March 15, 2012

American Fair Credit Council: Comments Regarding Raised Bill 362

The American Fair Credit Council (AFCC)[1], submits the following comment regarding Raised Bill 362 (RB 362). RB 362 adds a fee cap to the existing law passed in 2009 regulating debt negotiation companies, a group that includes debt settlement companies.

We respectfully request that the fee model and cap verbiage in RB 362 be stricken in lieu of adopting the same fee restrictions as our found in the Federal Trade Commission's (FTC) 2010 Debt Relief Amendments to the Telemarketing Sales Rule (the FTC Rule), as described in more detail herein.

A. Introduction to Debt Settlement

Debt settlement is an effective and needed debt relief option for consumers at a time when they need more options in managing their unsecured debt, not fewer options. Debt settlement does not involve mortgages, loan modification, foreclosure, or any other secured debt issues. Debt settlement serves those who cannot qualify for or afford other options such as bankruptcy and traditional credit counseling. Debt settlement is also effective when compared to these other debt relief options. The national rate of completion for confirmed Chapter 13 bankruptcy plans is 33%.[2] Nonprofit credit counseling companies historically have an approximate success rate of 21-26%[3]. Debt settlement completion rates for TASC members are higher – approximately 34.5%[4]. Further, those who only complete part of the debt settlement plan often benefit – for example, someone who had 10 debts coming into the program and now have 5 may leave the program citing his debt is not at a manageable level. Nonprofit credit counselors often cite similar benefits of partial completion and have recently even used "completion rates" that are based on consumers completing 60% of the credit counseling program. If the debt settlement industry used similar measurements, our completion rates would be significantly higher as well.

Another difference between debt settlement and credit counseling is that debt

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[1] Formerly, The Association of Settlement Companies (TASC)
[2] "Bankruptcy by the Numbers: Measuring Performance in Chapter 13" by Gordon Bermant and Ed Flynn, Executive Office for the U.S. Trustees.
[3] *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.
[4] TASC Comment Letter to FTC, October 2009.

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settlement is a reduction in principal of the debt, not just a reduction in the interest rate. TASC companies settled over $1 billion of debt nationwide in 2009 alone for approximately $400 million saving consumers approximately $600 million. In other words, these consumers paid creditors approximately $400 million in total satisfaction of $1 billion of debt owed.

B. <u>The FTC Rule passed in 2010 regulating debt settlement companies and the manner in which providers may charge fees results in significant protection for consumers such that fee caps are not necessary.</u>

1. The FTC Rule against advance fees provides significant consumer protections disposing of the need for a fee cap.

   i. Debt settlement fees are only earned once a settlement has been made and accepted by the consumer providing significant protection for the consumer.

   The FTC regulation on fees is sufficient and no fee cap is needed in light of the significant consumer protection offered by the FTC restrictions for the following reasons:

      i. The FTC rule provides the following protections:
         - The fees must be clearly and conspicuously disclosed prior to the consumer entering into an agreement with the provider.
         - No fees are chargeable until a settlement is reached.
         - The consumer has another opportunity to reject the fees by rejecting the settlement. Until a satisfactory settlement accepted by the consumer is reached, the consumer pays no fees.
         - The consumer not only must approve of the settlement, but must affirm that approval by making a payment towards the settlement.

      ii. The FTC rule imposes a fee structure that is limited in the timing of when a provider may collect fees. It also requires that fees must be proportionate to the debt settled, thus, protecting against fees being front-loaded in the program.

   Thus, debt settlement fees are only earned once a settlement has been made and accepted by the consumer providing significant protection for the consumer. The consumer always gets to decide what is best for him.

   ii. Companies now bear all the risk of providing the service.

