Options for Consumers in Crisis:

An Updated Economic Analysis of

The Debt Settlement Industry

(Data as of March 31, 2017)

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1. Executive Summary

Please refer to §2 for a Glossary of capitalized terms used in this report.

In 2012 the American Fair Credit Council commissioned the 2012 Report, the original study upon which this update is based, with the objective of performing the first-ever independent analysis of the economic consequences of participation by financially challenged consumers in debt settlement programs. The 2012 Report examined the outcomes of more than 1.0 million Accounts associated with approximately 170,000 individual Clients enrolled in debt settlement programs from January 1, 2006 through December 31, 2012.

The 2012 Report focused on analyzing consumer outcomes from what were, essentially, two completely different business models: Version 1 (the "advance fee model," which was virtually universal prior to October 27, 2010) and Version 2 (the "no-advance fee model," which became the only legitimate operating model for debt settlement companies operating on and after October 27, 2010). Because Version 2 program enrollments occupied only 26 months of the 84-month study period, for purposes of the 2012 Report, Version 2 programs were not only underrepresented in all segments of the Account population but not truly predictive due to insufficient volume of program completion.

An update to the 2012 Report was issued in 2015 (the "2015 Report"). The 2015 Report expanded the analysis to 1.9 million individual Accounts enrolled in debt settlement programs from January 1, 2006 through March 31, 2015. At that time, the number of Version 2 Clients and Accounts slightly exceeded the residual number of Version 1 Clients; however, because no more Version 1 Clients have been enrolled since October 2010, as Version 1 Clients have aged out of their programs the size of the Version 1 Client population is no longer meaningful. Accordingly, this Report focuses exclusively on Version 2 Clients and Accounts enrolled in a debt settlement program over the more than six-year period from January 1, 2011 to March 31, 2017. This time period enables a complete analysis of the prospects for consumer success in a Version 2 debt settlement program.

The analysis presented below addresses the outcomes of 2.9 million individual Version 2 Accounts. These Accounts are associated with approximately 400,000 individual Clients. As described in greater detail below, the following conclusions are evident:

- Across all Version 2 Client types (including all Active, Terminated or Completed Clients), Debt Reduction is $2.64 for each $1.00 of Fees,

- Since Version 2 Clients do not pay Fees until a settlement is reached, these Clients have experienced, and will continue to experience, Savings irrespective of program tenure (*see* Chart 5.2). On average, Version 1 Clients required seven months of

program tenure to realize Savings, whereas Version 2 Clients generally realize Savings on the first settlement, which commonly occurs within the first four to six months of program tenure (*see* Chart 5.3).

- At the time of the 2012 Report, only two years of data on Version 2 Accounts was available and, at the time of the 2015 Report, approximately four years of data was available on Version 2 Accounts. This report now considers more than six years of data on Version 2 Accounts. The expanded data set supports the following conclusions:

  - The likelihood that a Client will obtain at least one settlement has increased: 61% of all Clients that are no longer Active (*i.e.*, Completed and Terminated Clients) settled at least one Account. When the data set is expanded to include Active Clients, 67% of all Clients have settled at least one Account. Amongst Terminated Clients, 42% settled at least one Account.

  - The probability that a Client will achieve multiple settlements continues to increase. 50% of all Clients that are no longer Active settled more than two Accounts. This equates to a similar increase in the probability that a given client will complete his or her debt settlement program (see §§4.c and 4.d, below).

  - Version 2 Clients can reject any offered settlement for any reason or no reason at all. As a result, more than 96% of settlements result in Debt Reduction that is greater than the related Fees (*i.e.*, realized Savings).[1]

  - The completion rate for Clients that participate in a settlement program for at least six months exceeds 50% (*see* Chart 4.5 below).[2] For Clients that participate for more than two years, the completion rate exceeds 60%.

- Clients across all vintages are achieving substantial reductions to their debt (*see* Charts 5.7, 5.8, and 5.9).

- After approximately nine months (*see* Charts 6.1 and 6.2), accretion experienced by Clients on Enrolled Debt due to interest, fees and penalties, falls below accretion that

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[1] In unusual cases, almost always associated with collections lawsuits, a settlement will occur that, when fees are included, aggregates more than 100% of the enrolled amount. While there is significant anecdotal evidence to the effect that these "100%+" settlements are subsequently renegotiated and settled for significantly less, we have assumed in the data that these settlements stand as originally accepted by the client.

[2] As described in §4.d, an analysis of completion rates for Clients that do not participate for at least six months is not relevant because insufficient time has transpired for completion to be a practical outcome.

would otherwise occur if Accounts were to amortize at normal credit card rates of interest.

- Since Version 2 Clients only pay for settlements actually achieved, economic benefit should be measured on an Account-by-Account basis, not on a total-debt basis (in other words, Clients receive economic benefit from each settlement, irrespective of whether or not additional debts are settled). *See* §6 below, including Charts 6.3, 6.4, and 6.5.

These findings support the conclusion that debt settlement results in an economic benefit for consumers.

2. Glossary of Terms Used in this Report

As used in this report, unless the context otherwise requires, the following terms have the meanings given below.

2012 Report (Report 1) and **2015 Report** (Report 2). The previous studies of debt settlement programs described in the Executive Summary.

Account. A record of an obligation owed by a Client to a creditor. An Account may have one of three different statuses: an "**Active Account**" is an Account that is currently enrolled in an active debt settlement program; a "**Settled Account**" is an Account that has been successfully settled; and a "**Terminated Account**" is an Account that has been withdrawn prior to settlement by a Client from a debt settlement program.

AFCC. The American Fair Credit Council. The American Fair Credit Council (formerly known as "TASC," the acronym for The Association of Settlement Companies), is the industry trade association representing virtually all of the national debt settlement companies operating in compliance with the FTC Rule.[3]

Client. A consumer who has enrolled in a debt settlement program. A Client may be in one of three different statuses: an "**Active Client**" is a Client that is currently enrolled in an active debt settlement program; and a "**Terminated Client**" is a Client who has withdrawn from a debt settlement program prior to achieving "completed" status. *See* §4.d below for information on how "**Completed Client**" is defined for purposes of the analyses contained in this report.

[3] The FTC Rule refers to the Amended Telemarketing Sales Rules (16 C.F.R. Part 310 et seq.), as issued by the Federal Trade Commission on July 29, 2010, which rule implemented the "advance fee" ban, effective as of October 27, 2010.

Debt. An unsecured obligation, represented by an Account, owed by a Client to a creditor. An "**Enrolled Debt**" is a Debt that has been enrolled by a Client in a debt settlement program. Debts eligible for enrollment in a debt settlement program are predominately credit card obligations and other forms of unsecured indebtedness (including medical debt and non-Federally guaranteed student loan obligations); secured indebtedness is not eligible for debt settlement.

Debt Reduction. The difference between the amount owed by a Client to a creditor at the time of settlement and the amount for which that Debt is actually settled. By way of example, if a Client owes $10,000 at the time of settlement and the Debt is settled for $4,000, the Debt Reduction would be $6,000.[4]

Fees. The compensation charged by a debt settlement services provider. Generally, Fees are determined in reference to the Enrolled Debt balance. This structure aligns the interests of the debt settlement service provider and the consumer to avoid penalty fees and other accretion.

Savings. The net economic value of a settlement to a Client. "Savings" represents Debt Reduction minus Fees. By way of example, the settlement of a $10,000 Debt for $4,000 with a 20% Fee yields Savings of $4,000 ($6,000 of Debt Reduction minus the $2,000 Fee).

Version 1/Version 2. The terms used to denote pre- and post-FTC Rule debt settlement programs, respectively. "Version 1" programs are debt settlement programs that were entered into on or prior to October 26, 2010; "Version 2" programs are debt settlement programs that were entered into on or after October 27, 2010, the effective date of the FTC Rule.

3. Introduction and Background

a. Debt Settlement

Debt settlement is the process by which a debt settlement service provider, working on behalf of a Client (a financially distressed consumer enrolled in the service provider's debt settlement program), negotiates the settlement and discharge of the Client's unsecured

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[4] The FTC Rule mandates that, for marketing purposes, "savings" must be measured as the difference between the amount paid and the original (*i.e.*, enrolled) balance of a Debt. However, using the original balance as a baseline for calculating savings distorts the economic benefit realized by a Client because, by ignoring accretion, actual savings is understated. Accordingly, for analytic purposes, the economic analyses presented in this report generally use actual savings, meaning savings measured against the amount owed at time of settlement.

indebtedness. Debt settlement generally serves those who cannot qualify for or afford other debt relief options, such as consumer credit counseling, or who are unable to satisfy the means test required as a prerequisite to personal bankruptcy.[5]

Although the debt settlement process involves functioning as the intermediary between the debtor and the creditor, debt settlement service providers do not provide legal representation, nor do they provide tax or bankruptcy advice or counseling services. Similarly, debt settlement service providers do not provide assistance with secured indebtedness, such as mortgages or any other type of secured indebtedness (a creditor holding secured debt has no incentive to negotiate, or reason to accept, a settlement of less than the value of the underlying security).

Although debt settlement has been available to commercial enterprises for many years, it only became widely available as an option for consumers in 2003 and took off, as an industry, following the passage of the Bankruptcy Reform Act of 2005. The Bankruptcy Reform Act of 2005 made it more difficult and expensive for consumers to seek discharge of their debts, particularly credit card-related debts.[6]

b. <u>The American Fair Credit Council</u>

The AFCC's predecessor, TASC, was formed in 2005 for the twin purposes of articulating clear and fair operating standards for the debt settlement industry and promoting strong legislation that protects consumers from both real and perceived abusive practices.[7] TASC changed its name to the American Fair Credit Council following the October 2010 adoption of the FTC's advance-fee ban to reflect a new and expanded mission. The AFCC's standards, along with industry "best practices" and the association's mission statement, may be found on its website at <u>www.americanfaircreditcouncil.org</u>.

c. <u>The Version 2 Fee Structure Shifted Risk to the Debt Settlement Service Providers</u>

The FTC Rule set in place the Version 2 model, a pay-for-performance requirement for those debt settlement service providers that are subject to FTC jurisdiction.[8] The

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[5] Refer to §7 below for discussion regarding other debt relief options available to consumers, including the related fees.

[6] Federal Reserve Bank of Boston, *Forgive and Forget: Who Gets Credit After Bankruptcy and Why?*, Working Paper No. QAU09-2, July 23, 2009, p.9.

