settlements will not be formalized until both fees and the settlement amount are available for payment.

Contingency Fees Threaten Third-Party Objectivity

An "up front fee" ban will also threaten one of debt settlement's biggest strengths - the objectivity of a third-party advocate who takes a comprehensive view about how to best resolve a client's debts. It is easy to imagine this fee structure causing more debt settlement companies to be short-sighted in their aims, settling the accounts that promise the steepest discounts and larger commissions first instead of creditors that are more likely to cause problems for the client by becoming aggressive in terms of

[40] Assuming a client with $30,000 of debt settles their accounts for 42% of their original balances, the typical resolution for 2007 clients, the fee paid under the proposed legislation would be $6,090, or $1590 more than what he or she would currently pay under our 15% conditional fee arrangement.

pursuing legal action. Even though a broader view of the client's debt situation would ultimately benefit both the client and the debt settlement company by helping more clients complete the program for less money and in a shorter time period, it would be naïve to assume that debt settlement companies will not consistently look for "quick fix" settlements that pay a lot immediately and help their short-term cash flow, which will undoubtedly become a major business concern for all debt settlement companies under the proposed legislation, but put the client at greater risk in the long run. One important cause for why the percentage of legal accounts is relatively low compared to settled accounts is due to efforts made by companies where negotiators are encouraged to negotiate with historically litigious creditors before unproblematic ones.[41]

Contingency Fees Do Not Reflect Most Consumers' Main Objective – To Avoid Bankruptcy

Another problem with a contingency fee arrangement is that clients lose a great deal of control over their programs, as there are now two aims that must be met – the client's and the company's. Contingency fees will give settlement companies a powerful incentive to bring in the largest cash savings for clients, but what if this is not the goal of the client? The assumption that in every or even in a majority of instances the purposes will be the same fails to recognize the variety of client objectives in debt settlement programs, not to mention the varying degrees of how much clients hope to save. It has been the industry's experience that most consumers simply want to resolve their debts and success for them is determined by whether or not they become debt free, not how much saved off their balances. In a contingency arrangement, it is easy to imagine scenarios where settlement companies pursue aggressive strategies to save their clients as much as possible, which again may not be their goal, or dragging out negotiations for longer than what is necessary in order to obtain a needlessly low settlement percentage. Along the same lines, it is easy to imagine scenarios where companies turn down reasonable payment plan offers on legal accounts in order to force settlements so they can receive compensation.[42] Many scholars have shown that contingency fees ultimately lead to attorneys to pursue riskier legal strategies, and one should expect the same in the debt settlement arena even though this is the very last approach their clients desire.[43]

Contingency Fees Will not Make Companies More Precise In Terms of Who They Select for Enrollment

A final myth to dispel is that of how debt settlement companies will be more selective under a "percentage of savings" model. The truth is a business model based on investing little in qualification

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[41] Client has an account with Creditor A and Credit B. Creditor A is offering a 55% settlement of a client's debt and the company knows from past experience that Creditor A is the more likely to pursue legal action against a past due debtor than Creditor B and has been difficult with the payment terms in these situations. The settlement company also knows that Creditor B will settle for 20% of what's owed regardless of when that occurs, whether that's today or 18 months from now. Even though the settlement company knows that by settling with Creditor A instead of B, the client can avoid the risk of a lawsuit and ultimately save more in the end, the company decides it's not worth the risk of not getting a high commission if the client drops out and chooses to settle with Creditor B anyway.

[42] The social costs of a contingency fee arrangement will also be higher as debt settlement companies will aim to settle for unnecessarily low rates and drag out negotiations to the point where there is more litigation, further clogging up courts with debt collection cases that ultimately are paid for by taxpayers.

[43] Emons,Winand, "Conditional versus Contingency Fees", CEPR Discussion Papers, 2004

services, enrolling as many accounts as possible, hiring commission-only employees to negotiate them, and "playing the lottery" with consumers' debts is arguably more financially viable than one based on attempting to precisely determine the likelihood of success and only accepting those clients who will complete their programs, which, as shown earlier, is difficult if not impossible to gauge. Furthermore, the fee structure required by the legislation gives companies just as much incentive to enroll consumers that have one or more accounts that can potentially be settled, but have no realistic hope of resolving the rest of their accounts and will have to file bankruptcy anyway. Although it is worth noting that this demographic does not benefit in a conditional fee arrangement either, it is important to dispel the misunderstanding that contingency fees will benefit *all* consumers who do not complete their programs and that debt settlement companies will not benefit from enrolling consumers who will not realistically complete their plans under this fee structure. Finally, even if contingency fees do in fact cause settlement companies to be more selective in their qualifications, this could lead to a situation where only "cherry-picked" clients are chosen, causing thousands of consumers who would otherwise benefit from a debt settlement program to not be accepted. Certainly complaints would be reduced, but a better way to achieve this, again, is through strict written and verbal disclosure requirements.

