

To: Federal Trade Commission, Office of the Secretary
From: Richard A. Briesch, PhD
Re: Telemarketing Sales Rule –Debt Relief Amendments- R411001
Date: October 27, 2009

I appreciate the opportunity to respond to the joint comments of Consumer’s Union FTC and Consumer Federation of America (CFA). Their comments provide critique of my study and it has several statements which are either inaccurate or need clarification. Before providing specific responses to their comments, I note that I am an outsider to this industry, so am unaffiliated with any industry group. While an industry group did sponsor some of my research, this situation is common in the academic community and does not affect the results found in the study. Also, I have not received (nor will I receive) any financial or other benefit from any organization for this testimony.

While I will discuss specific comments about their testimony below, I have two general comments about their testimony. First, without any data to support their position, they want to conclude that consumers who cancelled their accounts received no offers and no settlements (e.g., p.4). This information is not in the data, so this conclusion is not only improper, but misleading. The research was very careful to point out this limitation and discuss the results with appropriate language. However, I have received data from another company that can shed some light on this issue. DMB Financial provided a raw data set for my analysis in response to the release of the original study.¹ This dataset is comparable to the one used in my paper and included all accounts (914 clients) from a single state from May 31, 2006 until May 8, 2009. A summary of the statistics for the cancelled accounts is provided in Table 1. It should be noted that DMB Financial did not provide (and does not collect) data on settlement offers, they only provided data on settlements which were accepted by the client for all accounts, including the cancelled accounts. For clarification, debt settlement companies typically receive multiple settlement offers from creditors on behalf of clients; however, it is up the client to accept the settlement offer. Therefore, value can be measured in either the number of settlement offers obtained or settlement offers accepted.

¹ DMB Financial does not provide me any financial or other support, either directly or indirectly, and stated their intent for providing the data was the following: ‘We are excited to see the beginnings of transparency and independent research focus on the debt settlement industry where, to date, regulations and consumer perspective have been driven by anecdote almost exclusively. We’d like to offer access to our data, an onsite visit, or whatever data we can provide to drive the collective body of research forward. We are confident in the services we deliver to consumers and the hundreds of client testimonials of the people whom we’ve helped each year are what drive us forward every day. We look forward to the day when their story is heard in the public discourse as well.’

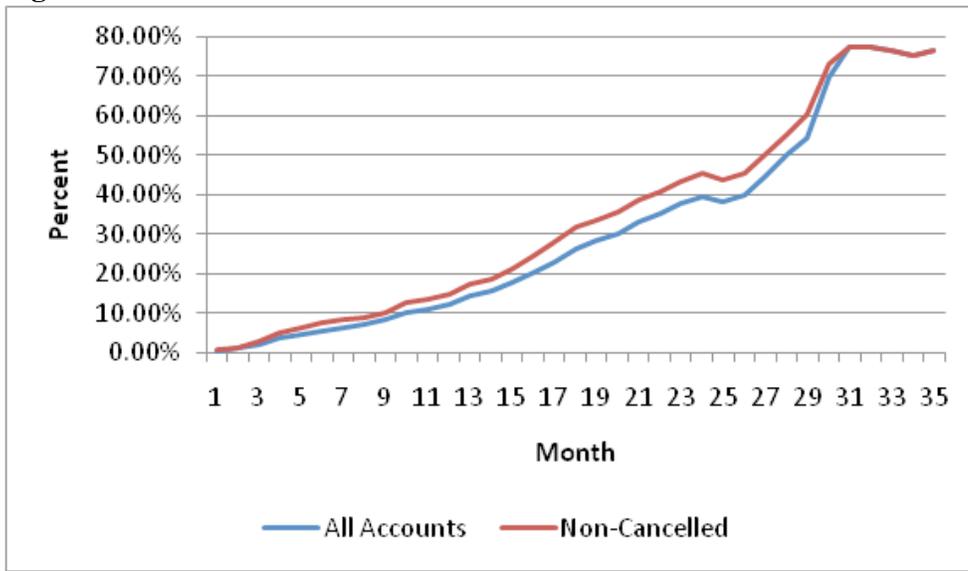
Table 1 – Welfare for Cancelled Accounts

	Mean	Std Dev
Percent of clients who cancelled	45.7%	
Percent of cancelled clients with at least one settled account	43%	
Years in program for cancelled clients	1.27	0.70
Percent of total debt settled for cancelled clients	39%	0.24
Settlement percent of original debt for cancelled clients	58%	0.19

It is important to note that 43% of the clients who cancelled had at least one account settled. These accounts were settled, on average, for 58% of the original debt. And, 39% of the client’s total debt, on average, was settled prior to them cancelling the program.