[7] *See* http://www.americanfaircreditcouncil.org/who-we-are

[8] The FTC's jurisdiction extends only to certain persons who use an instrumentality of interstate commerce in the sale of a product or service. The FTC Rule does not reach those whose sales process occurs in

Version 2 model shifted the economic risk of program success from the consumer to the service provider. Specifically, the service providers incur considerable costs before being able to charge a Client fees. For example, service providers engage in pre-enrollment program education, provide extensive program disclosures, perform client suitability analyses and account verification and set-up services, and conduct numerous settlement-related negotiations with creditors. Per the FTC Rule, before the service provider is entitled to recoup any of those costs, three contingencies must be satisfied: (1) the service provider must negotiate the terms of settlement for a debt; (2) the Client must agree to the terms of the negotiated settlement; and (3) the Client must ratify that acceptance by making at least one payment to the creditor. If the Client fails to do any of these things, the service provider will experience a financial loss because Fee revenue may only be realized when the Client actually agrees to a negotiated settlement. Moreover, the Fee for the provision of services may only be charged on a per-debt basis (*i.e.*, the service provider may only collect the Fee attributable to the specific Debt being settled).[9]

4. Scope of Engagement and Data Considered

a. Analytic Approach

The objective of this report is to provide an independent and impartial analysis of the economic consequences of participation in a debt settlement program. It is premised on data obtained from the nation's largest debt settlement service providers, all of whom adhere to the AFCC's Code of Conduct. More specifically, the statistical data presented herein is representative of, and consistent with, the FTC Rule that Fees may only be charged or collected at such time as the underlying Debt has actually been settled. The analysis includes approximately 400,000 Clients, with approximately 2.9 million Accounts, residing in most of the 50 states as well as the District of Columbia and Puerto Rico. Ultimately, this analysis measures whether, and to what extent, a Client is economically advantaged by participation in a debt settlement program.[10]

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face-to-face interactions and persons operating under the provisions of Section 501(c)(3) and 501(q) of the Internal Revenue Code.

[9] The Fee that may be collected upon settlement of a debt must bear the same relationship to the total Fee for all Enrolled Debts as the settled debt bears to the total of all Enrolled Debts (*i.e.*, "frontloading" of Fees is not allowed under the FTC Rule).

[10] This report has not excluded any Clients or Accounts based on their respective outcomes (*e.g.*, whether the Client terminated within one month of enrollment or exited without having achieved a settlement) despite the fact that valid reasons exist to consider such exclusions. Further, it was deemed to be beyond the scope of this report to address or attempt to monetize either the "soft" benefits (*i.e.*, the value to a Client of improved cash flow when the Client chooses to stop making minimum monthly credit card payments and substitutes a reduced periodic deposit requirement) or the "soft" costs (the detriments of various debt relief alternatives,

b. Summary of Data

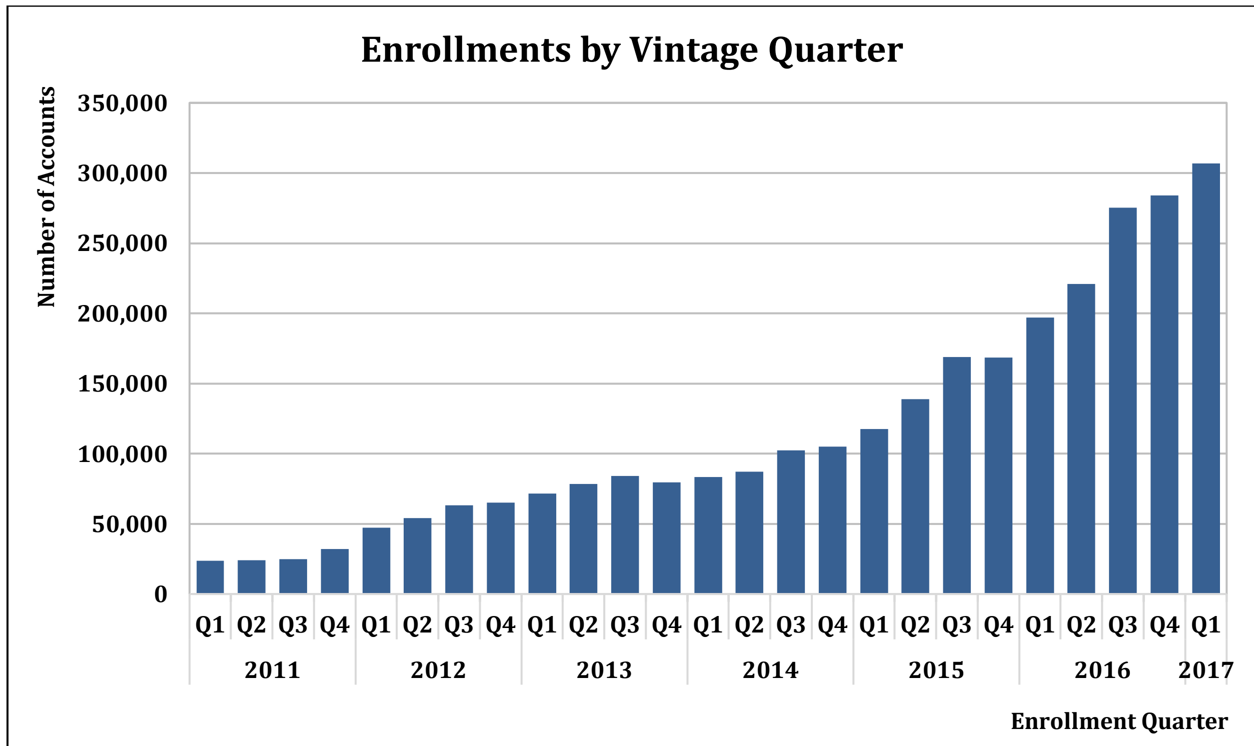
Table 4.1 summarizes key attributes of each of the data sets analyzed for purposes of the three reports issued to date (Version 2 Clients and Accounts only):

Table 4.1

Fee Model	Report 1 (2012)	Report 2 (2015)	Report 3 (2017)
Enrolled Clients	56,000	165,000	397,000
Enrolled Accounts	354,000	1,133,000	2,904,000
Total Enrolled Debt	$1.7 billion	$5.0 billion	$12.0 billion

Chart 4.2 below summarizes as of March 31, 2017 the Accounts included in the analysis herein based upon the date of enrollment:

Chart 4.2



The first quarter of 2011 marked the first full quarter of enrollments following the onset of the FTC Rule. At that time, service providers, unsure about their ability to withstand the cash flow impact of delayed fee collection, restricted the enrollment of new accounts to better assess the capital investment that would be required by the deferral of Fees associated with

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such as damage to one's credit report, the social costs of bankruptcy, etc.). Finally, while relief of indebtedness may be considered taxable income under some circumstances, consumers who are insolvent at the time such debt relief occurs may not have to treat such "income" as taxable, *see* §7, below.

the Version 2 account structure. Since that time, the data indicates that service providers have experienced an increasing enrollment trend.

Continued enrollment growth is expected as consumers become more aware of debt settlement as an economically beneficial way to address unsecured debt and as creditors become more accepting of debt settlement as a practical way of managing consumer defaults without the time-delay and cost associated with enhanced collection activities. This conclusion is further supported by IBISWorld's projection that aggregate U.S. household debt will expand at an annual rate of approximately 2.8% during the five-year period from 2017 through 2022 as compared to 0.5% for the past five years (*i.e.*, indebtedness is increasing).[11] As an additional data point, the Federal Reserve reports that the rate of credit card charge-offs has increased from approximately 3.0% of outstanding debt from 2014 through the third quarter of 2016 to 3.5% from the fourth quarter of 2016 through the third quarter of 2017 (though these levels are low compared to earlier periods).[12] These metrics indicate that the recent growth rates observable in debt settlement enrollments is likely to continue.

c. Critical Client and Account Attributes

The data included in this report has been segmented into three principal categories:

- **Active**: Clients and Accounts continuing to participate as of March 31, 2017. Amongst these Clients, 30% of all Accounts have been settled while 2% of Accounts have been terminated.
- **Completed**: Clients that have reached settlements of all Enrolled Debts that had not become Terminated Accounts.[13] 88% of these Clients have settled at least 75% of the number of enrolled Accounts.
- **Terminated**: Clients and Accounts that have withdrawn prior to completion and/or settlement.

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11 IBISWorld Industry Report 56144 Debt Collection Agencies in the US, December 2017, "All debts paid: Aggregate household debt is expected to expand, boosting industry revenue," p.4.

12 Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks (available at https://www.federalreserve.gov/releases/chargeoff/chgtop100sa.htm).

13 The data indicates certain Clients terminate participation in a debt settlement program simultaneously with the settlement of other debts. For example, many Clients settle a 3rd debt after 12 months in the program, and at that same time, terminate all remaining enrolled Accounts. This activity suggests the Client has learned how to self-serve debt settlement; to the extent that this propensity results in Client-directed settlements for which no Fee will be earned by the service provider, this implies both enhanced economics for Clients and added pressure on service provider margins, as well as an increased need to focus on both Client service and settlement performance that is over and above what the Client could achieve on his own.

Chart 4.3 summarizes the median outcomes for Clients of all types at the Account level:

Chart 4.3

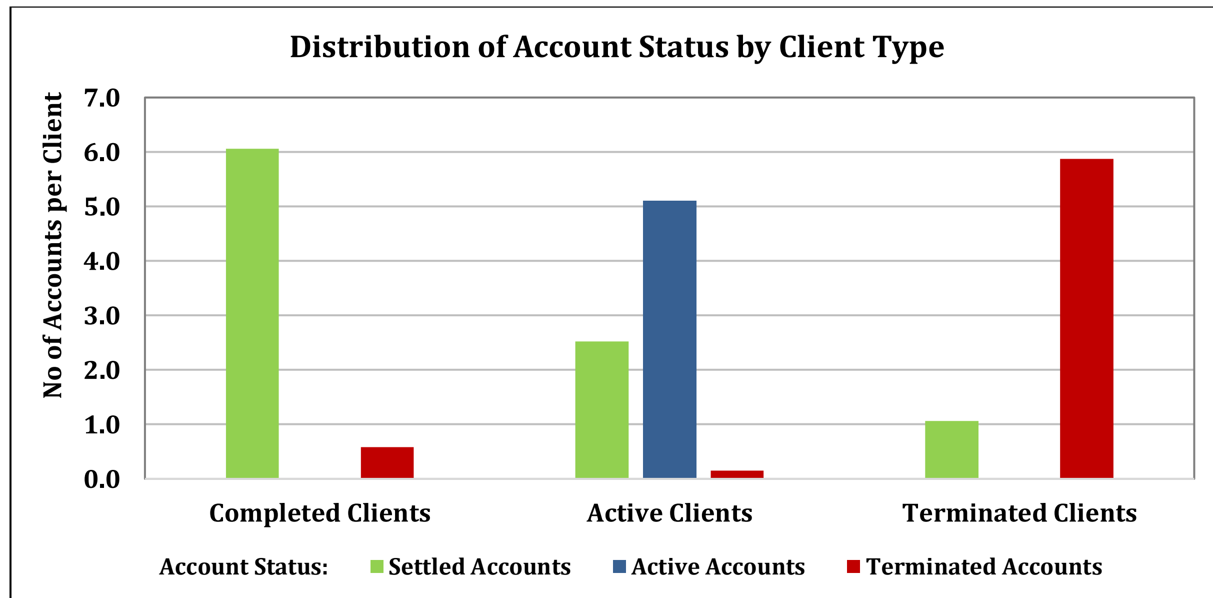
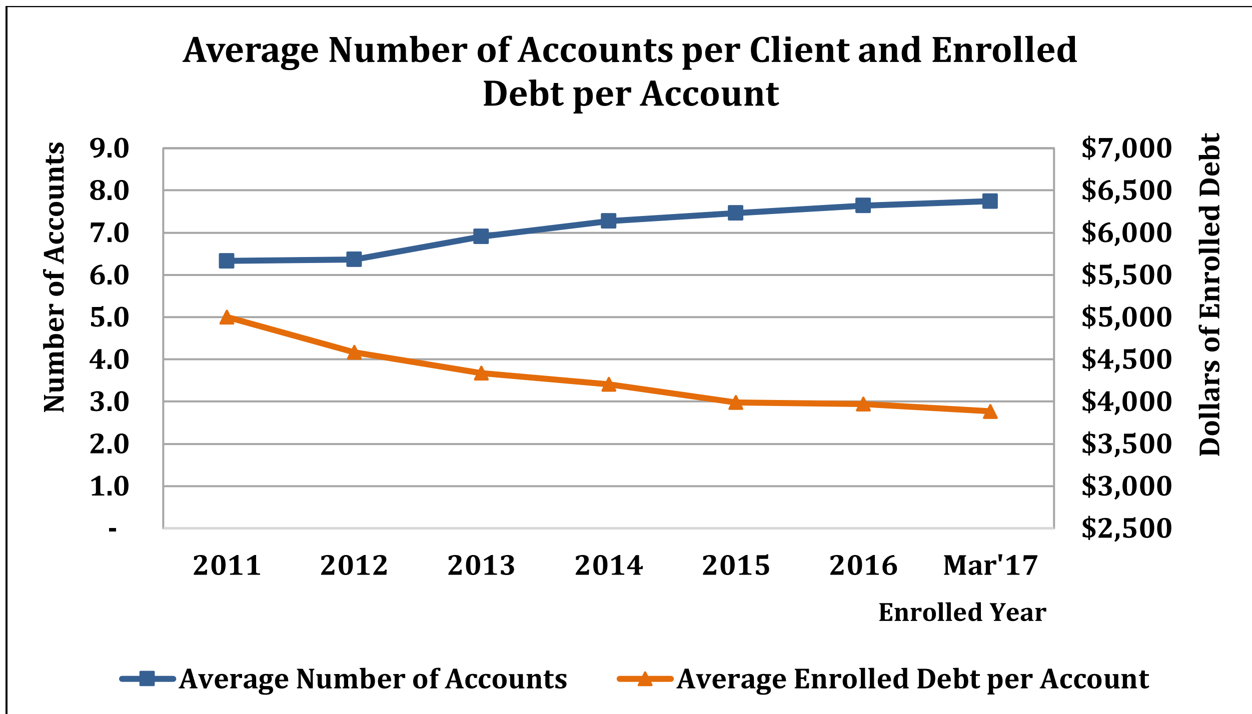


Chart 4.3 illustrates how Clients experience a benefit from debt settlement during the course of the debt settlement program. The typical Active Client has realized three settlements and attendant Savings. Many Terminated Clients also generated Savings prior to exiting their program (refer to §5 below for additional analysis). Specifically, 42% of Terminated Clients settle at least one Account and 13% of Terminated Clients settle at least 50% of their enrolled Accounts.

A Client that settles even one debt for less than the sum of the amount owed at the time of settlement and Fees is, by definition, less in debt by virtue of participation in a debt settlement program. In other words, Savings are realized on a per-debt basis, **not** on a portfolio basis: a Client does not need to settle all enrolled debts before Savings may be realized (*see* §6). Thus, when measuring outcomes for Version 2 Clients, it is important to analyze both Debt Reduction and Savings at the Account level.

Counterbalancing the growth in enrollment rates, the data indicates that Clients are enrolling more accounts today than in 2011 but the average amount of each enrolled debt has decreased. Since each creditor is independent, the Client has less leverage with respect to the settlement of smaller debts and the service provider is required to do more work to effect the settlement of a greater number of debts. Given that the total Fees owed to the service provider remain unchanged relative to the total amount of enrolled debt, service providers today are doing more work for the same total Fee. *See* Chart 4.4, below.

Chart 4.4



d. <u>Vintage Analysis</u>

The data in this report has been analyzed and presented on a vintage basis. Vintage analyses are the most accurate way to evaluate performance when time is relevant to Client outcomes. A vintage analysis examines the performance of a group of Clients or Accounts that have been segmented by dates of enrollment. By way of illustration, colleges report graduation rates as a percentage of students eligible for graduation. The graduation percentage is typically calculated by dividing the number of graduating seniors by the number of freshmen that entered the same class four years earlier. Stated differently, the graduation rate is not computed by dividing the number of graduating seniors by the total number students at the college because most college students have not completed enough coursework to be eligible for graduation at that time.

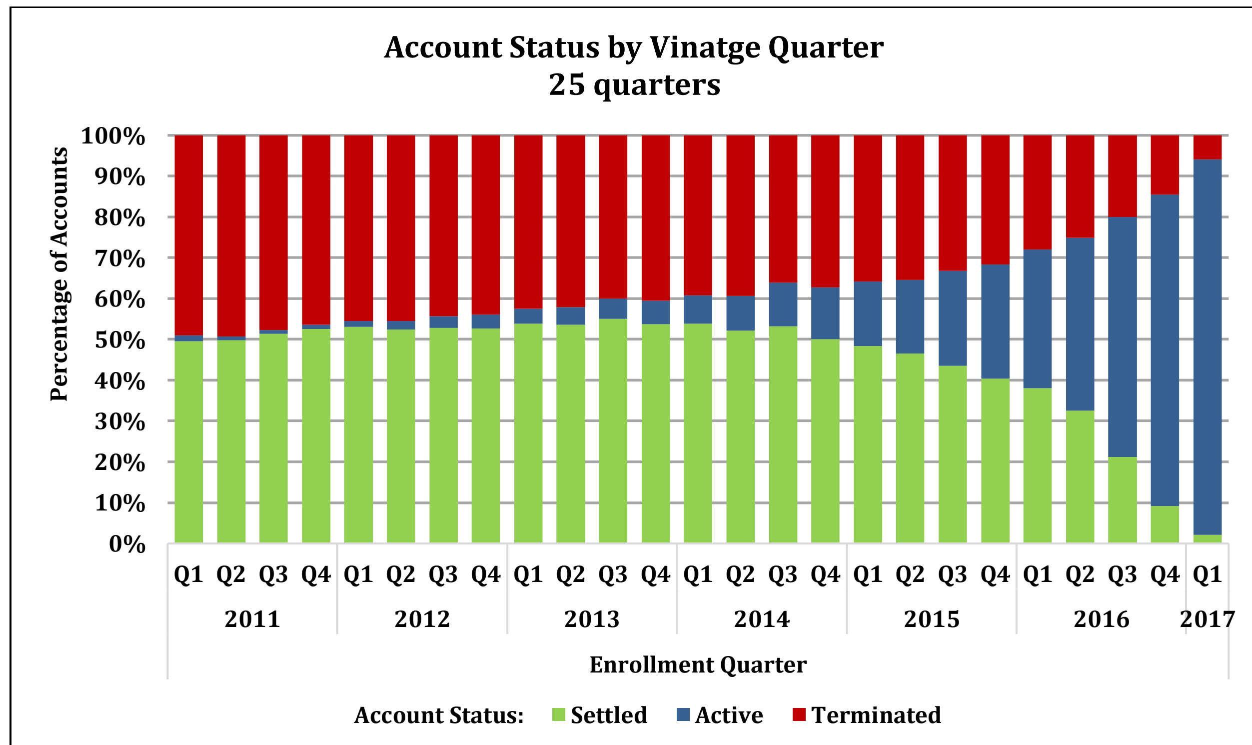
A concept similar to a graduation rate applies in the debt settlement industry (*i.e.*, a completion rate). That is, a Client who enrolled in January 2014 is less likely to have completed the program by December 2015 than a Client who enrolled in January 2012 or earlier. This is why vintage analysis is both relevant and necessary to an accurate presentation of outcomes (*e.g.*, how much Debt Reduction was generated within 24 months of enrollment?).

Based on the four years of data available for purposes of Report 2, the completion rate for Version 2 Accounts was predicted to stabilize at slightly above 50%. This projection has

been validated by the settlement rates experienced across Accounts in the expanded period addressed in this Report 3 (ended March 31, 2017).

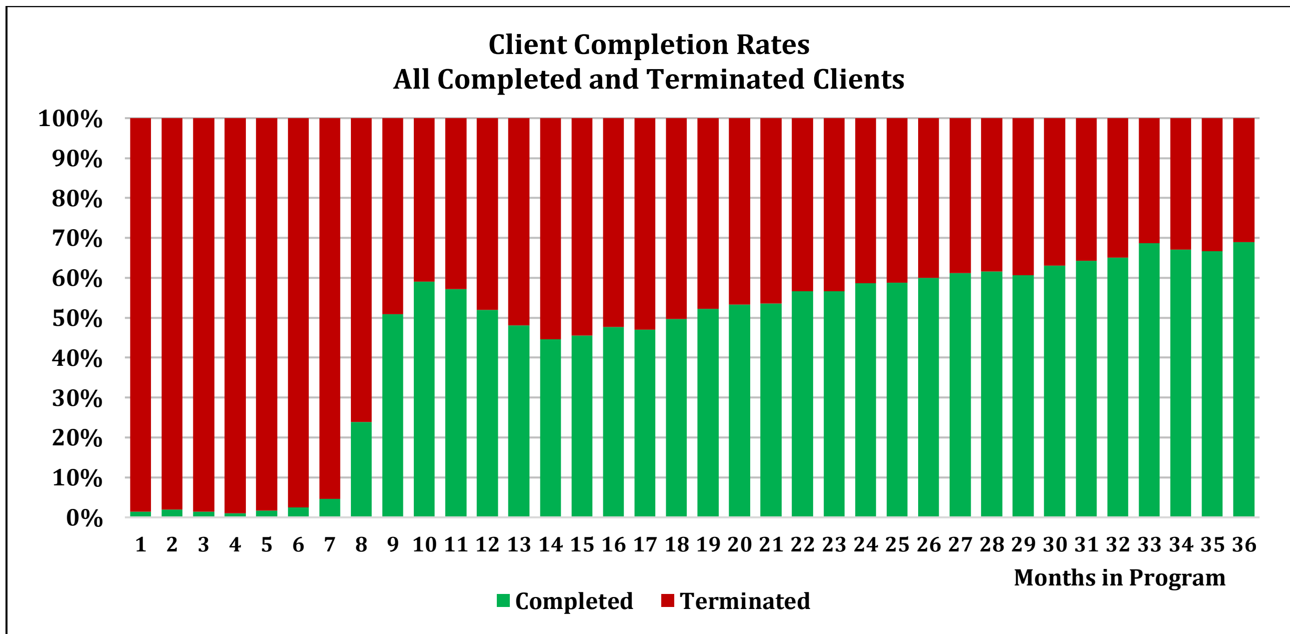
Chart 4.5 illustrates that, for vintages with at least 2 years of experience, the Account settlement rate consistently exceeds 50%. Many of these vintages have additional Accounts that remain Active, which as described above are more likely to result in settlements than terminations.