Contingency Fees Will Only Benefit a Minority of Parties

Overall it is clear that we can only say that an up front fee ban would benefit a small minority of the main parties who have a stake in legislation – those consumers who do not realize <u>any</u> settlements, which only makes up a portion of the consumers who do not complete debt settlement plans, while harming (1) consumers who otherwise would complete their plans but cannot due to their inability to accumulate the savings necessary for settlement amounts and fees, which will be higher under a contingency arrangement than a conditional fee arrangement and (2) consumers who do complete their programs but pay thousands more in fees than they would otherwise. With only a small segment of consumers standing to benefit from these changes, lawmakers must ask: is it worth reshaping the fee structure so dramatically to the point that it threatens to eliminate the industry altogether, especially when all signs point to the fact that fee structure created by free market forces may foster a greater amount of consumer welfare anyway?

The Fees Charged by Debt Settlement Companies is in Line with other Debt Relief Options

Astonishingly, the free market may have not only found a fee structure that benefits the greatest number of consumers, but it has also found an amount that is alarmingly similar to the fees received in other debt relief plans. Hunt (2005) shows that credit counseling companies earn approximately 12.2% of the debt owed on the average DMP when accounting for Fair Share, and from the Government Accountability Office's 2008 report on attorney fees since the Bankruptcy Reform became effective in 2005 shows that the total cost for filing is roughly $4,000, or just $500 less than the typical client pays in debt settlement.[44]

[44] Hunt (2005) reports that the average Fair Share fee earned on DMPs is 6% of the payments collected. Assuming a 12% interest rate on $22,000, the figure widely cited as the typical amount owed for a DMP, and monthly maintenance fees of just $15 for 60 months, one concludes that the agency will receive $2700 in fees. Bankruptcy

Debt Settlement is More Labor Intensive than DMPs

The relative similarity of the fees received alludes to the fact that fees charged by settlement companies are likely justifiable, but it becomes even more clearly justified when one considers that credit counselors have a much less labor intensive process. Administering DMPs is almost completely automated since the qualifications and concessions offered by banks are 100% pre-determined, and there is little to no customer service beyond changing of payments. Debt settlement programs, on the other hand, are very labor intensive since the qualification and creditor negotiations are almost entirely individualized. Unlike DMPs, where obtaining creditor concessions on each of a client's accounts is literally as fast and as simple as entering their creditor information and clicking a "submit" button, negotiations for settlement offers is very time-consuming and typically involves speaking to a variety collection agencies and departments within banks, submitting numerous verbal and/or written offers and counter-offers, and in some cases, providing written documentation of budget, asset, and financial hardship information just to settle one account. This does not even include the "behind the scenes" work done by negotiators such as creating a tentative settlement priority list; calculating client savings and determining which accounts can be settled, for how much and over how many months; calculating and adjusting client debits to account for payments being made to creditors on structured settlements; obtaining the record for each settlement and documenting it accordingly; and communicating to clients the merits and drawbacks of settlement offers made by creditors and advising them on ones that are worth accepting.

On top of all of this, settlement programs also require a great deal more of ongoing customer service in order to combat creditor threats and collection tactics that pose serious threats to the success of the program. The significant differences in labor intensiveness between administering the two options is also supported by anecdotal evidence that suggests that a debt settlement company with an equivalent number of clients to a credit counseling agency needs ten times the staff to service those clients.[45]

Despite all of this, however, the fees proposed in the legislation would put us on the same pay scale as credit counselors, who as shown above, have a much less costly program to manage and yet receive approximately 2/3 of their revenue from fees not accounted for in the legislation.[46] Clearly it would be difficult, if not impossible, for debt settlement companies to operate under these regulations, which is further supported by a TASC survey (2009) that found that 9 out of 10 debt settlement companies would be forced to close if they could not charge an up front fee.

A No Up Front Fee Ban Will Increase Costs & Fewer Consumers Will Complete Their Plans

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fees are based on information provided in "Bankruptcy Reform: Dollar Costs Associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" by the Government Accountability Office (2008). The fee quoted here for bankruptcy is referred to as a "no look" fee, and attorneys usually charge additional fees if cases are complicated, creditors contest the plan, or there is additional work outside of a routine filing.

[45] Housser, Andrew. "Re: Telemarketing Sales Rule – Debt Relief Amendment – R41101," The Association of Settlement Companies, 2009. As an example a credit counseling agency with 30,000 clients has a staff of 50, whereas debt settlement companies would need 500.

[46] This can also be deduced from the figures provided in footnote 21 since the total Fair Share received in the above example is $1808 out of a total $2700 in fees.