Still using the same DMB Financial data, Figure 1 provides the percentage of total debt paid off over time (i.e., conditional on being in the program for a certain number of months, what percentage of the total debt has been settled). The blue line represents all accounts (including cancelled accounts) whereas the red line represents only non-cancelled accounts. This graph demonstrates that consumers are paying of their debt over time. It also demonstrates that clients who cancelled did receive settlements (and implicitly offers), contrary to the assumptions made in the testimony.

Figure 1 – Percent of Total Debt Settled Over Time.



Do we know if this data is representative of the firm in the previous study? No, this would be an improper conclusion. However, this data makes it more likely that the cancelled accounts received offers and settlements. This conclusion is supported by the fact that after 24 months, the firm in the original study had 30% of total debt settled for non-cancelled accounts (as we do not know the amounts settled for cancelled accounts), similar to the percentage in this

graph. However, this data does show that it is improper to conclude that clients who cancelled received no benefit. This is especially true because the author argues that financial education is a benefit to consumers (p.4), which is provided by both DMB Financial and the firm in the study.

The second major issue in regards to the testimony is that they gloss over the fact that the data length is shorter than the program length in drawing conclusions about firm performance. This non-sequitur is analogous to the conclusion that credit counseling is a poor option because has a zero percent success rate in the first two years of a five year program and/or because none of the accounts are completely paid off in the first two years of a five year program.

In regards to specific comments, there are at least nine factual errors, misrepresentations of findings, and/or misleading analyses provided in their testimony dated October 9, 2009.

Fee structure needs to be consistent with existing regulations and compared to full fees and interest with credit counseling.

They try to draw conclusions about consumers welfare in terms of fees paid. This data is not provided by the firm in the original study, so some assumptions need to be made. That said, given that the firm is identified, they could have gotten the fee structure from them instead of using the maximum fees approved by the trade association. Even if they reported more accurate numbers, the assumptions of the analysis on pp 5-6 are not consistent with current regulations or practice, making the conclusions meaningless. For instance, using the regulations from the Uniform Debt-Management Services Act (UDMSA – see, e.g., <http://www.udmsa.org/>) which has been codified in several states²:

- They assume that consumers pay all fees (18% settlement plus 2% setup) regardless of when they leave the program. Current regulations require a 3-30 day cooling off period where any contract can be cancelled for any reason and all fees are refunded. The act requires a minimum of 3 days.
- They assume that consumers pay set-up fees, settlement fees and monthly fees. However, this is triple counting, as the act stipulates:
 - “Subsection (f) authorizes a debt-settlement entity to charge a settlement fee, but requires it to credit against the settlement fee all set-up and monthly fees.” (p.60).

² My calculations here are somewhat simplistic, as they are for the “average” consumer. A more accurate picture would do the calculations considering the distribution of these values, but time does not permit these calculations. However, these calculations provide a “gross estimate” which is much more accurate than what was provided in the testimony.

- Therefore, the total payment of the consumers, under their assumptions is only 18% of the debt, not 20% of the debt plus fees.
- They assume that all settlement fees are non-refundable. However, the act stipulates all unused settlement fees (e.g. for debt not settled) must be returned to the consumer as they are only “advances” on the settlement fees.
 - “Subsection (f) authorizes a debt-settlement entity to charge a settlement fee, but requires it to credit against the settlement fee all set-up and monthly fees. The underlying idea is that the settlement fee represents the real compensation of the provider, and the other fees provide cash flow pending receipt of the settlement fee. Hence, they are advances against settlement fees and are to be credited against the settlement fee. This approach accommodates the provider’s need for cash flow pending the first settlement and provides a simple way to effectuate the credit mechanism.” (p.60).
 - Therefore, there is no ‘loss’ associated with settlement fees for non-settled debt.
- If they assume that no debts have been settled (which is an unreasonable assumption, as shown above), they must adjust the set-up fees.
 - “The provider will refund 65 percent of any portion of the set-up fee that has not been credited against the settlement fee.” (p.48)
 - “To maximize the refund under this section, as contemplated here, the monthly service fees should be (sic) credited first. To determine the refund due under paragraph (1)(B), the provider must deduct from the total amount of any settlement fees the total amount of monthly fees paid up to the time of termination. If the result is less than 0 (or if there have been no settlement fees), then no part of the set-up fee has yet been credited against the settlement fee, and the refund is 65% of the set-up fee. If the result is greater than 0, subtract that result from the set-up fee. The refund is 65% of the difference.” (pp 51-52).
 - So, under their assumptions, the “loss” for these consumers is $35\% * \$1.3$ million or \$455,000. Note that their payments over six months (assuming a 3-year plan, and payments assuming 50% settlement, 18% of original debt in settlement and setup fees) would total \$7.4 million. Under these regulations, each cancelling consumer would have \$2563 in savings (ignoring any interest) after six months and paying the set up fees. For these consumers to be worse off, the creditors would have to charge $\$2,562/\$24,099$ or 10.6% of the original balance in interest and penalties over six months. This does not include the value of financial education

