RDR
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Federal Trade Commission
Office of Secretary
Room H-135 (Annex Z)
600 Pennsylvania Avenue, NW
Washington, DC 20580

RE: Telemarketing Sales Rule -- Debt Relief Amendments R41101

Ladies and Gentlemen:

As a participant in the September 25, 2008 Debt Settlement Workshop, I commend the Federal Trade Commission (FTC) in its continuing efforts to improve consumer debt relief products and services available to the escalating number of consumers in financial distress. Accordingly, I am submitting the following comments to be included in the FTC's formal record pursuant to the Telemarketing Sales Rule -- Debt Relief Amendments R41101.

CURRENT ECONOMIC CONTEXT

As a scholar that has studied consumer credit and debt for over twenty years, it is crucial to recognize the unprecedented, perilous condition of the American household and its significance to the ongoing recession and consequential impact on the US economic recovery. Indeed, as one of the first researchers to accurately forecast the collapse of the US housing bubble and subsequent recession, the Commission's examination of consumer debt relief services must recognize the recent factors that contributed to extraordinary increase in household debt. That is, sharply diminished underwriting standards by lenders—both secured (houses, HELOCs, autos) and unsecured loans (credit cards)—that was encouraged by the risk incentivized retail banking culture that was exacerbated by the short-term profitability of investment banks' popularization of securitized consumer loans.

Over the last four years, I have referred to this period as the "Double Financial Bubble" whereby housing price appreciation encouraged soaring household debt loads that featured artificially inflated home equity paying off soaring credit card debt levels. Unfortunately, consumers and the US government (eg, itemized tax advantages) were not concerned by Fannie Mae paying off Visa as the bubble economy essentially suspended the financial laws of gravity. Today, most "upside down" homeowners are struggling to pay Visa with MasterCard while coping with employment instability and aggressive debt collection actions. In comparison, the banks that issued their credit cards and originated their mortgages have been provided a variety of public subsidies in order to develop viable "workout" plans while coping with their own financial insolvency issues. This inequity between Wall Street and Main Street should not be ignored by the Commission in its efforts to formulate regulatory policies that balance the extraordinary financial distress on American households as their debt loads further dampened the government's efforts to promote a stable and vigorous economic recovery. Indeed, how the issue of consumer debt relief is addressed will have a significant impact on the pace of the US economic recovery and long-term consequences for US economic security.

UNDERESTIMATED SCALE OF CONSUMER DEMAND. First, I would like to address the scope of the problem as it relates to the consumer debt relief industry. On page 42014 of the Commission's summation of the debt relief industry in the August 19, 2009 Federal Register, it states that 78% of 91.1 million households possess credit cards and, with a delinquency rate of 6.5%, the overall population of Americans that are in need of debt relief services is approximately 5.9 million households. However, as affirmed by the US Bankruptcy Courts, individuals execute borrowing agreements and both individuals and couples may file for relief through approved discharge and reorganization petitions. And, a large proportion of households include more than two adults and thus the number should be adjusted to at least 1.5 at risk debtors. Furthermore, the delinquency rate at the end of the 2nd Quarter of 2009 exceeded 8.0%. As a result, the number of Americans in need of debt relief services is closer to 11 million rather than the cited 5.9 million.

CURRENT POLICIES OF CREDIT CARD COMPANIES. Second, as explained in my recent article, the business model of the credit card industry is fundamentally bankruptcy in the aftermath of the "Double Financial Bubble." The large number of account holders that do not generate substantial finance and fee revenue together with the collapse of the "cross-marketing" revenue bundles (mortgage, auto, insurance, brokerage, investment banking fees) that buttressed the arguments for the Financial Services Modernization Act of 1998, is resulting in an increasingly unfavorable collections environment for consumers. That is, credit card companies are inadvertently driving millions of Americans to seek debt relief due to sharply rising finance rates, dramatic reduction in lines of credit (from $5.5 trillion in 2006 to $3.1 trillion today), and reluctance to pursue reasonable debt concession policies due to inflexible prudential bank regulatory policies ("charge-off") and lack of innovation in assessing consumer debt capacity. The result is soaring demand for nonprofit Consumer Credit Counseling Services (CCCSs) consumer counseling and debt management plans as well as consumer and small business debt relief programs including bankruptcy.