The assumption of this survey was that all other market conditions in existence today would hold true and many of those surveyed were in essence answering the question, "Can you afford to sustain your operations for six to eight months without receiving any fees?" Due to changes in how fees would be charged, however, one should reasonably expect the cost of administering debt settlement programs will increase as well. One, consumers will have very little disincentive to enroll in debt settlement programs even if they do not have the resources to fund it and therefore, it is reasonable to expect that settlement companies will be forced to absorb the costs of underwriting, counseling, and customer service on behalf of consumers who never even save for settlement. [47] Two, up front fees are for many a financial as well as a psychological commitment to the program, and far more clients will terminate their plans in the face of even small obstacles without paying it, forcing companies to absorb significant costs servicing clients who deactivate their accounts before any settlements can be realized. In the same way that homeowners who make a down payment are less likely to default on their mortgage than those who do not, it is plausible that debt settlement companies will experience higher termination rates without an up front fee. [48]

Clients Will Have an Incentive to Settle with Creditors on their Own

Inevitably some clients will attempt to circumvent the debt settlement company by refusing the settlements we arrange and working directly with creditors instead. Under the proposed fee requirements, both clients and collectors will have an incentive to agree to settlements with each other that are *costlier than the ones negotiated by the settlement company*.[49] If some clients do not realize this on their own, surely their collectors will remind them of this fact, especially since this type of behavior should be expected by collection agencies given their compensation and their poor ethical track record, not to mention the proposed legislation specifically bars settlement companies from advising consumers to not deal with their creditors.[50]

Contingency Fees Will Put Consumers in Danger & Weaken Competition

In the end, the fee requirements in the proposed legislation will cause costs to go up for debt settlement companies, while simultaneously delaying the time they will have to wait until they can receive fees to subsidize those costs. This being the case, in a worst case scenario, the industry would be eliminated altogether, and in a best case, some companies willing to burn through massive amounts of capital and

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[47] Anyone who questions what incentive a consumer has to enroll when they have no hope of completing the plan underestimates just how much nervous debtors want to find ways to get collectors to leave them alone or how much debtors intent on avoiding bankruptcy will convince themselves that a plan can work, particularly when they are already delinquent on their payments and have very little to lose by enrolling.

[48] See "New Evidence on Foreclosure Crisis, "Wall Street Journal. July 3, 2009. Based on a regression analysis of 30 million mortgages compiled by McDash Analytics, homes where the buyer paid less than 3% of the value as a down payment was the fourth leading cause of foreclosure, after negative equity, subprime credit, and unemployment.

[49] Consider a situation where a debt settlement company negotiates a 20% settlement and charges a 30% fee on the savings, which is less than the maximum fee allowed under the legislation. Under the provisions of the legislation, the consumer would pay less by accepting a 43% settlement made directly by the creditor *after* a company already negotiated the account.

[50] Individual collectors are usually compensated based on the volume of debt they are able to collect on a monthly basis. The FTC reported that in 2008 almost 20% of all consumer complaints were directed at collection agencies.

take out large lines of credit will try to survive. This begs not only the question is it safe to put the financial welfare of thousands of consumers in a position where they are forced to choose a company willing to assume such risks, but perhaps just as important, do consumers stand to benefit from legislation that significantly weakens competition between debt relief alternatives and within the settlement industry itself?

Banks Will Be Able to Directly Impact our Industry

By tying our fees to the savings of clients, the legislation gives banks a way to directly control the future of the industry. As one can easily deduce from the lessons learned from their role in bankruptcy reform and the credit counseling industry, it is only reasonable to expect credit card companies to create policies that will severely limit the consumers who are allowed to benefit from our service, if not eliminate it as an option altogether. In theory, banks could do this even without the proposed legislation. However, this does not directly impact debt settlement companies under a conditional-fee arrangement and therefore, it is a futile exercise for banks because it would only force a higher number of consumers into bankruptcy without financially impacting the settlement industry outside of negative publicity. In other words, the conditional-fee arrangement gives banks a high incentive to work with settlement companies because they stand to lose more than them by not doing so. The same cannot be said of a contingency fee arrangement, where deep-pocketed banks would gladly force consumers into bankruptcy and sustain losses to permanently and severely weaken one of their biggest adversaries, much as they did by paying millions of dollars to lobbyists in order to get bankruptcy reform passed in Congress.

At best, banks and collectors will insist on higher settlement terms for clients of debt settlement companies and hold out knowing that these companies need settlements to fund their operations. At worse, credit card companies and the collection agencies they assign debts to will effectively blockade our industry by refusing to negotiate with debt settlement companies. Under the fee structure of the proposed legislation, it would take six months of a unified front of collectors and credit card companies refusing to negotiate with settlement companies to permanently eliminate the industry.[51]

Contingency Fees Attract Consumers whose Goal is to Save off their Balances, not to Avoid Bankruptcy

Realistically this type of event should be expected under the proposed legislation because a contingency fee structure will attract more consumers whose underlying goal is to save as much money on their balances as possible, as opposed to the group attracted to a conditional fee arrangement – consumers who simply want to avoid bankruptcy. That is, a consumer who can realistically pay off their debts but whose aim is to save as much as possible will be attracted to a compensation arrangement that rewards low settlements rather than one where the company is rewarded so long as the client avoids bankruptcy. This being the case, one of the mechanisms causing banks to deride our industry will be much more prevalent under the proposed legislation. Furthermore, the invisible social returns being

[51] This type of situation does not come without precedent. Between 2005 and 2006, Citibank attempted to do exactly this, refusing to negotiate with settlement companies and mandating that collection agencies who they assigned accounts to do the same.

rendered by debt settlement companies – benefits to banks and subsequently borrowers as a whole from helping creditors recover money that otherwise they would lose in bankruptcy – is going to be partly offset by losses sustained from those consumers enrolling that would otherwise pay their debts off in full.