(required under the act, see p. 60) or the value of the consumer learning how to save \$455.20 per month.

- To put these numbers in context, the average consumer has 4.8 accounts. Assuming that these same consumers enrolled in a credit counseling program and cancelled after six months, and assuming a \$25 account set up fee and \$15 monthly account service fee, the consumers would have paid \$1,490,400 in fees (excluding fair share payments). *That is, a similar number of consumers cancelling a credit counseling service would pay 3.3 times the fees than they would have if they enrolled in a debt settlement program, ignoring the 'fair share' payment.* If the monthly fees were capped at \$50 per month, and there was only one \$25 setup fee for all accounts, consumers would still pay \$877,500 in fees, 93% more than the debt settlement program.
- To be fair to the credit counseling program, the comparison should also include the reduction in debt due to the payments made in the credit counseling and the difference in payments between the two programs. This requires a lot of assumptions which drive which alternative is "best." For instance, at 10% interest for a 5 year program, the monthly payment in the credit counseling program is \$584.03 (including \$15 per account service fees), of which \$1,906.58 goes towards the principle in the first six months. So, with these assumptions, the net difference per consumer after accounting for debt reduction is $6 * (\$584.03 - \$455.20) - \$1906.58 + \$25 * 4.8$ or $-\$1013.6$. **That is, the consumer still has a net positive balance of \$1,548 if they entered the debt settlement program instead of a credit counseling program and cancelled after six months, not including interest and fees charged on the original debt.** Put another way, the consumer is indifferent between the two options when the interest and fees on the debt equal \$1,548.
- If the consumer cannot save the monthly payment of \$455.20 (or anything less than the monthly payments in the credit counseling program) in the debt settlement program, they certainly cannot afford the \$584.20 monthly payment required in the credit counseling program. Therefore, they will fail in the counseling program and be forced into litigation and/or bankruptcy
- This analysis makes one unrealistic assumption: the consumer could have continued paying off the debt at the current levels. Given that they are in financial hardship and are entering a program, this appears to be an unrealistic assumption. So, if they cannot make the current monthly payments, then a portion of the interest and fees would have accrued

anyway and this accrual would have to be taken into account in the above analysis. It also implies that that the appropriate comparison case is not the consumer continuing the current payments. The appropriate comparison case is what would have happened if they went into bankruptcy and/or litigation.

- If we assume that the minimum payment is 2.5% of the debt, it implies a monthly payment of \$602.48. A secondary question is whether the relatively small savings of \$18.28 per month in the credit counseling program would be enough to keep the consumer solvent.
- This analysis also suggests that one effective regulatory approach would be modeled after UDMSA.
- To provide an accurate picture of total consumer welfare, they would need to include the benefits (e.g., savings due to settlement percentages on the debt) versus the costs, which was not done. However, these calculations have been done in my paper assuming that the consumer does pay off their debt; and it shows that consumers are better off in debt settlement. This analysis could be refined to include the distributions of settlement percentages, offer and settlement timing, etc. instead of mean values.

Debt levels, fees and interest are needed to compare debt settlement to credit counseling.

They state **“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”** (p.4, bold from original text). This conclusion is only supported by an improper “apple and oranges” comparison: They compare the fees for a \$10,000 debt level in credit counseling to the fees associated with a \$24,099 debt level for debt settlement. Given that the total fees for both types of organizations are based upon the debt level, this comparison is improper and misleading. More importantly, this statement does not fairly address the full costs paid by the client, or consumer welfare received by the client. By ignoring the substantial cost of interest payments under credit counseling, the comparison claim is inaccurate.