Chart 4.5



Finally, the completion rate may also be measured at the Client level. Here again, the data indicates that Client tenure (months in the debt settlement program) is highly correlated with the Client completion rate. For all Clients (Completed and Terminated) that participated in the debt settlement program for seven months or more, the Client completion rate is 52%. The Client completion rate exceeds 60% for Clients that participate for more than two years. Conversely (and not unexpectedly), the Client completion rate is much lower for Clients that participated for six months or less. As described in the vintage analysis above, however, it is not reasonable to anticipate a meaningful completion rate for these Clients. Chart 4.6 illustrates the Client completion rate at each month of program tenure.

Chart 4.6



Because Client-level analyses requires the Client to have exited the program, these percentages are significantly understated by the existing population of Active Clients. Specifically, 60% of all Active Clients have participated in their debt settlement programs for more than six months (*i.e.*, the cohort with a greater than 50% probability of Client completion). As indicated in Chart 4.3, the typical Active Client has already settled more than 33% of enrolled debts, and may be expected to continue to receive settlements through their remaining program tenure.

5. The Benefits of Participation in Debt Settlement Programs

a. The Aggregate Economic Benefits of Debt Settlement Programs

Chart 5.1 summarizes the total Debt Reduction and Fees experienced across all Client outcomes, where those outcomes are known (*i.e.*, it does not include the 1.0 million Active enrolled Accounts):

Chart 5.1

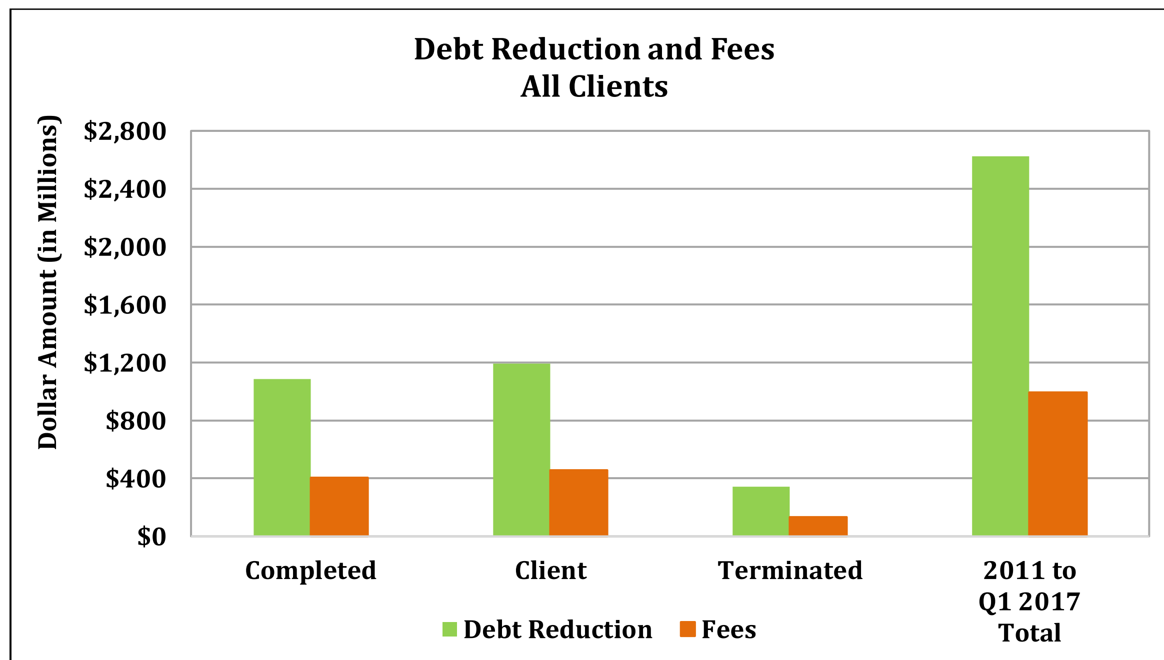
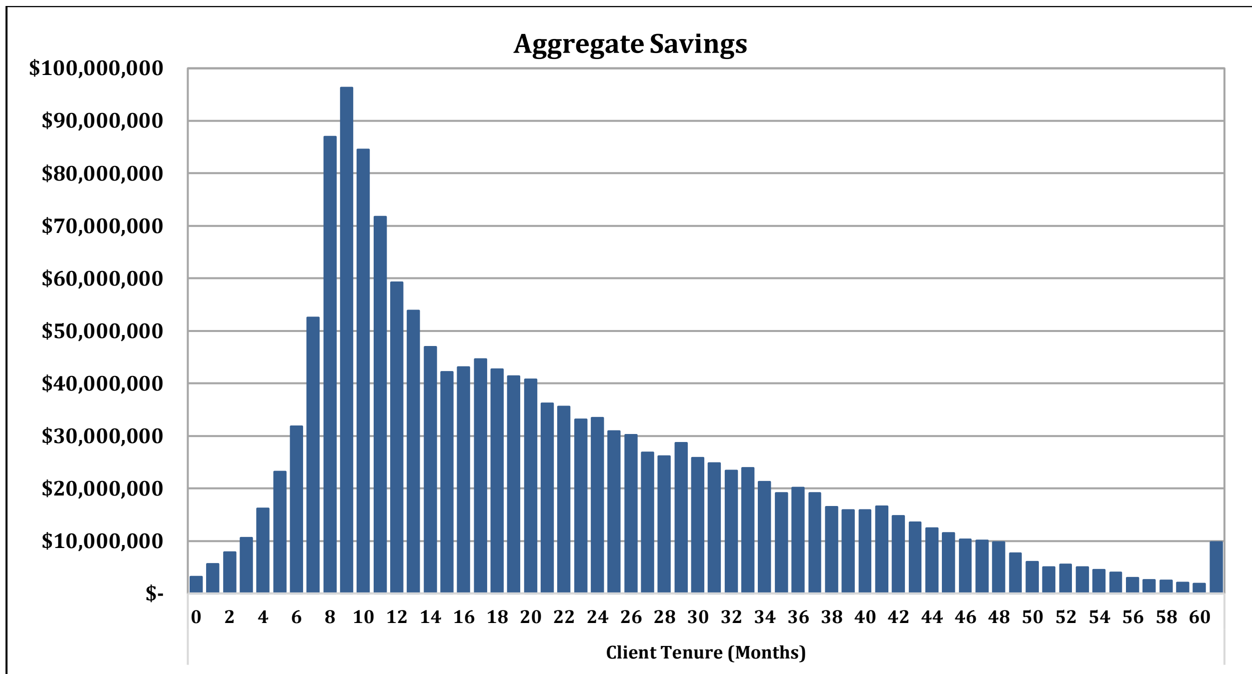


Chart 5.1 illustrates that all Clients studied for purposes of this report (including Terminated Clients) have realized $2.6 billion in Debt Reduction (*i.e.*, the difference between the Debt at the time of settlement and the amount actually paid to settle that Debt) while incurring Fees of $1.0 billion (*i.e.*, actual hard-dollar Savings of $1.6 billion, or approximately $4,000 per Client, regardless of status). In the aggregate, each segment of Clients (including Terminated) has experienced Savings.

In numerous ways, our analysis found a persuasive relationship between program tenure and Debt Reduction. Chart 5.2 illustrates how Savings (*i.e.*, Debt Reduction minus Fees) are accumulated by Clients based upon the number of months of participation in the debt settlement program. Since Fees are not paid by Version 2 Clients until a settlement occurs, Version 2 Clients experience Savings in all periods from and after the first settlement.

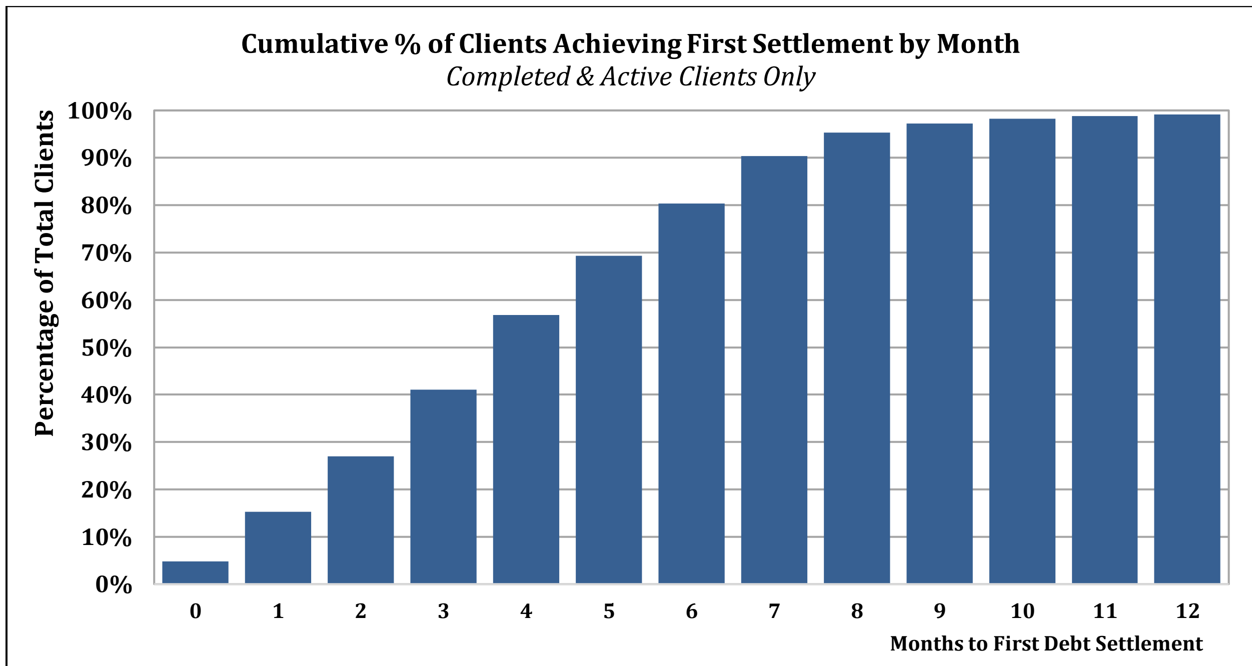
Chart 5.2



Another important trend that may be drawn from Chart 5.2 is that Version 2 Clients are experiencing Savings earlier in the program lifecycle as compared to earlier versions of this study. This issue is addressed further in Chart 5.3 below, which illustrates the timing of the first settlement achieved by Completed and Active Clients. Chart 5.3 also shows that the probability a Client achieves a settlement is strongly correlated to the length of time that a Client participates in the debt settlement program (*i.e.*, by month four, 50% of Clients have reached a settlement, and by month seven, 90% of all Clients have reached a settlement).[14]

[14] The availability of bank-sponsored consolidation loan programs, whereunder settlements and Fees are funded through a consolidation loan offered to certain debt settlement program participants, has contributed to a shortening of the time-to-settlement. See §7(c), below.