FAILURE OF CCCS DEBT MANAGEMENT PROGRAMS. Third, the assumption that debt management plans (DMPs) administered by nonprofit CCCSs can satisfactorily address the consumer debt crisis belies the reality of enormous debt levels, upwardly adjusting home mortgage loans, negative home equity, near record employment instability, falling real wages, rising expenses such as health care and education, and the sudden shift in consumers absorbing a greater share of the cost of CCCS administered debt management plans. The latter is particularly important as the creditor "fair share" to CCCS has fallen sharply (from 15% to as low as 0 and typically 4-5%). Furthermore, CCCSs declining "fair share" contributions have actually increased their dependence on maintaining good relations with the largest banks. Indeed, due to rapid consolidation in the CCCS industry, a monthly "fair share" contribution from a single credit card company can generate millions of dollars per quarter to the largest companies. The result is that CCCSs are becoming more responsive to the dictates of creditors (such as negotiating less desirable interest rates) than to the deteriorating financial condition of their clients. The coalescence of these factors has led to a crisis in the CCCS industry. That is, DMPs are becoming less important to the overall revenues of large CCCSs (partially mandated by new federal regulations) and rising costs to consumers has led to substantial decline in the proportion of consumers that can qualify for a DMP. Today, the major CCCSs accept less than one out of ten consumers that contact them for debt management assistance. And, comparable to the success rate of Chapter 13 bankruptcy reorganization plans, less than 30% will succeed. This is a crucial issue as the number of consumers seeking debt relief programs will increase sharply AFTER the recession is over.

PROPOSED FTC RULES FOR DEBT RELIEF SERVICES

In regard to the specific "rules" that are being considered by the Commission, I have several specific issues that I would like to introduce in regard to general business operational issues of the debt relief industry and their pertinence to the proposed Telemarketing Sales Rule (TSR). My comments will be summarized in the following three topics: (a) What are the products and services offered, (b) How much do they cost, and (c) what are appropriate disclosures in presenting the effectiveness of the products and services.

CALCULATION OF CONSUMER DEBT CAPACITY. First, and most importantly, the major omission in the formulation of new regulations of the debt management/relief industry is the failure to promote a standardized methodology for estimating consumer/household debt capacity. This is crucial in determining whether a consumer is enrolled in the most appropriate debt management/relief program. The rapid dilution of traditional loan underwriting standards over the last decade has incapacitated traditional metrics such as debt-to-income ratios and FICO scores. The bankruptcy reform legislation of 2005 initially intended to rectify this flaw through the formulation of a standardized "means test" that was eventually replaced with a facile regional median income and debt loan measures. The central issue is the objective and standardized estimate of consumer debt capacity that would efficiently match debt distressed consumers with the most appropriate debt assistance program: (a) CCCS administered DMPs (full payment plus interest), (b) less than full balance payment plans, and (c) consumer bankruptcy. Once consumers are placed in the most appropriate debtor assistance program, then performance can be more accurately assessed and appropriate regulations can be formulated. For example, the most notable deficiencies in the qualification criteria of these different programs is: focus on individual rather than household, neglect of state and local taxes in assessing financial capability, ignore tax filing and homeownership status, failure to calculate adjusted gross income, imprecise estimate of available cash flow according to household structure, tend to overlook court imposed payments, and inability to assess other family/personal financial obligations. The result is an imprecise estimate of consumer repayment capability that contributes to falling DMP success rates and lack of creditor confidence in debt relief programs. In terms of full disclosure, I have spent the last four years refining an objective and highly reliable "Responsible Debt Relief" algorithm/software that is the most accurate estimate of individual and consumer debt repayment capability.

