

Testimony by TASC (The Association of Settlement Companies) regarding

Raised Bill No. 5409 – March 11, 2010

My name is Wesley Young and I am the Legislative Director of TASC (The Association of Settlement Companies). TASC is the predominant national association of settlement companies with approximately 200 members. We support high operating standards for member companies, consumer protection, and fair legislation consistent with those goals. TASC self regulates its membership to ensure that its standards are followed by using a third party company to “secret shop” every member on a regular basis by posing as a consumer. The third party company further visits each member company’s website to ensure that statements made are fair, accurate and consistent with TASC standards. Debt settlement can and is being performed in a fair manner by companies such as our members. In 2009, our members settled over \$1 billion in debt nationwide saving consumers almost \$600 million. Also in 2009, Connecticut passed a new law that resulted in debt settlement companies being included in the definition of “debt negotiators”, a law that was written for companies that deal with secured debt such as mortgages. This law does not effectively regulate debt settlement and as such, no debt settlement companies have registered in the State.

(1) What is debt settlement?

Debt settlement is an alternative to other debt resolution programs such as debt consolidation and credit counseling. Debt settlement plans differ in that the amount of the debt anticipated to be paid is ultimately less than the amount owed yet accepted as full satisfaction of the debt. The company negotiates, on behalf of the debtor, a settlement of the debt in exchange for short term payment plans. In other words, the creditors accept less money in exchange for a quicker payment. Credit counseling/debt management plans are usually payments made in full over a long period of time. *Debt settlement companies deal only with unsecured debt.*

(2) Why Consumers need access to debt settlement as an option to help deal with debt.

The financial stress due to unmanageable debt that consumers face, here in Connecticut and nationwide, is real and often overwhelming. The debt settlement

industry offers a solution when other debt management methods may not be a viable solution. Benefits provided to consumers by debt settlement include the following:

1. A method with which to pay back their debt at an affordable monthly payment level. Our typical client cannot afford a traditional debt management program and either does not qualify for or does not want to file for bankruptcy. In other debt management plans the consumer pays back his or her entire debt with fees and interest although creditors may grant concessions such as lower interest rates, fees and/or charges so that the entire balance may be paid over a period of approximately 5 years. In order to accelerate the payment into those 5 years, even with the concessions, a debtor must usually make monthly payments equal to or greater than the minimum payments required under the credit card agreements prior to the debt management plan. There are many consumers who, for hardship reasons such as the loss of a job, divorce, medical emergency, or unexpected increases of interest rates and fees, are now behind in their payments and/or are no longer able to afford their payments. As such, these individuals are often unable to afford traditional debt management plans. In fact, nonprofit credit counselors report that as few as 20% of consumers who they counsel are a good fit for their debt management plans.

2. Assistance with setting up a workable plan. While creditors claim that they can work directly with the consumer, they fail to consider that the typical consumer is dealing with 6 or 7 creditors, each of whom have no interest in a plan that works towards paying the others. Each creditor is concerned only about their own collections. Debt settlement plans are for most or all unsecured debt that the consumer owes.

3. Guidance to stay disciplined to stay with the plan. Whether the consumer exercised poor money skills or experienced a hardship, it is difficult to stay disciplined and on track with a long term program. Much like a personal trainer helps a person stay on track with an exercise or diet program, we help keep the client accountable and improve their success rate in completing the program; and

4. Consistent education throughout the plan to improve financial habits. In a survey of completed clients, 75% of respondents indicated that they were not interested in obtaining another credit card, and 50% said they were going to continue to save and invest the money that they had previously been setting aside for settlements.

Because of the change in bankruptcy law, many consumers are now also unable to qualify for Chapter 7 bankruptcy. Under the alternative, Chapter 13 bankruptcy, a debtor is placed on a plan to repay the debt in full over an extended period of time, and for reasons ranging from affordability to long term adverse effects, bankruptcy is often not an appropriate or feasible alternative for the consumer either. The national rate of completion for confirmed Chapter 13 bankruptcy plans is only 33%.¹ Credit counseling companies historically have an approximate success rate of 21-26%.² Debt settlement completion rates are higher – approximately 35%.³

Thus, debt settlement companies serve a need for consumers that is not met by other means. Debt settlement is a necessary debt relief option for consumers especially in this economic environment when even Fortune 500 companies are unable to meet their financial obligations. Consumers do not receive direct governmental “bailouts” and thus debt settlement often is their best hope. Other options such as credit counseling/debt management or bankruptcy are often either unaffordable or unavailable.

(3) Raised Bill No. 5409 properly regulates and incorporates consumer protections specific to debt settlement.