Finally, the proposed legislation implicitly makes the assumption that debt settlement companies guarantee success, when in fact all debt settlement companies guarantee is to offer their services to assist consumers in settling their debts. If the company does in fact provide the services promised to the client, they should be compensated according to the agreed upon fee for said services, as is the case in almost every other industry. Debt settlement companies cannot and do not guarantee success because much of it lies beyond their control since, as shown earlier, a great deal of the success is dependent on the client's ability to meet the savings requirements of the program. Therefore, forcing debt settlement companies to follow a contingency fee arrangement where they can only receive payment after a debt is settled would be akin to requiring doctors to receive compensation only once a patient is healthy, which would be at least slightly justifiable for a one-time surgery where the funds for payment were guaranteed by an insurance policy, but a more appropriate analogy for our purposes would involve a situation where the patient's health was largely dependent on whether they can afford to pay for their medication every month and be disciplined in taking it as prescribed over a two to three year period.

Part III – What Complaint Statistics & Economists Have to Say

Complaints in their Proper Context

As with much else in the analysis of critics of debt settlement, conclusions drawn about the industry based on complaints against it lacks context. Perhaps most importantly, the critics are failing to account for the volume of consumers the industry is transacting with. By looking at BBB complaint statistics from 2008, one sees that the debt settlement industry is in all likelihood exceeding customer satisfaction relative to other business sectors.

The BBB reports information not only about the number of complaints against industries, but also the number of consumers who inquire about particular industries, which they track online based on the number of times consumers click on companies' business profiles, as well as the number of times consumers call the BBB to get information about specific companies. Looking at inquiry statistics is useful because it puts complaints in their proper context. That is, 100 complaints against Verizon Wireless is a lot less problematic than 100 complaints against Joe's Auto Shop because Verizon probably transacts with a lot more consumers. Therefore, a more insightful metric than simply the number of complaints is the number of complaints relative to the number of inquiries.

The Number of Complaints is Very Low Relative to the Number of Consumers Using Debt Settlement Services

By comparing the number of consumer inquiries to complaints of industries nationwide, one finds that Debt Negotiation has the tenth lowest inquiry to complaint ratio of the 200 most inquired about

industries. [52] In sum, a meager 0.22% of consumers who inquired about a Debt Negotiation company complained about it, or six times less than the average industry (1.4%), and none of the nine industries ahead of Debt Negotiation have reputations as being particularly unfriendly to consumers, such Architects, Charity, Chambers of Commerce, CPAs, and Home Health Services, to name a few.[53] This highlights that a long-held contention of the industry – that the industry's complaints are low relative to the number of consumers using our services – is probably true.

Demand for Debt Settlement is Larger than the Number of Consumers Using It

Not only does this suggest that complaints are low when accounting for the number of consumers using debt settlement services, but also that the market for debt settlement is *much larger than the actual number of consumers participating in it*. The industry is not so naïve to believe that the service we provide is so far and beyond what other industries deliver to consumers as the BBB statistics would suggest. After all, a difference of more than six times what is typical is extremely significant, especially when one factors in the sometimes thorny nature of the service we offer and that debt settlement is just as prone to human error as the next one. Therefore, one might deduce that the very low complaint to inquiry ratio is a reflection of the fact that many consumers are interested in debt settlement, investigating companies, but not using their service, leading to far less complaints than what is even typical.

Therefore, based on BBB complaint statistics one can safely reason that three other long-held views within the industry are correct: (1) that the practices of our industry are certainly in line with the business practices of most other industries and probably better because of the pressure place on companies to shed even the slightest hint of being unfriendly to consumers in a difficult situation;[54] (2) the portrayal of our industry as filled with more scams and "bad guys" as every other industry is completely illogical, inaccurate and exaggerated; and (3) this faulty view held by the public is causing damage to consumers who would otherwise benefit from using debt settlement services.

Many Consumers Who Are Not Choosing Debt Settlement Are Suffering

Listed below are four groups of consumers who are suffering by not selecting debt settlement:

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[52] One should note that many debt settlement companies are inaccurately categorized under credit/debt counseling or credit/debt consolidation services by the BBB. These other categories include companies that offer DMPs and other debt-related services and have higher complaint to inquiry ratios, but nonetheless, an analysis of the debt negotiation category is worthwhile since presumably 100% of the companies under this category are debt settlement companies.

[53] Banks and collection agencies – two of the leading advocates against the "harm being done to consumers" by debt settlement companies - are two of the highest at 6% (# 2 of the top 100 most inquired about industries, 20,935 total complaints) and 4.6% (#6 of the top 100 most inquired about industries, 16,142 complaints in total), respectively.

[54] This extra pressure is further solidified by BBB statistics that show Debt Negotiation companies are resolving almost 25% more of their complaints than the average industry.

