Consumers Union
Nonprofit Publisher of Consumer Reports

To: Federal Trade Commission, Office of the Secretary
From: Gail Hillebrand, Financial Services Campaign Manager, Consumers Union
Re: Telemarketing Sales Rule –Debt Relief Amendments- R411001
Date: October 9, 2009

Consumers Union, the nonprofit publisher of *Consumer Reports*, will be filing joint comments during the extended comment period with the Consumer Federation of America, the National Consumer Law Center, and other consumer and community groups. We are also separately submitting this analysis of the white paper entitled 'Economic Factors and the Debt Management Industry" by Richard A. Briesch, PhD, Associate Professor, Cox School of Business at Southern Methodist University (August 6, 2009). The white paper has significant limitations that render questionable its ability to support claims about the level of any benefit to consumers from using debt settlement services. That report fails to demonstrate that debt settlement services benefit most consumers who sign up for it.

This report was released by the industry-sponsored organization Americans for Consumer Credit Choice (ACCC) and is branded as ACCC. The report does not disclose whether it was funded by ACCC or by members of the debt settlement industry. The ACCC's Web site does not disclose its members. When ACCC released the report in August 2009, it stated that: "ACCC, with other industry and interested groups" requested the analysis. (Press Release, "Americans for Consumer Credit Choice Releases Debt Management Industry Study," August 7, 2009, http://www.consumercreditchoice.org/node/4.) ACCC also stated that it asked the study's author for an independent objective assessment of the consumer benefit, if any, provided by debt settlement companies.

The study includes data from only one debt settlement company, which is not identified. **There is no way to tell from the study report if that company, its undisclosed fee structure, practices, dropout rate, or success rate are or are not representative of the debt settlement industry as a whole.** In addition, the study does not describe important information relevant to the consumer experience such as the amount or timing of the fees, the total fees paid by the consumers in the sample to the debt settlement company, or the amounts by which the debt grew during the time of the debt settlement program. The study also does not provide data on the number or percentage of debts settled for all consumers in the sample, nor even for all of the 40% of consumers who did not drop out of the program during the study period.

The study's author forthrightly admits some of its limitations. The study's author discloses that: "it is unclear whether or not the findings can be generalized beyond this firm to the industry as a whole." (p. 23) The study also states bluntly that: "Accurate measures of consumer completion and cancellation cannot be calculated." (p. 2) For consumers with cancelled accounts –those who dropped out of debt settlement – the author states: "…it is very difficult to determine if value was generated for these customers." (p. 23) The study states that the dataset included no information about either settlements or offers of settlement for the consumers who cancelled, even though that was more than a majority of the sample.

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The study documents a shockingly high cancellation rate.

The study reports that that 60% of the customers in the large sample cancelled the service within two years. (p. 2) The majority of consumers who signed up for debt settlement dropped out. For more than half of these consumers, the only reason given in the study for cancellation is "other." The consumers who owed the most dropped out at a higher rate than the overall dropout rate (64.5% vs. 60.57% overall). (p.15, Table 2)

This is a very high cancellation rate for an industry that often charges substantial fees upon signing up. The author asserts that a 60% cancellation rate is not excessive because other subscription-based businesses such as wireless service providers also have high cancellation rates. (p.15) However, there is no discussion about how the fee structures of those services compare to the fee structure in debt settlement. In addition, consumers who pay monthly for a cell phone also receive services each month, and are heavily marketed to upgrade their current plans or to switch companies. In debt settlement, consumers pay sizable fees upfront, and those who cancel without having any debts settled have not gotten what they sought– relief from their debts. The median duration of the debt settlement contract at cancellation was 5 to 6 months.

The study contains incomplete information about the reason for consumer cancellations. Reasons for cancellation are attributed as follows: bankruptcy - 13.5%; inability to save - 6.8%; buyer's remorse, that is, cancellation in an initial period of up to 90 days - 9.2%; actual or attempted settlements directly by the consumer - 14%; and "other - " 56.5%. (p.16) Because more than half the cancelling consumers are listed under "other," the study gives no detail on the reasons for cancellation for the majority of consumers who cancelled. Categories such as "debt not being settled"; "unhappy with service"; "program unsuitable for the consumer" or "consumer did not understand the program" or "promises to consumer not kept" apparently were not used.

The author suggests that the cancellation rate is overstated because the debt settlement company's records indicated that 14% of those who cancelled did so in order to "settle/try to settle on own." (p.16) But these consumers still cancelled; presumably after paying some fees. It is not reported whether those consumers later settled their debt on their own; but even if they did so there is no reason to attribute that to the efforts of the debt settlement company. In addition, if consumers did not settle their own debts, those debts presumably may have grown in size before the consumer cancelled the debt settlement contract due to creditor charges such as late fees or penalty interest rates.

With respect to the category of consumers who cancelled due to bankruptcy, the study's author states that these consumers were "forced out of the program due to litigation." A different perspective is that these consumers should have filed for bankruptcy instead of signing up for debt settlement and saved paying an upfront fee of perhaps 2% to 4% to start a debt settlement program.