Raised Bill 5409 provides significant protections and regulation including the following:

1. Licensing under the Department of Banking – the licensing provisions follow those already in place for debt adjusters and debt negotiators.
2. Mandatory criminal background checks.
3. Great discretion on the part of the Department of Banking to evaluate licensees, and grant, deny or revoke licenses.
4. Bond or insurance requirements.
5. Protection against nonperformance via access to the bond.
6. Requirements for licensees in providing services including the following:
 - a. Performing a financial analysis of the consumer’s financial circumstances.

¹ “Bankruptcy by the Numbers: Measuring Performance in Chapter 13” by Gordon Bermant and Ed Flynn, Executive Office for the U.S. Trustees.

² *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants*, Consumer Federation of America and National Consumer Law Center, April 2003.

³ TASC Comment Letter to FTC, October 2009.

- b. A determination that the consumer is appropriate for the program.
 - c. A clear and complete explanation of the services to be provided.
 - d. A clear and complete explanation of the fees charged for such services.
 - e. Nine separate and mandatory disclosures to ensure the consumer understands the manner in which the program works and the potential risks of such program.
 - f. Written agreements that set forth the above.
 - g. Seventeen prohibitions specific to the protection of consumers in debt settlement programs.
 - h. Reasonable fee caps as adopted in other states.
7. Strong enforcement power to the Department of Banking.

These consumer protection measures are specific to the provision of debt settlement services and add significant and relevant protections over and above that under existing law.

(4) The fee provisions in Raised Bill No. 5409 are reasonable for the services provided.

Debt settlement is the one debt relief option consumers have that is independent of creditors. Unlike nonprofit consumer credit counseling, debt settlement companies receive no compensation from creditors. Unlike nonprofit consumer credit counseling, there is no incentive, in the form of a fair share or commission from the creditor, to maximize the payment back to the creditor. However, the fees permitted for debt settlement companies must also reflect the fact that they receive no fair share payment as fair share fees are not restricted or regulated by law⁴. Additional support for the fees in Raised Bill 5409 are as follows:

1. Debt settlement companies do not receive any fair share payments from creditors, nor do they have the financial benefit of being tax exempt.
2. Debt settlement is a labor intensive service requiring up to 10 times the staff of a traditional credit counseling debt management program.
3. Debt settlement is cost effective compared to 25-30% APR in interest rates paid

⁴ Fair share payments are not regulated as they are often not considered to be paid by the consumer. However, these payments are often a percentage of the monthly payment made by the consumer, so in fact, the consumer does pay those fees.

to creditors. The effective fee for a 3 year debt settlement program is approximately 6% APR.

4. Debt settlement is as effective or more effective than confirmed Chapter 13 bankruptcy plans or nonprofit credit counseling.
5. There are significant other consumer protections as detailed above that should alleviate the need to regulate debt settlement companies solely via the fee cap.
6. Debt settlement companies should be able to charge flat rate fees spread out over time as provided for in Raised bill 5409 for the following reasons:
 - a. Providers perform significant services prior to settlement of a debt.
 - b. The success of a program and/or settlement is dependent on many factors over which the debt settlement company may not control. E.g. The consumer's discipline in saving, his or her job performance and income, creditor policies, a consumer choice to accept or reject a settlement.
 - c. Many other service providers whose outcome is heavily dependent on outside factors do not use contingency fees. e.g. Doctors, lawyers drafting a contract, physical trainers, investment advisers, financial planners.
 - d. Contingency fee allows the creditor to influence or affect the provider since they "control" the receipt of fees. Leverage is shifted from the consumer to the creditor since creditors know providers do not get paid until a settlement is finalized.
 - e. The flat fee as provided for in Raised Bill 5409 must be spread over time to protect consumers from providers that charge significant upfront fees.
 - f. Negotiations become fee driven instead of what is in the best interest of the consumer. E.g. it may be in the better interest of the consumer to wait to settle another debt instead of taking the low hanging fruit.
 - g. The debt settlement company becomes a creditor of the debtor if a fee can't be collected until a debt is settled.
 - h. Consumers choose the flat fee model consistently when given the choice.

Conclusion

Debt settlement is an important option for consumers in managing their debt and an option that helps consumers when other options are not viable. Regulation of the industry should both allow access to debt settlement while appropriately regulating the industry for consumer protection. Consumer protection involves both preventing harm to consumers as well as providing assistance to consumers. Regulation, as exists in Connecticut today, that makes debt settlement unavailable to consumers through companies who provide good faith services, fails in the second instance – it takes away a service that provides a needed option to consumers in a time when consumers need more options to deal with their debt, not less options. Raised Bill 5409 accomplishes both sides of consumer protection and TASC supports its passage.