- The hundreds of thousands of consumers every year who continue to pay thousands of dollars in DMPs before filing bankruptcy that have a much higher likelihood of becoming debt free through debt settlement
- Consumers who lose their homes or other property every year by discharging credit card debt in Chapter 7 bankruptcy who could have otherwise settled their debts
- The thousands of consumers who are forced to file Chapter 13 bankruptcy, which is arguably worse for their credit and more expensive than debt settlement, not to mention it is less likely they will successfully resolve their debts
- The thousands of consumers who fall behind on their credit cards and have as much as 25% of their paychecks garnished until the debts they owe are paid off in full plus interest
- The thousands of consumers who call the credit card companies and request interest rate concessions but are refused that are skipping mortgage payments, dipping into savings and retirement, and struggling to make ends meet because they refuse to file bankruptcy on principle or because it is taboo

In other words, all signs point to the fact that a debt-burdened public needs the market for debt settlement services to be expanded, not contracted, which is opposite of what will happen under a contingency fee arrangement.

Self-Regulation Efforts May Be Working

Complaints with the Illinois Attorney General against debt settlement companies verify another important contention made by the industry – that the industry's efforts to self-regulate and differentiate "good players" from bad ones are working. According to the Attorney General's consumer hotline, one non-TASC-accredited debt settlement company has 109 complaints with the state, or roughly 18 times as many complaints as presumably the four largest debt settlement companies, who are accredited by TASC, combined. In all these four TASC-accredited companies have six complaints. It is also worth noting that the presumed four largest credit counseling agencies collectively have nine complaints according the Attorney General's hotline.

Conditional versus Contingency Fee Arrangements – A Comparison to Debt & Equity Financing

Too many decision-makers, however, have a false impression that it will not matter if the industry is forced to adopt a contingency fee arrangement. Their logic goes: if there are consumers who actually stand to benefit from debt settlement, then companies will simply adjust to a contingency fee arrangement, and if they do not, then it is a sign that the industry could not deliver any results to consumers to begin with. While certainly sensible at first glance, further analysis shows that this reasoning is faulty.

An appropriate analogy to consider is the issue of how markets respond to cases where financing is limited to either debt or equity contracts. Debt financing is actually very similar to the fee requirements of TASC, which are conditional. Under debt financing, where the business receives a loan and is required to pay it back according to the terms stipulated in that loan, the bank gets paid in every case except in those instances where a business fails and files bankruptcy. The same is true for the TASC

conditional fee requirement that mandates debt settlement companies cannot receive compensation in the event that the program fails, which is defined as situations where a consumer made consistent payments for the duration of the program but did not save anything off their balances when accounting for fees paid to the company. Equity financing, on the other hand, is where the bank extends capital to a business in exchange for a stake in that business. Under this type of arrangement, the bank only gets paid in instances where a business succeeds, which is also true for the fee requirements in the proposed legislation, since compensation can only be received upon the successful settlement of a debt.

A Contingency Mandate Will Limit the Number of Consumers Who Are Able to Benefit

Economists have shown time and again that when only one type of financing is available it creates distortions in the marketplace where the number of parties allowed to benefit is unnecessarily limited. For example, University of Chicago's and Nobel-Prize winning economist, Milton Friedman, famously argued in 1945 that the underlying cause for why the number of students who are benefiting from higher education is limited is because people can only finance their education with debt, but not equity for those banks and students who would prefer this type of arrangement.[55] That is, for students who are risk-averse and do not want to finance schooling unless they are sure they will not lose (future income must be greater than cost of education and the income lost while schooling), and investors or banks who are seeking opportunities for a greater return on their investment, an income-contingent loan makes sense for both parties and society as a whole since an educated populace and skilled workforce is good for the public. Complications with the 13th Amendment abolishing slavery make this type of arrangement difficult, however. This being true and since more people pursuing higher education is considered beneficial to society, the government offers subsidies to schools, which has the effect of reducing the cost of education, and guarantees many types of student loans, which has the effect of reducing the cost of financing, and together these actions induce more risk-averse students to pursue higher education.

This being true, and knowing the following:

(a) that there are thousands of consumers who would suffer less by choosing debt settlement
(b) that consumers who choose a debt settlement company are more likely to avoid Chapter 7 bankruptcy than if they did it on their own or used another debt relief option such as credit counseling or Chapter 13 bankruptcy;
(c) that the aggregate savings for consumers is higher than the fees paid for that service;
(d) that the aggregate savings of those who complete their plans is in all likelihood greater than the non-refundable payments lost by consumers who did not;
(e) that consumers who use this solution are helping banks recover more than they would if they filed Chapter 7 or simply stopped paying,

Then is not debt settlement a public "good"? This being the case, should not the government be seeking ways to maximize the number of consumers who are allowed to benefit from it? Therefore, unless the

[55] Friedman, Milton, "The Role of Government in Education," in Robert A. Solo, ed., *Economics and the Public Interest*, Rutgers University Press, 1955

government is prepared to offer subsidies to the industry along with a contingency-fee mandate, the greatest welfare even in the short-term will be produced by the free market, where both companies and consumers are allowed to choose a fee arrangement based on their individual preferences and the optimal number of contracts is entered into. Further, if economists are correct, this welfare in the long-run will exceed the welfare produced by government subsidization as competitive forces naturally drive down the fees charged to consumers to attract more business without costing taxpayers.