   Clients who paid advance fees in the past bore the risk of the success of the program. Now, companies provide valuable services prior to getting paid and without the promise of being paid and so companies, not consumers, bear the risk. After a consumer enrolls, a company must provide client support including taking phone calls and making phone calls; receiving and reviewing paperwork such as creditor communications and financial records; providing financial education and advice; communicating with clients and creditors via email, phone, and fax; analyzing client records and accounts to determine a strategy and identify negotiations opportunities; initiating or responding to negotiations, offers and demands; and obtaining client approval and authorization for settlement offers. All of this work is provided without the promise of being paid. If a client rejects a settlement, or terminates the program, the work will not be performed but not paid for, yet the company has spent resources and paid staff to perform that work. So the company bears the risk of providing the service while the consumer experiences little risk.

2. There are numerous other protections in the bill such that imposing a fee cap is not necessary.

   a. Connecticut law for debt negotiators imposes numerous requirements on providers including the following.
      1) Licensure by state agency including disclosure of the following:
         i. Personal information of business officers and directors
         ii. Disclosure of any criminal history
         iii. A determination by the agency that the financial responsibility, character, reputation, integrity and general fitness of the provider warrants belief that the business will be operated soundly and efficiently, in the public interest and consistent with the purposes of the law.
      2) Surety bond in the amount of $50,000.
      3) Right to cancel at anytime.
      4) Financial Analysis – A financial analysis by the debt settlement provider must be performed to ensure that consumers enrolling in its program are appropriate for debt settlement.
      5) Form of agreement – The Act also mandates certain information be spelled out in service agreements with consumers including the amount of the fee and a list of services that will be provided.
      6) Enforcement power – The law gives the regulator strong enforcement authority as well as a private right of action for the consumer.

   The prohibition against advance fees combined with this extensive state regulation provides complete consumer protection.

3. Given the existing protections, a fee cap is not in the best interests of the consumer.

   a. The FTC, who studied this matter for two years and who received comments from

321 interested parties, has affirmatively stated that fees should be set by competitive markets when restricted against charging advance fees.

The FTC believes that, with this fee model, the market should set the fees. It stated in the comments of its final rule prohibiting advance fees:

> "In general, fee setting is best done by a competitive market, and the Commission's role is to remove obstacles to consumers making the informed choices that are necessary to a properly functioning market. The provisions of the Final Rule, including the narrowly tailored ban on advance fees, are designed to ensure that the debt relief market functions properly ....[5]"

This policy position, that with the restrictions in the FTC Rule the market should set fees, was repeated by Joel Winston, Associate Director, Division of Financial Practices for the Federal Trade Commission's Bureau of Consumer Protection, at the 2011 TASC Conference[6] and reaffirmed by Riley Dolan, Acting Associate Director, Division of Financial Practices for the Federal Trade Commission's Bureau of Consumer Protection, at the Fall 2011 AFCC Conference[7].

4. Consumers will benefit significantly from debt settlement services even when paying fees greater than that proposed in RB 362.

    a. In states where there is no fee cap, fees are already set by the market at rates that are fair and reasonable. Fees in these states are an estimated 21-25% of the enrolled debt. The below chart compares fees for debt settlement at the amount in RB362 with the highest market rate of 25% of the debt enrolled, or $5,000 based on $20,000 of enrolled debt. At the rates in SB362, debt settlement providers are paid less than nonprofit credit counselors. Even at market rates, the provider would still receive less in fees and the consumer pay less than half in total payments compared to nonprofit credit counseling.

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[5] TSR at 114-115.
[6] TASC Conference - April 29, 2011
[7] AFCC Conference – November 8, 2011