Finally, see the above analysis, which shows this conclusion is factually incorrect when current regulations (i.e., UDSMA) are used to calculate fees using their example and assumptions.

The number of clients receiving offers and settlements provided.

They said that the number of clients receiving offers and settlements is not identified (see, e.g., p. 5). While this is correct, in an email dated September 14, 2009, I provided these

numbers to Susan Grant of CFA (55.7% of non-cancelled clients have at least one settlement, and 74% of non-cancelled clients have at least one offer). Excluding these numbers from their analysis is not only intellectually dishonest, but it appears to be intended to mislead the FTC.

The cancellation rate is comparable, if not better, than credit counseling.

They spend a lot of time discussing cancellation rates and argue that 60% is “shockingly high.” According to a National Consumer Law Center report, “the National Foundation for Credit Counseling reported completion rates of about 26%”, which means their failure rate is 74%. If 60% is unacceptably high, what do they have to say about the 74% cancellation rate for Credit Counseling Companies? By not providing the comparison to credit counseling, it once again appears that this whole section is hyperbole intended to mislead the FTC as CFA is well aware of their industry cancellation rates.

The authors go on to argue that the cancellation rates cannot be compared to cable and wireless companies because, among other reasons, consumers receive services every month from these companies. If we take this argument at face value, then the cancellation rates for these other industries should be much lower than those for debt settlement; which implies this is a debt settlement companies are doing much better than these other industries. They also state that the large marketing budgets in these industries will increase the cancellation rates (due to switching behavior), so it is a countervailing force. At some level they are correct, but research has shown that the majority of consumers do not switch based upon price or advertising, but because of their experience with the company, e.g., poor service (see, e.g., Kessler, Sheila (1996), *Measuring and Managing Customer Satisfaction*. Milwaukee: American Society for Quality).

Fair share payments are indirectly paid by credit counseling clients.

They argue that fair share payments should not be included in fee calculations because consumers do not directly pay the fees. Note that they do not dispute the total amount of fees collected, only whether or not the fees should be included as part of what the consumer pays. They argue that there is no evidence that creditors are indifferent to receiving total payments and paying fair payments versus receiving net payments from consumers, which indicates a lack of understanding of basic economic principles (for further reading and support of this argument, see, e.g., any behavioral economics textbook or publication, especially any works by Kahneman and Tversky). From an economic standpoint, the firms are indifferent as they receive the same total net payments in either case. Given that the creditor is indifferent, these fees are paid, albeit indirectly, by consumers.

Consumers do benefit from debt settlement.

They state that many consumers did not benefit from debt settlement (p.4). They base this argument, in part, on the consumers who cancelled the service. There is no information in

the study to justify this conclusion as we do not know what offers/settlements were made by consumers who cancelled. See the section above which provides data from DMB Financial and shows that this conclusion is probably factually incorrect, and the section above which calculates the economic welfare of consumers who cancel after six months in the program.

This argument is also based, in part, on the amount of debt still owed by consumers after one to two years (the length of the data) (p.5). Given that many programs are three years in length, the fact that, on average, 46% to 48% of the debt is still owed after one to two years is not surprising. As a comparison, after two years in a five year credit counseling program, more than 65% of the debt will not have been paid off, assuming a 10% interest rate and constant payments. Also, see the above welfare analysis which takes this into account.

Canceled clients are shown to have received benefit from debt settlement.

They state “60% of consumers who dropped out of debt settlement in the sample still owe all of the debt they started with” (p.3). This conclusion is not supported by the data and cannot be drawn from the research, as it is unknown how much debt is owed. Also, see the above discussion where it is demonstrated that at least for DMB Financial, this conclusion is factually incorrect.

It is fair to say 57% of clients have offers to settle at least 70% of their debt.

They state “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...” (p. 6). This data is shown in Figure 2 of the report. If they had used the numbers provided by me, they would have concluded that 42% ($57\% * 74\%$) of the clients had offers to settle at least 70% of their debt. We cannot include cancelled accounts as we do not know the percentages of debt with offers. The above data from DMB Financial implies that it is incorrect to conclude that consumers who cancelled their accounts received no settlements and no offers.

Programs must be fully completed to measure settlement of all debts enrolled.