Why Are Companies Opposed to a Contingency Fee?

It is very reasonable for third-parties to be skeptical of the fact that our industry is aggressively opposed to a contingency fee requirement. On the surface it seems like we have no faith that our service works and that there is truth to statements such as, "consumers seldom, if ever, see their debts settled," which statistics show could not be further from the truth. Again, a comparison of conditional (mandatory by TASC) and contingency fees (opposed by TASC) to debt and equity financing, and debt settlement companies and consumers to banks and businesses, is useful to understand what is at play.

To start, consider Webb and De Meza (1987), which shows that investors with limited information about returns (how much a business will earn) but not risk (whether or not the business will file bankruptcy) prefer debt over equity.[56] Debt settlement is certainly a situation where there is limited information about "returns" but not "risk", since settlement companies are fairly certain a consumer will be able to avoid bankruptcy if they meet the savings requirements but are less certain about exactly how much a consumer will save. According to Webb and De Meza, therefore, it is completely reasonable that debt settlement companies would prefer conditional fees to contingency fees.

To understand why this is true consider the following example of a business that contacts a bank and offers them a 33% stake in his business. The bank tells the business they are not eligible for equity financing but qualify for a $10,000 loan. In essence, the bank is telling the business: *The bank is not willing to bet that the business will be wildly successful because no one can predict that. Certainly that has happened before, but we're not willing to take that gamble. What the bank is willing to bet is that the business will make some money, you won't file bankruptcy, and we'll both benefit. Basically we just want to know if we give you $10,000 we'll be able to get around $11,500 in 18 months. Is that ok with you?*

Now consider the following example of a consumer who contacts a debt settlement company and offers a 33% contingency fee for settling his debts. The company tells the consumer they will not do a contingency fee, but they are eligible for a conditional fee of 15% of what is owed, which will be returned in the event that the consumer does not save any money off his originally enrolled balances. In essence, the company is telling the consumer: *We are not willing to bet that you will be wildly successful because no one can predict that. Certainly that has happened before, but the company is not willing to gamble on that. What the company is willing to bet is that if you make your payments to the*

[56] Webb, David C. and De Meza, David, "Too Much Investment: A Problem of Asymmetric Information," *The Quarterly Journal of Economics,* Vol. 102, No. 2, May 1987, p. 281-292

program you will save some money, you won't file bankruptcy, and we'll both benefit. *Basically all we want to know is that if we provide the service, we'll get $1,500 in 18 months. Is that ok with you?*

These types of arrangements are very simple and have been preferred by most consumers, businesses and lenders over equity financing and contingency fees since commerce began. The reason is simple and not some evil plot to rip off consumers: people by and large prefer to know what they will earn if they invest their money or time into something.

If Companies Are Forced to Accept a Contingency Fee Model, They Need Rights or Control

Now that we understand the preferred type of financing and fee arrangement, let's consider what a businesses' preferences are if they are forced to operate under a contingency basis. According to Nobel-Prize winning economist Joseph Stiglitz, a bank's (debt settlement company's) decision regarding the type of financing (fee arrangement) they will offer will depend upon their risk-preferences, which agrees with what Friedman assumes in the case of student loans. However, Stiglitz further clarifies that what determines a bank's risk-preference "will depend on the extent to which their actions can affect the probability of bankruptcy (or completion or failure in the case of debt settlement)."[57] He goes on to point out that this "probability of bankruptcy" or success will depend on "what actions can be specified within the contract or controlled directly by the principal (which is the bank or debt settlement company in our example)."

That is, a bank or debt settlement company is more likely to offer equity financing or contingency fees if they have more *rights* or *direct control* over what happens. Specifically, one would assume that an investor would be more likely to accept equity financing if, for example, the contract specified the investor would obtain preferred stocked, which stipulates they get paid out as debt in the event of a company's bankruptcy (*rights),* or if, for instance, they received a majority interest in the company *(control)*. In the case of a debt settlement company, one would expect them to be more likely to offer a contingency fee arrangement if it had a guarantee creditors would cooperate (*rights)* or a portion of the funds required to settle were guaranteed by the consumer or government (*control)*. In the case of debt settlement as it stands, however, a company has no rights and all they can control is the counseling, support, and negotiation services provided, not whether consumers fund the program as promised or whether creditors are cooperative. In other words, the current fee proposal is the least preferred fee arrangement possible, and it is so bad for companies that 9 out of 10 debt settlement companies will not continue to operate under it according to TASC's survey.

So in sum, not only is it odd that people have claimed that debt settlement companies are a scam for wanting fees on a conditional basis, which is the preference of most businesses, but it is also odd for our industry to be attacked as a scam on the basis that we are warning government officials that we will not continue our service under the proposed contingency fee arrangement, which gives us none of the requisite concessions needed in order for most businesses and investors to continue under equity or contingency arrangements - namely, *rights* or *control*.