Market Rate Debt Settlement Fees Comparison

$20,000 debt	Debt Settlement – 30% of savings	Debt Settlement- market rate	Nonprofit Credit Counseling	Debt Consolidation Home Equity Loan[1]	Pay Minimum Due @ 2.5% of Balance
Months to pay off debt		36	60	120	472 Mo | 39 Yrs
Interest Rate		0	13%[2]	7.37%[3]	21.00%
Consultation fee		0	$50[11]		
Total Monthly Fees		0	$3,000[5]	$1,200.00[6]	
Debt settlement fee	$2,928.30[13]	$5,000.00[4]			
Fair Share by Creditor to nonprofit CCCS			$2,160.88[7]		
Total fees	**$2,928.30**	**$5,000.00**	**$5,160.88**	**$1,200.00**	
Interest[8]	**$4,380.00[10]**	**$4,380.00[10]**	**$7,011.00[8]**	**$8,325.25[8]**	**$41,815.05[8]**
Amount of Debt on Day 1	$20,000.00	$20,000.00	$20,000.00	$20,000.00	$20,000.00
Amount paid on debt	**$10,239.60[12]**	**$10,239.60[12]**	**$27,011.00**	**$28,325.25**	**$61,815.05**
Total Cost inc fees	**$13,167.90**	**$15,239.60**	**$30,061.00[9]**	**$29,525.25**	**$61,815.05**

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[1] Assumes good credit and sufficient home equity.
[2] Testimony of nonprofit credit counseling agency at a committee hearing in Salem, Oregon, February 9, 2009 – the credit counselor stated she was unable to obtain concession rates better than 16% for her consumers;
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 – average of concession rates was approximately 13%.
[3] Per Bankrate.com for St. Paul, MN area – average of Wells Fargo Bank and US Bank.
[4] Market rates vary between 21-25% of enrolled debt. Assumes a fee of 25% x $20,000 = $5,000
[5] Assumes a fee of $50 per month x 60 months = $3,000
[6] Assumes 10 year loan and total fees 6% of loan value.
[7] 8% of client payments fair share - See page 2, lines 41-43 of H.P. 895, Legislative Document No. 1289, 124th Maine Legislature.
[8] Interest calculated by using Bankrate.com or CNNMoney.com calculators; does not include potential late fees, penalties, other costs.
[9] $20,000 principal + $7,011 interest + $3,000 fees + $50 origination fees = $30,061.00. Fair share comes out of the principal/interest payment and so is not accounted for separately.
[10 Interest of 21.9% is average total accretion at time of settlement per TASC Comment Letter to FTC, October 2009
[11] Assumes $50 origination fee
[12] ($20,000 + $4,380) x 0.42 = $10,239.60. Based on average settlement percentage of 42% of total balance per TASC Comment Letter to FTC, October 2009
[13] ($20,000 – (($20,000 + $4,380) x 0.42) x 0.3) = $2,928.30

5. The fee caps in the RB 362 will result in no lawful companies operating in the state or at best, result in a monopoly.

RB 362 only allows a debt negotiation company to utilize the 30 percent of savings fee model. States which allow this fee cap report zero to one company operating in the state. There are no companies registered in North Dakota. Only one is registered in Rhode Island, and it is unclear whether that company offers debt settlement, or only debt management/credit counseling services. Quite simply, it is not feasible for virtually any debt negotiation company to operate at the proposed fee cap of 30% of savings. We only know of one company that claims they can operate under the proposed fee cap, and they are responsible for the contemplated cap in order to create a debt negotiation monopoly in Connecticut.

a. No lawful companies operating in the state only helps unlawful companies.

Consumers demand debt settlement services and will seek help from companies, whether they are operated lawfully or not. Without any lawful companies operating in the state, the only option for consumers will be to use unlawful and unlicensed companies. By preventing lawful companies from operating in Connecticut, RB 362 as drafted benefits unlawful companies by removing competition and hurts consumers by taking away legitimate and regulated services.

b. Even with fee caps, a monopoly is harmful for consumers.

Some have stated that as long as there are fee caps in place, a monopoly cannot harm consumers because the monopoly would be unable to "overcharge" for its services. This is an overly simplified and narrow statement about economics. Price is only one side of the service. A monopoly subject to low fee caps will cut corners, maintain low staffing levels, provide poor service and only take opportunistic settlements. i.e. settlements that are easy to make with little effort while harder accounts are ignored. A monopoly will not act altruistically and give away its services at a loss – it will still make a profit, but without any competition to do a better job.

c. Prohibiting advance fees means that both fees charged as a flat fee or as a percent of savings are contingent upon success.