Chart 5.3



Approximately 96% of settlements result in Debt Reduction that is greater than the Fees associated with the respective settlement. Having achieved a first settlement earlier, Version 2 Clients are then able to pursue subsequent settlements earlier. This effect is consistent with academic research on this topic.[15]

Chart 5.4 expands on Chart 5.3 to include the settlement outcomes of Version 2 Clients of all types (*i.e.*, including Terminated Clients) based on Client Tenure. Chart 5.4 demonstrates how Version 2 Clients accumulate additional settlements as program tenure increases. For example, of all Clients with 18 months of tenure, 25% settle six or more accounts, 35% settle five or more accounts, 50% settle four or more accounts, more than 60% settle three or more accounts, etc. Less than 5% of Clients with a program duration of 18 months had not settled an Account.

[15] *See* "Can Small Victories Help Win the War? Evidence from Consumer Debt Management," Journal of Marketing Research, Vol. XLIX (August 2012), pp. 487–501. This research found that achieving settlements earlier in a debt settlement program increased the probability of achieving subsequent settlements.

Chart 5.4

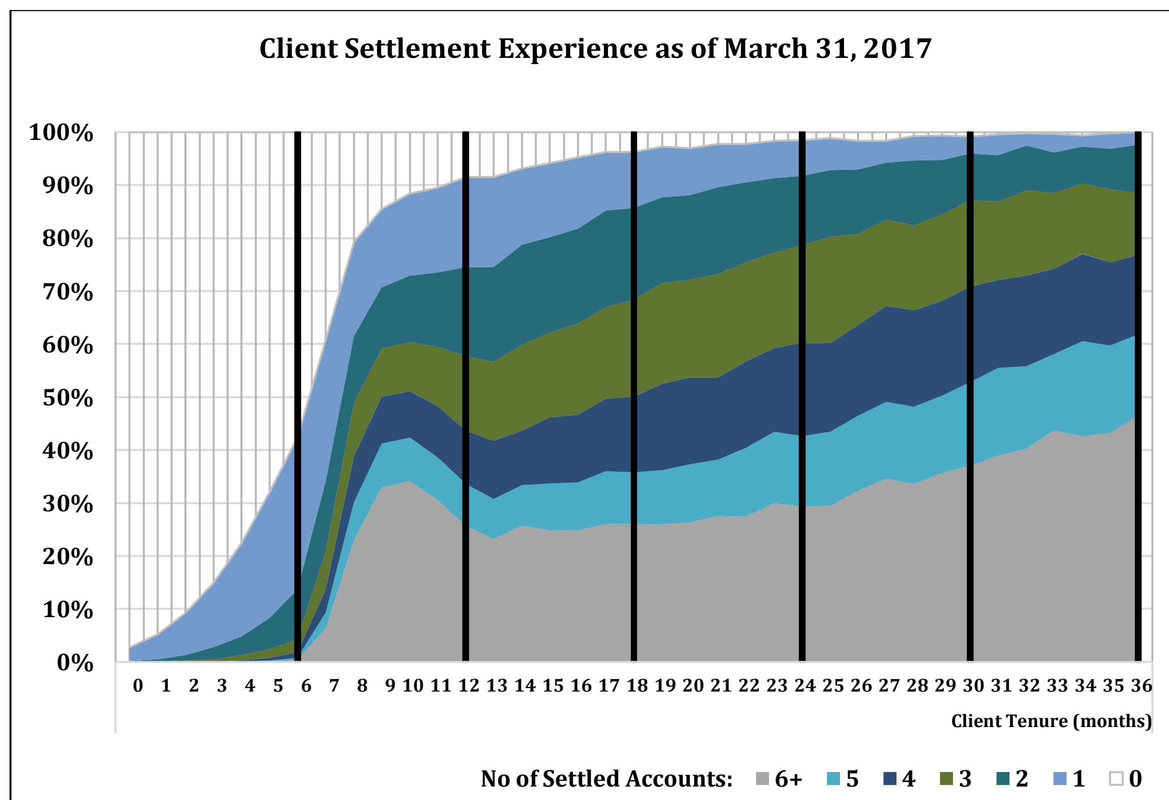


Chart 5.4 clearly illustrates how the number of settlements increase as Clients remain in the debt settlement program (*i.e.*, a Client is much more likely to have four settlements at month 24 than at month 18).

b. <u>Benefits as Measured at the Client and Account Levels</u>

A useful measure of Client success in a debt settlement program is Debt Reduction per dollar ($) of Fees (*i.e.*, total Debt Reduction ÷ total Fees). This metric measures a Client's return-on-investment: did the Client reduce his debt in an amount greater than the Fees paid, and if so, by how much? This is the exact choice that is made by Clients at the time of each settlement in the 2.0 model. Specifically, Version 2 programs provide the following rights to Clients:

(1) Ability to withdraw from a debt settlement program without any exit penalty at any time, for any reason;

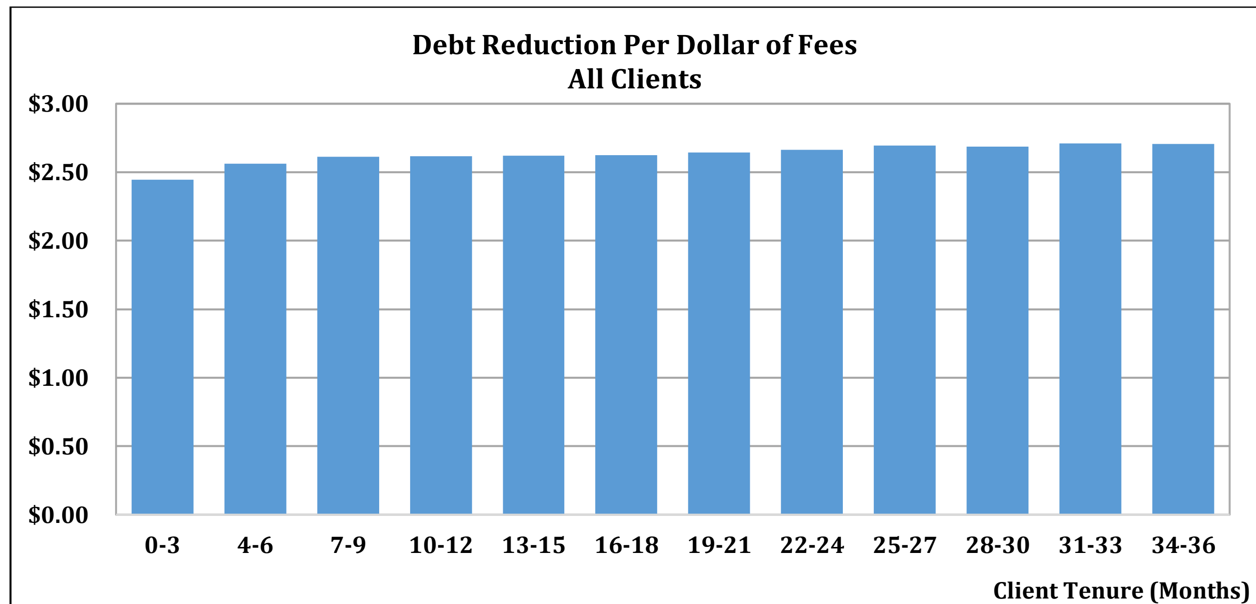
(2) Authority to reject an offered settlement for any reason or no reason at all; and

(3) Avoidance of Fees until an offered settlement is accepted, and then only assessed a Fee for only the debt actually settled.

Taken together, the Client can leverage these rights to evaluate whether a positive return will be realized in the form of Debt Reduction in exchange for Fees.

When Debt Reduction is greater than $1.00, the Client will realize Savings, but if Debt Reduction is less than $1.00, the client will not realize Savings. For Version 2 Clients, Debt Reduction is consistently in the range of $2.60 to $2.70 per dollar of Fees for all Client types (Completed, Active, *and* Terminated) (*i.e.*, Savings of $1.60 to $1.70).[16] Chart 5.7 summarizes the settlement outcomes for all Client types based upon the duration of the Client's participation in the debt settlement program:

Chart 5.7



[16] The small but measurable reduction in Savings results from (i) reduced accretion, as settlements occur earlier, and (ii) the increase in Fees from Version 1 to Version 2 programs.

c. <u>The Debt Reduction Experienced By the Typical Version 2 Completed Client</u>

Chart 5.8 summarizes the weighted-average outcomes for Completed Clients of all tenures included in this analysis.