[57] Stiglitz, Joseph and Weiss, Andrew, "Credit Rationing in Markets with Imperfect Information," American Economic Review, 1981

Why No Advance Payment Makes Sense for Credit Repair but not Debt Settlement

Much is made of the fact that credit repair agencies were able to adapt to advance payment prohibition of the Credit Repair Organizations Act, and this is used as justification as to how the same type of ban would work for debt settlement. In the same way that many proponents of the Vietnam War falsely applied the premises of the Korean War in their foreign policy decisions and the other countless examples of from history of decision-makers "fighting the last war," the *quick* application of past examples to current circumstances based on superficial similarities can have disastrous consequences. As shown by Stiglitz, a fundamental difference in terms of why credit repair can exist on a contingency basis is being ignored - credit repair organizations have both *rights* and *direct control* over the performance of their services.

Since credit repair is ultimately just a matter of asserting a consumer's privileges under the Fair Credit Reporting Act, which guarantees a consumer's right to have accurate information reported on their credit, it is easy to see why this is a much more predictable endeavor than debt settlement. Unless the government plans to enact requirements where credit card companies are forced to accept settlements or provisions allowing debt settlement companies to receive a fee for simply making an offer to settle a debt, then it is senseless to apply a situation where one of Stiglitz's preconditions for acceptance of a contingency arrangement exists (*rights)* to a situation where it does not. Solidifying this further is the fact that credit repair organizations have the other precondition required by Stiglitz, *direct control*. Unlike debt settlement where a large part of success is determined by the client's meeting the savings requirements for the program and creditor cooperation, credit repair companies share no such responsibility for success with their clients. In fact, one can assume that the only areas out of the direct control of credit repair organizations is whether their clients are truthful and whether creditors and credit reporting agencies abide by the law. Needless to say, these are safe bets, and therefore, any conclusions about debt settlement based on the credit repair industry's ability to adopt a contingency arrangement will be oversimplified and incorrect.

Part IV - Conclusion

The fact of the matter is no single party is really to blame for the misperception of the industry and the problems it posed. It was a confluence of multiple factors, but mostly a lack of information, a readiness to accuse, and a "perfect storm" of *appearances* that created the *expectation* that it was a "scam". Missing reason, context and important facts, the perception of the debt settlement industry has become completely distorted and the problem posed by it widely exaggerated.

Accusations based on appearances and a lack of information has caused problems in the past, and this is no different. The classic examples from American history are the Salem Witch Hunt and McCarthyism in the 1950s. As in these cases from history, there is a historical context that explains much of the concern. Underlying much of the apprehension about debt settlement is the recent subprime mortgage crisis, which reminded the public of the damage individual actors in the financial sector can do to the economy at large by pursuing their narrow self-interests. Furthering this concern is the Ameridebt scam of the earlier part of this decade, where a large-scale debt relief company and many others like it posed

as non-profits to solicit "volunteer" contributions from debt-ridden consumers. So while the concern of lawmakers is understandable in light of the recent historical background, in light of the actual facts and context surrounding debt settlement it is not.

Unfortunately, this fundamental misunderstanding of debt settlement has resulted in various pieces of legislation that are so ill-conceived that it will ultimately undermine the stated purpose of these proposed regulations – to help consumers and presumably the economy at large. The effects of this legislation will be far-reaching, negatively impacting thousands of consumers in Illinois, as well as thousands of people employed in the debt settlement industry. Therefore, any efforts to regulate debt settlement must be slowly considered and regulators should not hastily apply lessons from industries that share very little in common with it, such as credit repair. Ultimately, much can be gained by stopping the demonization of the industry because not only is this causing consumers who would otherwise benefit from using its services, but in the end the industry itself can provide the most insight into what type of regulation is needed to protect consumers and the industry itself from bad actors.

Appendix

TASC Statistics

TASC conducted a survey with data representing over 75% of the debt under management of member companies. The results from this survey show that debt settlement companies are in fact providing a clear benefit to their clients. The clearest measurement of this fact is consumers who used debt settlement services settled 3.5 times as much debt as they paid in fees. Perhaps just as important to contemplate for the purposes of this legislation, which poses to eliminate the debt settlement industry as a whole, is the volume of debt that companies are currently managing. Based on the TASC survey, it is estimated that member companies, which make up a substantial but not complete part of the debt settlement industry, will settle more than $1 billion in debt in 2009 for just 42% of what is actually owed. Finally, the survey shows that 34.4% of all clients have either substantially completed their programs or are actively saving for additional settlements, with more than 70% of the debts of active but incomplete programs having already been settled.

Assumptions Used to Determine Consumer Benefit & Cost & Recovery Rate for Banks for Debt Relief

Debt Settlement

TASC completion rate: 35%

TASC settlement rate: 42%

Percentage of accounts settled: 90% (conservative estimate)

Percentage of accounts resolved on payment plans: 10% (conservative estimate)

Total cost of legal accounts: 137% of the original balance (conservative estimate)

Average debt amount: $30,000 (anecdotal evidence)

Average fee amount: 15% paid out over 18 months (anecdotal evidence)

Average estimated payout quoted consumers by debt settlement companies: $19,500 (anecdotal evidence – 50% estimate plus 15% fee)

Average program length: 30 months (anecdotal evidence)

Average termination: 8 payments (no data available, so to be fair I applied the same drop out period of 8 months for debt settlement, DMPs, and Chapter 13 bankruptcy).