Common reasons that consumers would cancel any type of service are that they are unhappy with the service, think it costs too much, or it doesn't meet their expectations. The large "other" category may include customers who were signed up for an unsuitable program, those who were not satisfied with the program, and those with other reasons. It is simply impossible to tell from this study.

The study cannot support any conclusions about the results for consumers, because information about any settlements or even offers is missing for more than half the sample.

The report fails to include any information about debt settlements or offers of settlement for those customers who cancelled, because the company studied did not retain this information. (p.17) Consumers who cancelled may have experienced worse results than other consumers – they may not have had any debts settled at all. Indeed, this might be why they chose to cancel. The study's author forthrightly concedes: "it is very difficult to determine if value was generated for those customers [who cancelled]." (p.23)

The remaining conclusions are of limited value because they don't reveal what portion of the non-cancelling consumers are excluded from the table on consumer welfare metrics.

For that 40% of the sample for which there is data about offers and settlements, the study reports information about the size and frequency of offers and settlements, but only for those consumers who had at least one settlement or one offer of settlement. The report doesn't disclose how many consumers had no debts settled, and how many had no offers of settlements. It simply reports settlement data "conditional on the client settling at least one account." (p.17) While it is not entirely clear, it appears that the information about offers also includes only consumers who had at least one offer. The study appears to essentially divide the non-cancelling 40% of the sample into groups - those with at least one settlement or offer, and those without. The study doesn't disclose the size of each group, and it gives success-related data only for the first group - those who experienced some success. This is like calculating average results by first omitting from the average all of the people who received zero results.

The comparison between debt settlement costs and consumer credit counseling costs attributes some costs to credit counseling that are not paid by the individual in order to receive that service.

The study's comparison of the relative costs of consumer credit counseling and debt settlement include payments made by creditors, and not by the consumer, in the cost of consumer credit counseling. (p.11) The author suggests that creditors should be indifferent between making a fair share payment to a consumer credit counseling agency or giving individual consumers a discount of up to the same amount on the debt. However, the study offers no evidence that this is the case in practice. In addition, this argument ignores the value that creditors place on the services that legitimate credit counseling services provide such as education, advice on budgeting, and overseeing monthly payments to creditors over multiple years.

Since the cost analysis in the study includes some costs not paid directly by the individual consumers using the service, but instead spread throughout the credit system, the cost comparison discussion in the study does not provide a valid cost comparison from the perspective of the individual.

The study's discussion about the relative cost of consumer credit counseling and debt settlement also does not appear to consider the fact that the 60% of consumers who dropped out of debt settlement in the sample still owe all of the debt they started with; may have paid a set-up fee plus monthly fees or more; and because of late fees or penalty interest rates, may owe more debt at the end of the program than they did at the beginning on any debt that has not been settled.

The study cites another source stating that the average cost of consumer credit counseling services with a five year plan to pay off debt is $910 paid by the consumer and another $764.89 paid by the creditors. (p.11) Debt settlement would cost these consumers much more in fees. If these consumers were charged a total fee of 18% fee of the debt, which is within the range cited in the report, then they would owe an average debt settlement fee of $4,338 (averaging the three mean debt levels for the three subsamples to yield an overall mean debt for the sample of $24,099). (*See* p.15, Table 2; calculation of the overall sample mean by Consumers Union) **These numbers make clear a conclusion not drawn by the report; that consumers pay much higher service fees for debt settlement than for debt management plans offered through consumer credit counseling agencies.** Of course, it is difficult to compare the costs of apples and oranges. If consumers do get their debts settled, they should pay less on those debts, but the report provides no basis to assess how frequently that occurs overall for the full sample. Also, with a debt management plan administered by a consumer credit counseling organization, the amount owed falls each month as the payments are made. That benefit is missing in debt settlement.

The study shows that many consumers did not benefit from debt settlement.

In spite of the methodological limitations, the numbers reported in the study suggest that the majority of consumers did not feel that they were benefiting from debt settlement since 60% of them cancelled. The study also shows that even those consumers who did not cancel received offers or settlements on less than all of their debt at each of the three time periods comprising the sample of 12, 18, and 24 months. (p.15)

The study's reported percentages of debts settled appear to be calculated using only consumers for whom at least one debt was settled. (p.17) These results do not reveal how many consumers had no debts settled at all. These results also do not reveal how many consumers came in with the apparent median of four debts, and left the program with some of those debts unsettled and having grown larger in the time elapsed during debt settlement program. (p.15, Table 2) **This is like estimating the consumer benefit without averaging in all of the "zero benefit" people who got no settlements at all.**

Even for those consumers for whom at least one debt was settled, it appears that the debt settlement provider studied was consistently unable to settle all of the debt during the time of the sample. (For reasons not disclosed by the author, the study did not sample results at a time period that matched the usual end time for a debt settlement program.) The study concludes that "conditional on receiving at least one offer, clients seem to receive offers from more than 67% of their accounts and debts." (p.20) This means that even if the consumer had saved enough to fund all of the offers, and accepted all of the offers, this would still leave the consumers who got some offers saddled with 33% of the debts they started out with, plus additional creditor charges which might include late fees, additional interest, and perhaps penalty interest, accrued during the time period for debt settlement.