The development of an objective, third-party assessment tool assists consumers in both clearly defining their eligibility for the most appropriate debt assistance program as well as more efficiently guiding consumers that are unable to complete a particular program to the next most appropriate program. For example, consumers that can no longer satisfying the payment obligations of a DMP can be assessed for a precise amount of a less than full balance payment plan. In this way, consumers can make informed decisions as to the best debt assistance program for them—especially choosing bankruptcy versus a debt relief plan.

The lack of discussion over an objective and reliable "means test"—standardized in my methodology through the calculation of net monthly cash-flow—is shocking due to the profound implications that is has on the selection of debt relief plans and the formulation of debt concession programs. For example, I propose that all debt distressed consumers be initially pre-screened for eligibility in a CCCS DMP. That is, the ability to repay over 100% plus interest over the period of the plan (eg. 48 months). If a consumer can not satisfy this minimum threshold, then the consumer would be counseled regarding his/her options: debt relief or bankruptcy. Hence, with an efficient pre-screen filter, such as a consumer debt capacity assessment, it is not possible for consumers that should enroll in DMPs to be enrolled in debt settlement/relief plans. In this way, a standardized metric can be established for the different programs based on a specific percentage of consumer debt repayment capability.

Second, an objective, empirical measure of consumer debt capacity is the basis for detailing the costs of a less than full-balance payment program. For example, if a consumer opts for a debt relief program rather than bankruptcy, then the assessment would be recalibrated for a debt concession plan that specifies monthly maintenance and service fees that could not exceed a specific amount. For instance, a 36 month repayment plan with a total of 15% fees. The algorithm would then calculate the gross payment and net payment to the creditors. If, for example, the "means test" estimated a 40% net payment to the creditor over 36 months, then the total service fees can be calculated as well such as 15%. In this way, the consumer is informed BEFORE beginning a debt relief program what are the expected payments to the creditors, length of time of the program, total fees to service provider, and any other set-up and/or assessment fees. Furthermore, with this approach, creditors will expect accompanying documentation that verifies the consumer information that was the basis of the debt capacity assessment as well as other legal affirmations. Since a full financial documentation portfolio would be created by the service provider, as a basis for developing a repayment plan with all creditors at the onset of the program, it is recommended that financial incentives be provided to collect as much information as possible on behalf of consumers in advocating on their behalf to their creditors. This labor-intensive process merits a fee that is in addition to any costs associated with initially setting up the client account. Under such circumstances, I believe that a fee is acceptable before a repayment plan is presented to the consumers' creditors.

After the specification of the fees incurred to the service provider, it is crucial to explain the payment process to consumers. Indeed, what types of debts are included in the plan such as medical debt or secured debts such as home equity loans. Furthermore, based on my research and knowledge of the repayment industry, I do not believe that a debt relief company should mandate restrictions on communication between consumers and their creditors. The issuance of "cease and desist" letters from debt settlement companies to creditors provides a false sense of security to consumers that their accounts are being successfully negotiated and there is not any threat of impending legal action. Instead, debt relief companies should encourage communication between clients and creditors in order to facilitate a more rapid and efficient completion of the debt concession program. Hence, service providers must disclose the expected costs and net savings to the consumer, how the repayment plan is determined (size of debt settlements), order of accounts to be paid (low to highest balances?), risk and cost of potential litigation (how does client proceed when creditor engages in litigation), what is the likelihood that accounts will be paid after "charge-off" and original creditor will not be paid, how will a successful account settlement be reported to credit reporting bureau and its impact on consumers' credit report, and the tax liabilities incurred by consumer based on success of the program. Theoretically, debt settlements typically would occur over three years which would result in tax obligations in each year over $600 of savings. During the course of my research, I have encountered debt settlement clients that insisted that they would not have enrolled in the program if they had been made aware of their potential tax liabilities. Finally, consumer financial counseling and education programs must be clearly explained and not solely be limited to print and online materials.