Chart 5.8

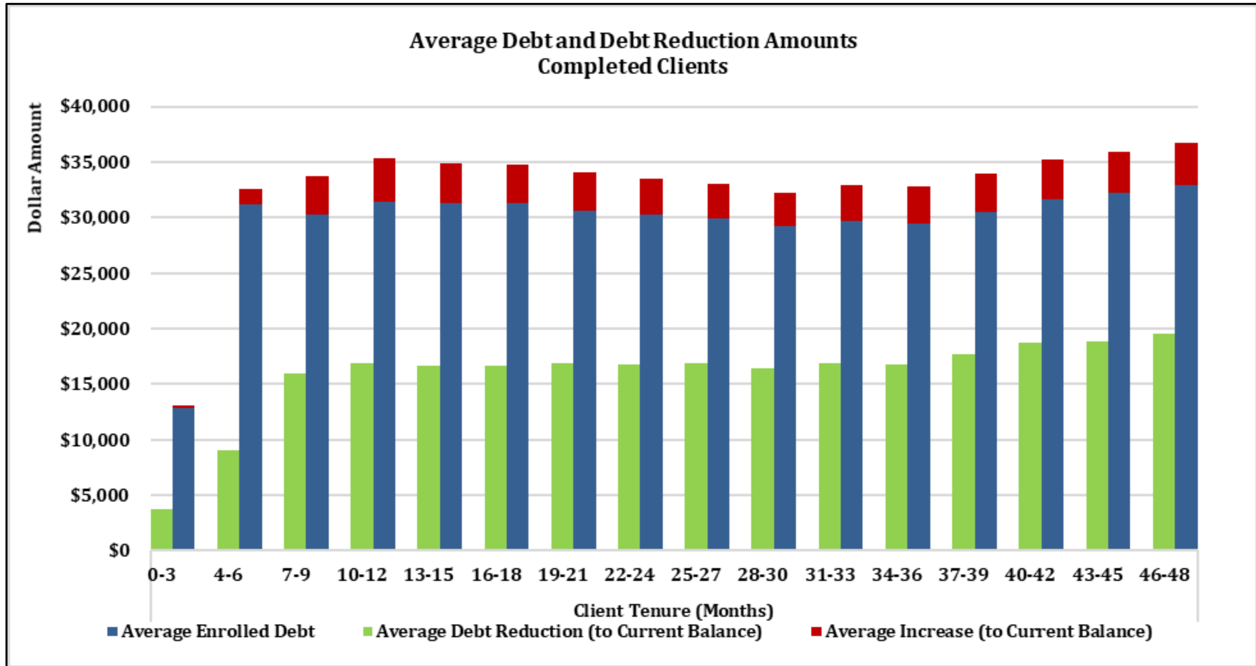


Chart 5.9 compares the typical Completed Client performance at the Account level. The data demonstrates that settlement outcomes have remained consistent with those identified in the prior version of this study:

Chart 5.9

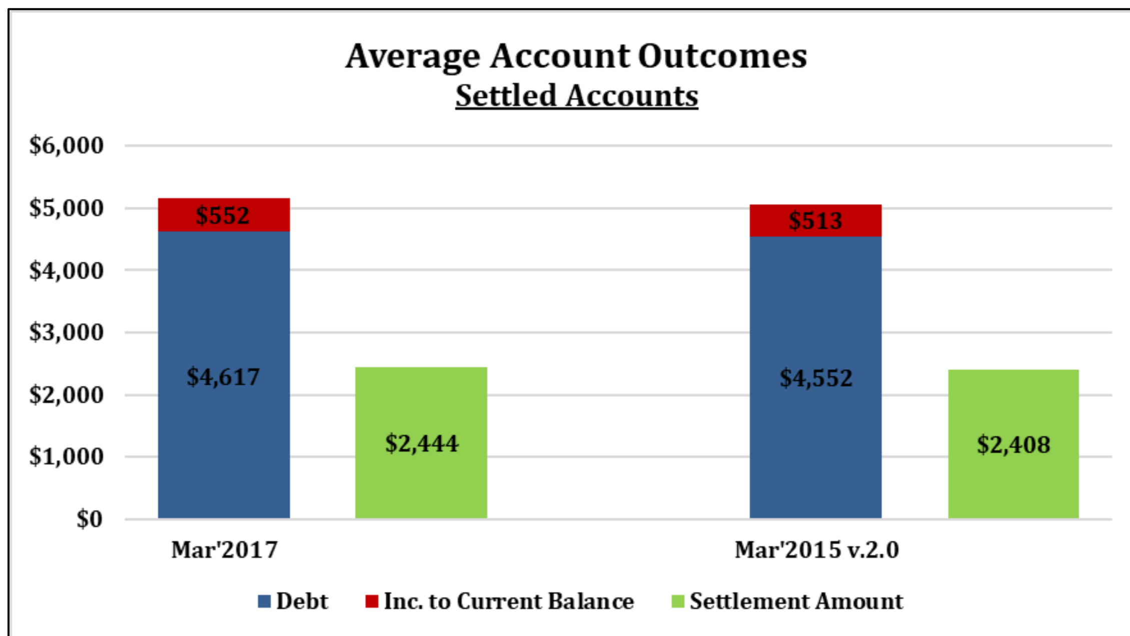


Chart 5.9 illustrates that the typical Settlement Amount for Version 2 Accounts is approximately 48% of the balance owed at time of settlement (exclusive of Fees) whether the analysis is conducted at the Client-level or Account-level. Stated another way, these charts demonstrate that Clients experience Debt Reduction equal to more than 50% of the amount owed at the time of settlement, and experience Savings of more than 30% of the amount owed at the time of settlement.

6. Accretion of Accounts in Debt Settlement Programs Is Demonstrably Lower Than for Other Alternatives

Consumers who obtain credit do so with the expectation that the borrowed amount will be repaid in full, either when due or repaid over-time, in either case with interest. The increase in the amount that a consumer owes between the initial debt and repayment is referred to as accretion. The amount of accretion is generally a function of the length of time needed to repay the borrowed amount. For example, if a consumer borrows $10,000, the total of all payments needed to resolve the debt will typically be less if the amount is repaid in one-year as compared with two-years. The amount of accretion is also a function of the borrower's status (*e.g.*, the borrower's credit rating and whether the borrower is current or delinquent). If a borrower does not make timely payments on the borrowed amount, accretion is likely to occur at a greater rate. This is because the lender typically applies a higher interest rate and/or penalty fees to the debt as the risk of default increases.

There is only one way to avoid accretion: fully repay a debt immediately. This option, however, is not feasible for many consumers, especially for the typical debt settlement Client.

The participants in this study have informed me that less than 10% of consumers seeking debt relief are accepted into a debt settlement program. Amongst those accepted, about 75% of Clients are already delinquent on at least one, and in many cases almost all, of their debts. Virtually all of the remaining Clients anticipate delinquency within the next one or two cycles. As noted above, Clients are free to exit the debt settlement program at any time without incurring Fees. Accretion, however, will not cease if the Client does so until such time as the debt is repaid. In other words, accretion is not a phenomenon unique to Accounts enrolled in debt settlement programs.

To understand the impact of accretion on the overall efficacy of debt settlement, it is relevant to compare 1) the accretion a Client experiences while enrolled in a debt settlement program to 2) the accretion a Client would have experienced if the Client had not enrolled in a debt settlement program. In other words, do Clients experience more accretion in the course of debt settlement as compared to other available alternatives?

a. Total Accretion

Chart 6.1 below assembles the data from the more than one million settled Version 2 Accounts addressed in this study. The green line, "Total Accretion at Settlement," represents the amount, in percentage terms, that Enrolled Debt had increased as of the time of the settlement. For example, after six months, the average Debt enrolled in a debt settlement program had increased by approximately 10%. The dotted red line provides context for this accretion rate. It represents accretion at currently available credit card rates of interest (16.75%).[17] This rate is highly likely to understate the interest rates for a delinquent borrower, which are typically in excess of 25%.[18]

[17] This rate reflects current credit card interest rates for non-delinquent accounts and is used here to calculate the effective accretion on reducing monthly balances taking into account regular payments of principal. (*see* http://www.bankrate.com/finance/credit-cards/current-interest-rates.aspx).

[18] For example, several of the major U.S. banks charge a penalty interest rate exceeding 27% (*see* https://www.valuepenguin.com/average-credit-card-interest-rates).

Chart 6.1

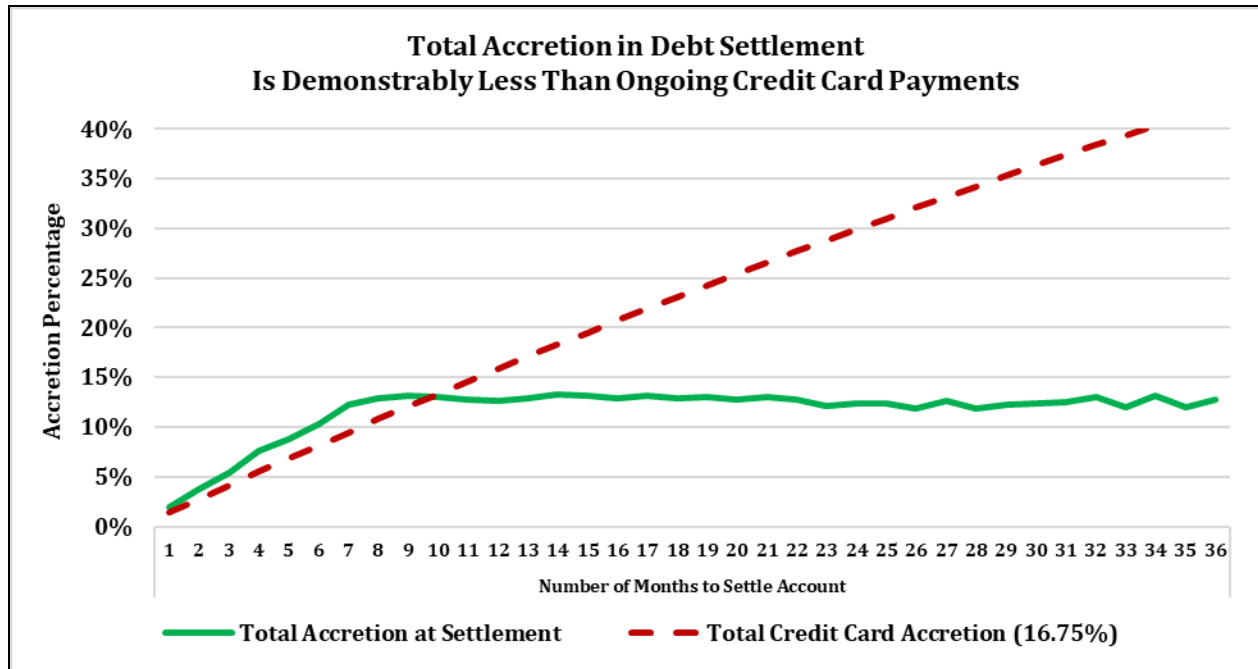
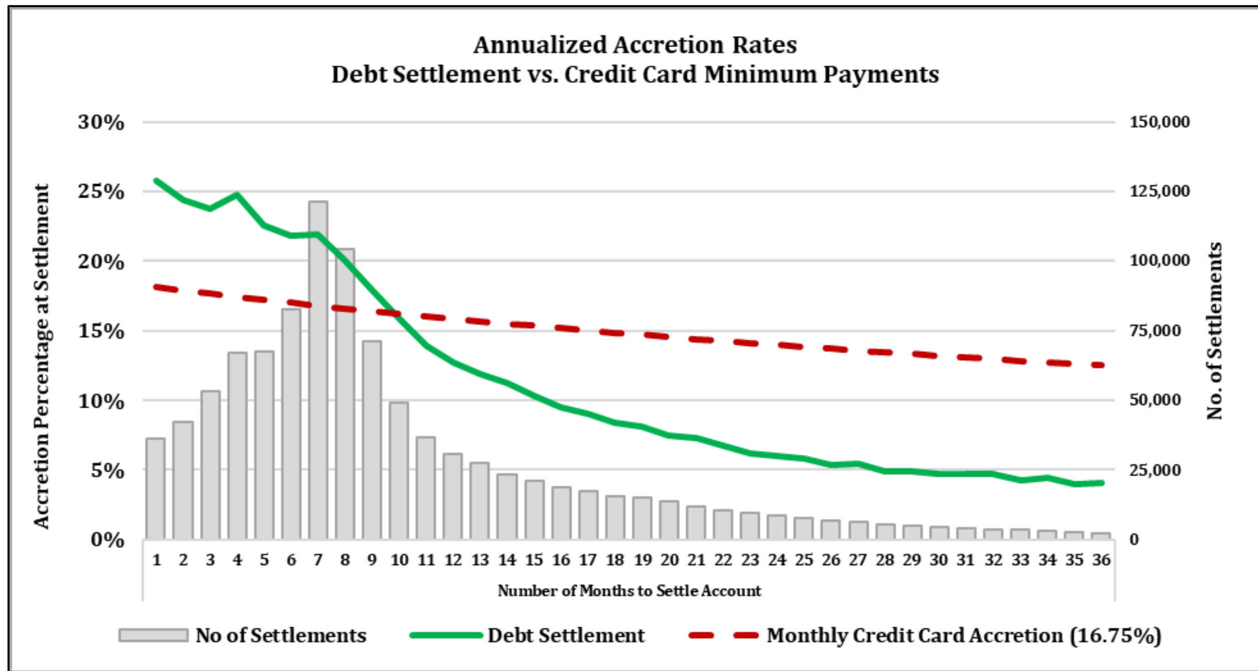