The numbers from the study's tables can illustrate some points not drawn by the study (Data from study is noted, other calculations are by Consumers Union)

The study examined 4,500 customers of one debt settlement provider. (p.15) Here is some further analysis by Consumers Union using the average debt, cancellation rate, and average results reported in the study.

The sample was divided into three groups of consumers, who owed an average (mean) debt of $7,927; $16,966; and $47,404. (p.15, Table 2) Since each group was equally represented, this yields an overall initial average debt for the full sample of $24,099.

Just over 60%, or 2,700, of those consumers cancelled the program within 6 months to two years of entering the program. (p.15) The study doesn't disclose the total fees paid by those consumers. **Using the mean debt in the sample and a 2% set up fee, which is the low end of the range cited in the study, those consumers who dropped out would have paid $1.3 million in fees, and there is no evidence as to whether or not they received any settlements before leaving the program.** Under the 6% set up fee cap promoted by the trade organization USOBA in its recent model act, a similar group of consumers could be charged $3.9 million in front-loaded set up fees before cancelling.

Of the 1,800 consumers who remained in the program, the study does not disclose how many settled at least one account. However, for consumers who did settle at least one account, the author reports at Table 5 that the mean "% total debt" for the three sub-samples was 54.7%, 54.1%, and 53.1%, respectively. (p.17) The average of those three numbers is 54%. In other words, an undisclosed percentage of the minority of consumers who did not cancel had at least one debt settled, and among those consumers, 54% of their debt was settled at either 12, 18, or 24 months from entering the program. These consumers still had substantial remaining debt – 46% of what they started with.

These consumers also had a substantial number of accounts remaining. For the undisclosed percentage of consumers who had at least one account settled, the percentages of all accounts settled were 52%, 51.5%, and 53%, for a mean of 52%. (p.17, Table 5)

Let's look at those results in plain language:

- After one to two years under a debt settlement contract, even those consumers who had not cancelled and who had at least one debt settled still owed 46% of the total debt that they owed when they started the debt settlement program, plus whatever amount that debt had grown to during the interim.

- After one to two years under a debt settlement contract, even those consumers who had not cancelled and who had at least one debt settled still owed money on 48% of the debt accounts that they brought into the debt settlement program.

The study's numbers suggest that the 4,500 studied consumers:

- Cancelled at a rate of 60%, or 2,700 consumers. (p. 2)

- Owed a total of $108.5 million in debt. (extrapolation from table 2, combined mean debt of $24,099 for each of 4,500 consumers)

- Paid $2.2 million in set up fees if they were charged a 2% set up fee. (This is a conservative estimate; the study cites other sources noting a range of 2% to 4% set up fees). (p.12)

- Lost $1.3 million in those set up fees when 60% of them dropped out.

- Would owe over $19 million in fees if they were charged an overall fee of 18% of the debt, which is within the two ranges cited by the report of 14-20% or 15-25% (this does not include a reduction for any fees still owed when the consumer dropped out). (p.12)

- Continued to owe $85 million in debt one to two years after starting debt settlement.

The remaining debt calculation is based on the full initial debt, of just over $65 million, for the 60% who cancelled and just under $20 million for the 46% of remaining debt for those who got at least one settlement. The actual remaining debt number may be higher, because this calculation applies to the entire 40% non-cancelling group the remaining debt percentage of 46% which the study provides for that subset of consumers in the non-cancelling group who received at least one settlement, and the study does not document or claim that each non-cancelling consumer had even one debt settled during the study period. Of course, the debt numbers could actually be higher because the debt amounts for unsettled debt can be expected to continue to increase during the settlement program.

The study does not analyze or discuss the cost to consumers of high upfront payments for debt settlement.

The study asserts that charging consumers reasonable upfront fees, *i.e.,* fees before settlement, “can be justified” but it offers no analysis of the actual fee amounts charged for debt settlement. (p.24) The fee structure and fee amounts imposed on the 4,500 consumers in the sample is not disclosed, and the report also has no discussion of the amount of fees lost by the 60% of customers who canceled, every presumably after paying both a setup fee and monthly fees.

The study also contains some internal inconsistencies.

As released in August 2009, the study contains some inconsistencies and makes some assertions it does not support. The study states on page 13 that 20.5% of consumers who cancelled did so because of bankruptcy, while Table 3 on page 16 says that bankruptcies accounted for 13.5% of cancellations.

Table 3 identifies 14% of consumers who cancelled in order to “settle/try to settle on own,” but the text on pages 16 and 20 treats the consumers in that 14% as if all of them in fact did pay off their debt on their own.

On page 3, the study says that more than 57% of clients have offers to settle at least 70% of their debt, but the only table of data to support this, found at page 17, contains data only on the offers for those consumers who received at least one offer to settle a debt. **Consumers who received no offers are omitted from the analysis of results, which would bias the reported results upwards by excluding the "zero" category from the calculations of mean (average) results.**

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