<u>Lastly, in terms of the traditional debt settlement program, it is not efficacious to promote plans that are based on serial settlements with creditors</u>. That is, accumulating a specific amount of savings that is then proposed to the creditors that are most likely to accept the immediate cash offers. The reasons that this model is fundamentally flawed is as follows. First, settlement companies will begin with client accounts that have the smallest balances and/or with "friendly" creditors. This approach gives the false impression to consumers that the remaining accounts will proceed in a similar manner. Second, and most important, there is not an accurate means test that determines the amount of the proposed settlement to the creditors. As the president of one of the largest debt settlement companies confided to me last spring, "determining the amount of the settlement is not an exact science." I could not disagree more vehemently. For example, when a 40% offer is made to the creditor by a debt settlement company, it is not known if the consumer can afford a 20% - 35%-50% -65% settlement over the duration of the program. Without a precise calculation of consumer debt capacity, neither the consumer or the creditor know if the offer is realistic and thus should be accepted. The result is that consumer debt settlements will generally be consummated <u>after</u> the federally mandated "charge-off" period which has the most severe negative impact on the consumers' credit report.

<u>It is my recommendation that pro-rata payment plans for all creditors be established in debt concession plans rather than the more typical, serial debt settlement programs</u>. This approach ensures that the cost and process of the debt relief plan can be clearly disclosed to consumers. Furthermore, this method offers several other related benefits such as early

agreement with creditors (within six months) that reduces possibility of litigation and that some agreements can be made before "charge-off" so that reports to credit reporting bureaus are as favorable as possible. Otherwise, by definition, serial account settlements necessitate "charge-off" before payments are made to creditors which increase the likelihood of lawsuits and the most damaging reports to credit reporting bureaus. Finally, consumers should always retain control over their financial resources and not deposit their funds into a third-party escrow system. <u>In a pro-rata distribution plan, consumers send monthly payments to their creditors--including service fees—that obviates the need for a large "upfront" fee to their service providers. Under the pro-rata distribution plan, service fees are earned on a monthly basis for each account that is in repayment status</u>. I strongly disagree that a service provider should receive a major portion of the expected service fees during the first three months of the plan. Also, disclosure must include a clearly explained refund policy. Consumers should be able to obtain a refund for most of their fees during the first 120 days of the program.

Third, disclosure of the effectiveness of the debt relief program. Consumers must be provided information on performance that is based on annual customer retention and completion of the program. For example, reporting the number of accounts that have been settled is not informative since smaller cards are the first to be negotiated. The essential metrics that must be reported are the percent of clients that complete the program within 39 months and the average saving in percentage terms net of ALL expenses. Too often regulators report the percentage of customers that have completed the plan based on the total number of all clients rather than the appropriate "cohort" analysis which is the percentage that started and finished within the agreed upon time period. Other important metrics include: percentage of settlements that are consummated after "charge-off," percentage of clients that filed for bankruptcy and dropped out of the plan, list of creditors that do not participate in the plan, and annual retention rates. Also, it is important to disclose the length of time that the service provider has been operating and the number of complaints and/or lawsuits filed against it over the last three years.

In conclusion, it is my hope that the proposed FTC rules will promote a fundamental reform and regulation of the debt relief/settlement industry that is based on empirical and precise estimates of consumer repayment capability. The need for debt concession options has increased dramatically over the last five years and will continue to grow over the next 2-3 years. The success of the regulation of the partial payment industry will have far-reaching consequences on the national bankruptcy rates as well as on the ongoing economic recession and future lending policies. It is my contention that the traditional debt settlement model is fundamentally flawed and essentially bankrupt for the purposes of yielding a successful benefit to the majority of its clients. Creditors could play a positive role in reforming the debt relief industry. However, their complicity as enablers of the traditional debt settlement model and pursuit of capricious pricing and collection activities suggests that they will not play a significant role without significant government regulatory incentives. Indeed, the current consumer debt "charge-off" policy can and should be reformed to benefit of both lenders and borrowers following the adoption of innovative collection/recovery policies. Nevertheless, it is crucial to promote a vigorous and consumer-friendly debt relief system that is based on a balanced regulatory framework. Without an objective approach to measuring consumer repayment capability, I fear that the proposed regulations will not encourage sufficiently innovative models that are responsive to the ongoing consumer debt crisis.

Sincerely,

Robert D. Manning, PhD
Filene Research Fellow, President
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