Average fees collected: 35 pay $4500 or $157,500, average termination is after 8 fee payments so 65 pay $2000 ($130,000) for $287,500

Total debt settled: 10% for 33% of consumers = $99,000, 100% for the 35% who graduate = $1,050,000 = $1,149,000

Total debt resolved on lawsuits: $114,900 (90% of accounts are settled and 10% are on payment plans)

Total cost of lawsuits: $157,413 (137% of the original balance)

Recovery rate for banks in debt settlement: 18% (based on 33% of consumers in settlement plans settle their 9% of their debts ($30,000) for the TASC settlement rate of 42% of what is owed ($2700 is settled for $1134, or $37,422) and 1% of their debts on payments plans for 137% of what is owed ($411 or $13,563), based on TASC completion rate, 35% settle 90% of their debts for 42% ($11,340 or $396,900 total) of what is owed, 10% resolved on payment plans for 137% of what is owed ($4,110 or $143,850), 32% settle nothing

Real total cost to graduates (including fees): $19,900 ($11,340 for settled debts, plus $4,110 for lawsuits, plus $4,500 in fees)

Total cost to graduates as a percentage of debt: 66.5%

Savings off balance- $509,250 ($15,660--savings on settlements---minus $1,110, which is the added costs of legal accounts is $14,550 for 35 consumers)

Highest possible tax amount (35%): $178,237

Savings versus the next least expensive option (DMPs, which is calculated as 12% interest paid over 60 months)= $742,000

Fees + non-refundable payments = $338,485 ($50,985 plus $287,500 fees)

Consumer benefit off balances assuming each is insolvent: $170,765 ($509,250, which is the savings off the balance) – ($338,385, which is the money lost in non-refundable payments)

Consumer benefit versus DMPs assuming each is insolvent: $403,515 ($742,000, which is the savings versus DMPs) – ($338,385, which is the money lost in non-refundable payments)

Savings off the balance if consumers are solvent and in the highest tax bracket (35%): -$7,000 (consumer benefit off balances if each is insolvent, $170,765 minus highest possible tax, or $178,237)

Savings versus DMPs if the consumers are solvent and in the highest tax bracket: $225,278 ($403,515, which is the savings versus DMPs, minus $178,237, which is the highest possible tax)

Debt Management Plan Assumptions (DMPs)

Average debt amount for DMPs: $22,000 (Hunt, 2005)

Average program length: 60 months (anecdotal evidence and this is oftentimes when a consumer can have a lower payment than their minimums, which are usually 2.5% of the balance)

Average interest rate: 12%

Average total payout for DMPs including fees: $31,230

Average payment with fees in DMP: $520

Average fee in DMP: $15 / month

Average set up fee in DMPs: $30

Average Fair-Share kickback: 6% of payment

Average number of payments before termination in a DMP: 8.63 (based on Hunt (2005) saying 50% are terminated within 6 six months but that 28% are self-administered and settlement statistics showing that 80% of consumers who enroll in our debt settlement program terminate in the first year)

Recover for Self-administer = (use the same proportions as DMPs for completions versus terminations, 57% terminate versus 21% 2.71 to 1 to terminate to complete, so of the 22% who self-administer one 16 would terminate, paying $69,728 and 6 would complete, paying $181,800 and therefore the recovery would be $251,528

Creditor recovery rate in DMPs: 52% or $1.144 million on $2.2 million 21% pay $30,300 = $636,300, 57% pay $4,358 = $248,046, 22%

Fair Share received by DMPs: $68,640

Creditor recovery rate minus Fair Share paid: 49%, or $1,075,360

Fees received by credit counselors from consumers: $18,900 from 21% graduates, $7,378 from terminations = $26,278 (self-administered are omitted even though credit counselors receive some monthly fees from them), set up fee of $30 x 100 = $3,000 = $29,278

Total received by credit counselors: $97,918

Chapter 13 Bankruptcy

Completion rate: 33% (Justice Department's "Measuring Chapter 13 Statistics across States")

Average amount scheduled to be repaid: 35% of the debt or roughly $10,500 (Hunt, 2005 says that the average attorney fee is $1500, which is 14% of the amount repaid; $1500 is 14% of $10,500)

Average debt amount: $30,000 ($10,500 is 35% of $30,000)

Average plan length: 48 months (between three and five years)

Monthly payment received by creditors: $219 ($10,500 divided by 48 months)

Recovery rate for banks in Chapter 13: 15.4% or $462,132 [$346,500 33% of consumers pay back 35% (average Chapter 13 payment amount according to Hunt) of their debt, $115,632 for the 66% make an average of 8 payments before terminating, which is pure conjecture applying statistics from debt settlement and credit counseling, for $115,632]

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