Chart 6.1 is instructive. In the initial year of a consumer's participation in a debt settlement program, accretion is not significantly different than if the consumer had continued to incur credit-card-related interest (with the early imbalance attributable to the effect of penalty rates of interest typically associated with defaulted credit card debt). Over time, however, while the accretion experienced by consumers outside of debt settlement continues to increase, the data indicates that accretion of debts within debt settlement programs stabilizes at a total rate of approximately 13% to 14%. In fact, the data indicates that, while accretion in a debt settlement program continues until approximately the eighth month of program experience, after that time accretion appears to plateau. A reasonable inference is that, at that point, the creditor has charged off the debt(s) and moved it or them to non-performing status, with a corresponding cessation of further accretion.

b. <u>Annualized Accretion</u>

Another way to present accretion is to illustrate its effect as if the accretion rate were annualized. This is the same tool commonly used to express the effective annual interest rate on a credit card (*i.e.*, annual percentage rate or APR). Chart 6.2 highlights that the effect of accretion is most significant within the first eight to nine months of a debt settlement program. However, the decline in annualized accretion rate is both steep and swift: after twelve months in a debt settlement program, the annual accretion rate has fallen from more than 25% to less than 13%, and by the sixteenth month the annual accretion rate has fallen below 10%. In contrast, the decline in annualized accretion within credit card programs is far more modest, falling from about 23% to 20% over the same period.

Chart 6.2



Charts 6.1 and 6.2 together demonstrate that, whenever a consumer requires more than nine months to repay a debt, that consumer would experience greater accretion (and potentially substantially greater accretion) by continuing to make minimum monthly credit card payments rather than by enrolling his credit card debt in a debt settlement program. At all times thereafter, total accretion within a debt settlement program is substantially less than the minimum monthly payments alternative, thereby actually benefiting the consumer rather than disadvantaging the consumer. For clarity, this benefit is not incorporated within the analysis set forth in §5 above.

c. Comparing Accretion in a Debt Settlement Program With Accretion Incurred with Credit Card Payments

The comparative effect of accretion on debt settlement Clients may be illustrated as follows. For Version 2 Clients, the median Enrolled Debt involves six accounts totaling approximately $25,250. Using these figures, the average Enrolled Debt is approximately $4,210. The typical Client settles her first Account in Month 4 of the Debt Settlement Program. Table 6.3 summarizes the key economic factors of that settlement:

Table 6.3

Settlement No.	1
Current Balance (All Settled Accounts)	$ 4,540
Total Settlement Amount	$ (2,179)
Total Fees	$ (928)
Savings	$ 1,433

Table 6.3 examines whether the Client obtains Savings from that first settlement. Because accretion occurs across all other debts until repayment or settlement, Table 6.4 summarizes the total accretion the Client experienced on his portfolio of unsettled Accounts at the time of the first settlement.

Table 6.4

Accretion on All Unsettled Accounts	
Actual - Debt Settlement	$ 1,616
Hypothetical - Credit Card	$ (1,375)
Incremental Accretion in Debt Settlement	$ 241

Table 6.4 compares the total accretion experienced by the Client in debt settlement to the hypothetical accretion the Client would have experienced by continuing to make minimum monthly credit card payments.[19] Consistent with Chart 6.1, the Client would have experienced more accretion in the debt settlement program (*i.e.*, $241 at that time), largely due to the application of penalty interest on delinquent debt. Table 6.5, however, demonstrates that despite this accretion, the Client still experienced Savings:

Table 6.5

Savings (Table 6.3)	$ 1,433
Incremental Accretion (Table 6.4)	$ (241)
Savings After Total Accretion	$ 1,192

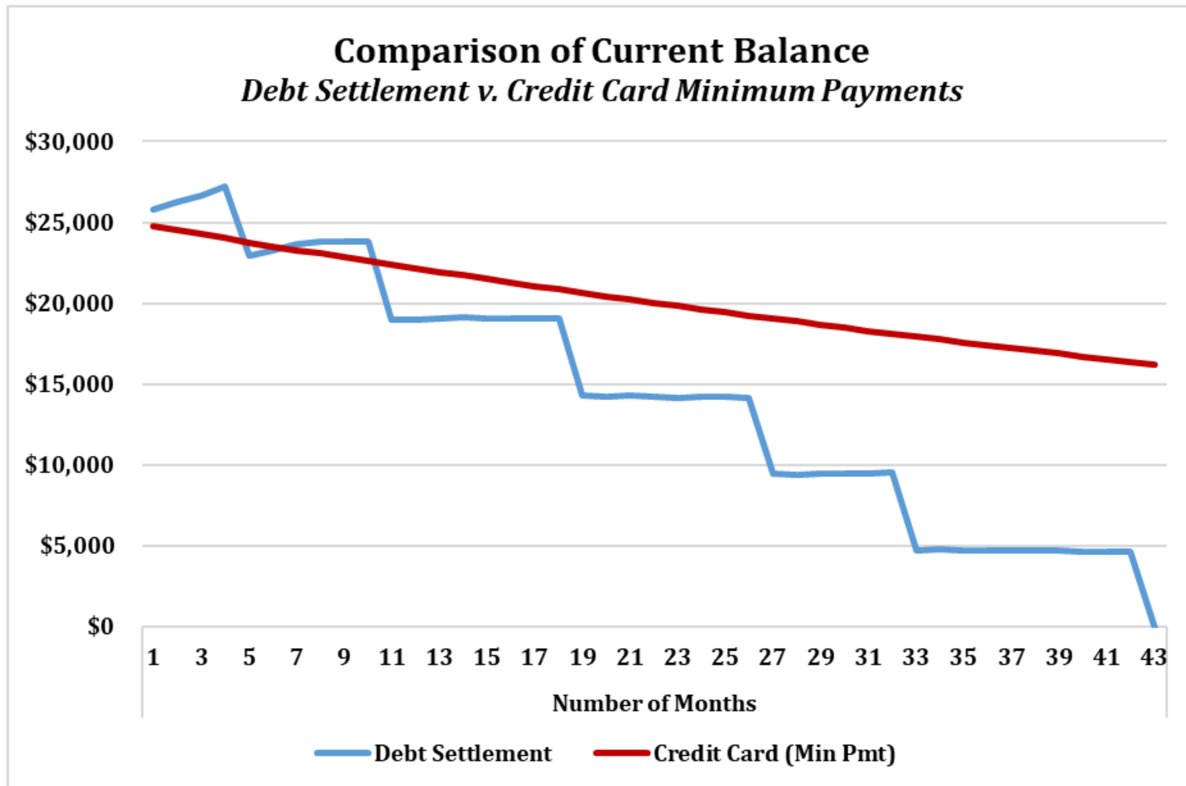
In other words, Table 6.5 accounts for the higher rates of accretion in the early months of the debt settlement program to show the Client experienced $1,192 of Savings net of portfolio accretion after the first settlement. When the analysis above is repeated after a second settlement, Savings significantly exceed the total accretion on all then-remaining unsettled accounts. Further, the data illustrates that at that time, incremental accretion is no longer a negative factor (*i.e.*, accretion in debt settlement is the same as accretion in a credit card payment). This pattern expands when subsequent settlements are realized.

Finally, Savings in a debt settlement program does not come at the expense of increased periodic cash outflow. Chart 6.6 compares the then-Current Balance of the Client's

[19] Table 6.4 also indicates that Savings from the first settlement nearly offsets all accretion experienced on unsettled accounts.

Enrolled Debt at each month, assuming typical settlement progress, compared with the amortization of the Client's Enrolled Debt, assuming minimum monthly payments. In debt settlement, Clients have demonstrated an ability to settle all Enrolled Debt in less than 42 months. If the Client had instead continued to make minimum monthly credit card payments, the Client would have had a remaining debt in excess of $16,000 at the same time interval:

Chart 6.6



7. The Economic Benefits of Debt Settlement Compared With Other Alternatives

At the time of enrollment, Clients may have other alternatives for debt relief, including filing for bankruptcy, entrance into a debt management plan ("DMP") offered by a credit counselor, accessing a home equity loan for debt consolidation purposes or continued attempts at self-management of accounts.[20] Each of these alternatives has different potential risks and costs as well as different potential benefits. This section compares the likely outcomes of participation in a Version 2 debt settlement program with the anticipated outcomes associated with other possible alternatives (without regard for whether such alternatives are actually available to the Client).