They state “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.)” (p.4). As noted above, this is hyperbole and an improper conclusion given that the data length is shorter than the program length. It is similar to concluding that credit counseling does not provide value to consumers because they have not repaid all of their debt by the end of the second year of a five year program. Given that CFA asked many questions of me, I am surprised that the question of why the data length is shorter than the program length was not one of them. The answer is

relatively simple: data quality. As noted below, I am attempting to gather more data for a more in-depth study.

The firm was properly identified.

They said that the firm was unidentified. This is incorrect; the footnote on p.14 identifies the firm.

It is important to note the conclusions which they did not dispute: **When debt settlement works, it works very well for consumers.** It is the most affordable option (i.e., lowest payments) and provides the highest consumer welfare (i.e., lowest total repayment amount). The implication is that there are many consumers who would be forced into bankruptcy if the debt settlement industry was eliminated because the payments for the alternative (credit counseling) would not be affordable. For instance, consider a consumer with \$10,000 in debt and a 20% interest rate who wishes to pay off their debt in five years. They would have to make monthly payments of \$264.94. If they went to a credit counseling service and had their interest rate reduced to 10%, they would have to make monthly payments of \$212.47 before any account maintenance or other fees. This saving of less than \$52/month may help the consumer but may not be enough for them to avoid litigation and/or bankruptcy.

They also did not dispute the total fees collected by credit counseling firms can amount to a large portion of the debt, much higher than permitted by the Uniform Debt-Management Services Act (UDMSA – see, e.g., <http://www.udmsa.org/>) which has already been codified in several states. They only argue that fair share payments should not be included in this calculation.

They also did not dispute the fact that the cancellation rate for programs offered by credit counseling firms is at least 65% - higher than the rate of the firm in the study.

That said, did the authors get anything correct in their testimony? Actually they did. First, there are many data limitations, as noted in the study. This study was intended as an initial study where much more research is needed for this industry. For instance, other than Manning, not much research has been done in terms of the appropriate screening criteria of the clients. I would tend to agree that one reason for the cancellation rates in both debt settlement and credit counseling is that bankruptcy is the appropriate option for some consumers who are enrolled in these programs. So, one project for which I am trying to collect data is to determine what factors predict success in debt settlement and credit counseling? Also, I am now collecting and analyzing data from more companies which can address some of the limitations of the prior study. As with all academic endeavors, many studies are required to get to empirical generalizations. That said, the study provides needed data to start understanding this industry and moves the discussion from speculation to facts.

Second, I would tend to agree that the cancellation rates need much more investigation. It is important to note the difference between the cancellation rates being high from managerial versus regulatory standpoint. From a regulatory standpoint, the rates need to be compared to other service industries to see if they are significantly higher than comparison industries; which was done in the original study. Given that credit counseling has higher cancellation rates than reported in the study, and, in their testimony, the Consumer's Union and CFA do not apparently have problems with credit counseling cancellation rates; it seems that a reasonable conclusion is the cancellation rates for debt settlement companies are not significant from a regulatory standpoint. From a managerial standpoint, I would argue that they are high and need managerial attention. Telecom and wireless companies are exerting significant effort to bring down their cancellation rates. Debt settlement and credit counseling companies should also be exerting significant effort to reduce their cancellation rates.

Third, I would agree that it is important to understand what happens to consumers after they leave debt settlement and credit counseling services. Specifically, did the financial education work? E.g., Are they less likely to get into financial hardship? Are they saving and how much?

Fourth, I would agree that both credit counseling and debt settlement need fair and appropriate regulation to protect consumers. This regulation should not favor one model over the other as each has its own benefits and drawbacks.

In conclusion, it is important to keep two factors in mind. First, it is relatively straightforward to demonstrate that the different alternatives (credit counseling, debt settlement and bankruptcy) are best for different consumers, based upon their financial situation. If one recognizes that the creditors know (or can find out) the financial situation of the consumers, then the creditors will not give consumers who can repay 100% of their debt sufficient concessions to make debt settlement an appropriate option. And if consumers can repay a large portion of their debt, but not 100%, even at reduced interest rates, they will fail in credit counseling. Therefore, the ability to match consumers with the appropriate solution is of utmost importance. While Manning has made some initial steps in this direction, much more research is required.

Second, there is much about this industry which is unknown and needs further study. These studies could provide guidance and needed facts for regulators to determine the appropriate actions for this industry. The key problem in this approach is getting the appropriate data to appropriate, independent researchers. That said it appears that this industry is desperately needed in today's economy (with unemployment around 9.8%), and this industry can generate tremendous value to some consumers.