By virtue of not permitting any fees until a debt is settled that the consumer accepts and authorizes payment on, the FTC has already mandated a success based fee whether charged as a flat fee or percent of savings.

i. Consumers have indicated a preference for the flat fee which is effectively not permitted in RB 362. Consumer's believe that a flat fee, the amount of which is known and certain at the time the contract is signed, is clearer and more preferable because they can see the actual dollar figure that they will be charged. A percent of savings fee is unknown and speculative and no dollar amount cost can be provided which makes some consumers nervous.

ii. Despite arguments otherwise, a mandated fee structure as a percent of savings also does not always incentivize acting in the best interests of the consumer. Sometimes a lower settlement is NOT in the consumer's best interest. Because the consumer may not be able to afford to pay one lump sum, a lower settlement offer may not do the consumer any good. Sometimes the consumer is better off taking a higher settlement but that is paid over a longer period of time (because of the consumer's cash flow). Yet limiting fees to a percent of savings essentially tells providers NOT to explore these types of arrangements and thus are not in the consumer's best interest. The FTC recognized this by adding in the flat fee structure to its Final Rule.

iii. The FTC initially proposed a fee structure only permitting fees as a percent of the amount saved, but in its final rule added in the flat fee model recognizing the above points. Thus, the FTC analyzed and determined that the flat fee model, when no advance fees are charged, is good for consumers.

6. Other states since the FTC Rule was promulgated have enacted laws with no fee cap.

Maryland, Colorado, Missouri and Texas all enacted bills regulating debt settlement with no fee cap in 2011.

These states along with the FTC believe that the prohibition on advance fees is significant of enough protection that a fee cap is not warranted. In fact, Colorado and Utah, which enacted fee caps in 2008 and 2009, removed the fee cap upon adopting the FTC Rule in 2011 and 2012 respectively.

III. Conclusion

In closing, debt settlement services, as regulated by the new FTC Rule prohibiting advance fees, is an effective and needed debt relief for consumers. The prohibition against advance fees as set out in the FTC Rule provides substantial consumer protection. Additional regulation such as licensing, disclosures, operational requirements and enforcement provisions add an additional== layer of consumer protection. Within these confines, it is neither necessary nor in the best interest of consumers to restrict fees such that they will not receive quality services. Instead, fee models and amounts should be set by the market per the FTC, the largest consumer protection agency in the nation. In states without a fee cap now, fees are fair and reasonable. However, only one known provider will register in Connecticut under RB 362 which is contrary to its purpose. Under the existing law with the FTC Rule, even with no fee cap, Connecticut consumers using debt relief services will be amongst the strongest protected in the nation.

As such, we respectfully request that the current proposed fee model and cap in RB 362 be stricken and replaced with the fee restrictions contained within the FTC Rule. Specifically, we request RB 362 be amended to limit fees a provider may change as follows:

1. A debt negotiator may not receive payment of any fee or consideration for any debt negotiation service until and unless:
    a. The debt negotiator has renegotiated, settled, reduced or otherwise altered the terms of at least one enrolled debt;
    b. The debtor has made at least one payment pursuant towards the settlement of such enrolled debt; and
    c. The fee or consideration charged for such service either:
        i. bears the same proportional relationship to the total fee for renegotiation, settling, reducing, or altering the terms of the entire debt balance as the individual debt amount bears to the entire debt amount. The individual debt amount and the entire debt amount are those owed at the time the debt was enrolled in the service; or
        ii. is a percentage of the amount saved as a result of the renegotiation, settlement, reduction, or alteration. The percentage charged cannot change from one individual debt to another. The amount saved is the difference between the amount of the debt when enrolled in the program and the total amount of money required to satisfy the debt.

Respectfully submitted,
American Fair Credit Council (AFCC)