20 *See e.g.*, https://www.debt.org/settlement/

a. Minimum Credit Card Payments

The average Client enrolled debt of approximately $25,250, substantially all of which was credit card-related. I understand that most of these Clients were either only able to make the minimum monthly payment of approximately $600, or were unable even to pay that amount. If a Client were able to pay the minimum monthly payments, the total cost to settle this Debt (*i.e.*, principal plus interest) would be approximately $58,000 over approximately 430 months (nearly 36 years).[21] Stated differently, by making only the required minimum monthly payments, the Client would have incurred a cost of $33,000 *over and above the principal amount owed.* Even if the Client could sustain the initial minimum monthly payment of nearly $600, the Client would pay approximately $38,000 over more than five years to resolve the initial debt balance. As described more fully below in the presented hypothetical, debt settlement programs compare favorably to this alternative.

b. Credit Counseling Programs

Another alternative might be a consumer Credit Counseling Agency (CCA) offering a DMP. A DMP involves only concessions on the interest rate charged on outstanding balances, not a reduction in principal. Emerging academic research indicates that reduction in principal provides a significantly greater benefit to a consumer than does the "soft" benefit of improved cash flow that occurs when monthly payments are reduced as a consequence of interest rate relief.[22] As noted in §4.a, above, this "soft" benefit is available to debt settlement Clients as well, and to a greater degree than with a DMP since the periodic deposit requirement in debt settlement programs is significantly lower than either the monthly DMP

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[21] This amount has been computed using an amortization table with an interest rate of 16% and a minimum payment of current interest plus 1% of the principal amount each month. These amounts are consistent with current industry standard requirements. *See, e.g.*, "The minimum payment on credit card debt is calculated as a percentage of your total current balance, or as all interest plus 1 percent of the principal. Card issuers also set a floor to their minimum payments -- a fixed dollar amount that the minimum payment won't fall below." (http://www.creditcards.com/calculators/minimum-payment.php) This calculation is consistent with the calculations of interest set forth in §6 above. These calculations may be replicated at http://www.bankrate.com/calculators/managing-debt/minimum-payment-calculator.aspx.

For purposes of clarity, this amount also assumes (1) a static interest rate of 16% on a declining principal balance, (2) no additional card usage and (3) no additional charges or fees, such as over-limit fees, late fees, etc.

[22] "Targeted Debt Relief and the Origins Of Financial Distress: Experimental Evidence From Distressed Credit Card Borrowers," by Will Dobbie and Jae Song, June 2017, p.3, "Taken together, however, our results indicate that there are significant benefits of debt relief targeting long-run debt overhang in our setting. In sharp contrast, we find no positive effects of the minimum payment reductions targeting short-run liquidity constraints."

payment or the minimum monthly payments required to amortize credit card debts (*see* Table 7.1, below).

A DMP is available to consumers who are able to make a monthly payment in excess of the periodic deposit of funds required for a debt settlement program. As a result, DMPs are generally not available to those in situations of serious financial hardship (there is relatively little overlap between the client constituencies of CCA and debt settlement). There is limited publicly available data on either the rate of acceptance into DMPs or completion rates. It has been reported that less than 30% of individuals that contact a CCA qualify for a DMP and that persons who qualify for a DMP actually complete the program at a rate between 20-25% (current completion statistics have not been identified).[23]

c. Consolidation Loans

Another option for consumers is to obtain a debt consolidation loan. Additional credit, however, is rarely extended to consumers who are already overextended or delinquent on existing debt. Such loans, if available, would be expected to carry high interest rates and terms favorable to the creditor.

Debt settlement companies, leveraging their knowledge of Clients' financial status and performance, as well as their extensive data on settlement outcomes, have begun offering, in conjunction with bank partners, unsecured loans for the express purpose of accelerating debt settlement activity. Such loans enable the Client to settle the entire portfolio of debts more rapidly than would otherwise be the case if the only source of funds was the gradual accumulation of settlement funds within the dedicated deposit account. In addition, a consolidation loan for settlement purposes provides an opportunity for the consumer to develop a positive experience on their credit report by converting multiple delinquent debts into a single performing loan. Consolidation loans are generally offered by federally insured financial institutions through affiliates of debt settlement companies to those consumers with acceptable credit and/or income characteristics.

For such consolidation loans, the terms vary based upon the particular consumer's circumstances. The study participants have informed me that the annual interest rate of such loans is typically in the range of 22% to 25%. During the application process, the total cost associated with the debt consolidation loan is estimated based on the debt settlement provider's best estimates of the anticipated settlements, and consumers are provided with a comparison of the estimated total cost to the estimated cost of remaining in the debt

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[23] "Behind the Credit Counseling Curtain," by Fred O. Williams, February 4, 2013 (www.creditcards.com/credit-card-news/business-credit_counseling-1282.php)

settlement program. The consumer begins repayment of the consolidation loan approximately 30 days after the settlement of the last debt.[24]

d. Comparative Results

Table 7.1 compares the results of a hypothetical debt settlement client with the anticipated outcomes of enrollment in a DMP, continuing to amortize the existing debt on a monthly basis by making only the minimum monthly payments required by the creditors, and accessing a home equity loan to repay debt. The comparison assumes the availability of all described options to a consumer with $25,000 of credit card debt under prevailing market conditions (although few of these options are generally available consumers eligible for a debt settlement program).

As described above, the analyses presented in this report do not attempt to examine (or incorporate) the effect of most externalities, including those viewed as either positive (improved cash flow attributable to ceasing to pay the full amount currently due) or negative (reduced access to credit). It is possible, however, that a consumer will be deemed to have received a tax benefit as a result of the forgiveness of debt. At the same time, financially challenged consumers, the constituency of debt settlement programs, are typically able to file IRS Form 982, "Reduction of Tax Attributes Due to Discharge of Indebtedness." This filing enables consumers who can demonstrate insolvency at the time of debt reduction to exclude from taxable income amounts associated with the discharge of indebtedness.[25]

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[24] Consolidation loans appear to have impacted several of the trends described in this report, including acceleration of the timing of settlements and the overall number of settlements realized by consumers (*see e.g.*, Charts 5.3 and 5.4). Accordingly, the next iteration of this study will endeavor to explore the costs and benefits of such programs, including how consumers have performed in these programs.

[25] An analysis of after-tax Savings that assumes taxability of Savings and ignores this option is likely to misstate Savings. Moreover, it is impossible to predict at what point a consumer will no longer be considered "insolvent," and therefor ineligible for the Form 982 exclusion.

Table 7.1 *(see table below for description of data and calculations)*

$25,000 Enrolled Debt	Debt Settlement	Credit Counseling	Monthly Credit Card Payments	Home Equity Loan
Months to Pay Off or Settle All Debts	48	48	429	60
Monthly Payment/ Program Deposit	$412	$668	$583	$480
Interest Rate on Outstanding Balance	n/a	9.00%	16.00%	5.75%
Total Program Interest [a]	n/a	$5,092	$32,793	$3,825
Settlement or Full Repayment of Principal [b]	$13,800	$25,000	$25,000	$25,000
Program and Bank Fees [c]	$5,980	$1,995	$-	$375
Total Program Cost Paid By Consumer =[a]+[b]+[c]	**$19,780**	**$32,087**	**$57,793**	**$29,200**

Thus, financially, a Client's outcome from participation in a debt settlement program appears to be significantly superior to all other available forms of debt relief. The following table provides a description of the calculations and data used to develop Table 7.1.

Description	Debt Settlement	Credit Counseling	Monthly Credit Card Payments	Home Equity Loan
Months to Pay Off or Settle All Debts	Generally, require 24-48 months to complete. 48-month term is used to be conservative.	Providers and the FTC estimate the duration of the program as between 36 and 60 months.[26] This period represents the midpoint.	It is not possible to resolve a credit card debt within 60 months by making the minimum monthly payment.	The loan repayment period assumes 60 months.
Monthly Payment/ Program Deposit	Total Program Cost Paid by Consumer ÷ payment months	The payment which, based on the payment term and interest rate, will fully repay the principal.	Initial payment. Payment amount will decline as principal is reduced (or increase if interest rates rise).[27]	Same method as Credit Counseling.
Interest Rate On Outstanding Balance	n/a	Estimate, based on inquiries with three separate credit counseling organizations.[28]	Static interest rate on declining principal balance.	Average home equity loan rates available at report date.
Total Program Interest	n/a	Interest Rate on Outstanding Balance over program term.	Same method as Credit Counseling.	Same method as Credit Counseling.
Settlement or Full Repayment of Principal	Enrolled Debt * (1+15% for total accretion) * 48% (average settlement amount).	Full repayment of principal.	Same method as Credit Counseling.	Same method as Credit Counseling.

[26] https://www.consumer.ftc.gov/articles/0150-coping-debt

[27] *See* §7.a above for a description of the calculation.

[28] *See also*, https://www.debt.org/management-plans/

Description	Debt Settlement	Credit Counseling	Monthly Credit Card Payments	Home Equity Loan
Program and Bank Fees	Settlement Fees: Enrolled Debt * 22% + Bank Fees: $480 ($10 monthly service fee during the program).	Typical fees range from $25 to $55 per month plus a $75 set-up fee. Estimate is the midpoint of the monthly fee multiplied by payment months plus the set-up fee.	No additional charges or fees assumed.	Assumes five-year term loan with no fees other than a $75 annual fee.

e. Chapter 13 Bankruptcy Statistics

Some Clients may have the alternative of declaring bankruptcy. The chapter of the United States Bankruptcy Code that provides for adjustment of debts of an individual with regular income is Chapter 13.[29] This type of bankruptcy is similar to debt settlement programs in that it enables individuals to establish a plan to repay part or all of their debts, and similar to credit counseling, in that it requires participants to pay a monthly amount to the bankruptcy court for distribution, after fees, to approved creditors. Table 7.2 displays statistics on the completion rates of Chapter 13 bankruptcy matters in the five most recent twelve-month periods for which data is available (years ending December 31st):

Table 7.2[30]

Year	Cases Closed	Plans Completed	Completed/Cases (%)
2012	289,125	106,543	36.8%
2013	336,858	152,333	45.2%
2014	351,960	178,369	50.6%
2015	352,159	188,893	53.6%
2016	345,058	179,614	52.1%

29 http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter13.aspx

30 2016 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 at www.uscourts.gov/data-table-numbers/bapcpa-6

The bankruptcy completion rates are similar to those for debt settlement clients, however individuals typically incur substantial upfront costs to enroll in a Chapter 13 bankruptcy plan, including filing fees and attorney costs.[31] Those fees are not refundable if the individual does not ultimately complete the plan. This upfront hard cost poses a risk to the Client that is not present in Version 2 of the debt settlement programs.

Greg J. Regan, CPA/CFF
February 5, 2018

31 These costs average approximately $3,000. *See, e.g.*, http://www.natlbankruptcy.com/how-much-does-it-cost-to-file-bankruptcy/ and https://www.debt.org/bankruptcy/cost/