CRL Finds AFCC Debt Settlement Report Falls Short

CRL Issue Brief
February 2015

Brandon Coleman 919-313-8512
Lisa Stifler 919-313-8551

In February 2013, the American Fair Credit Council, an association of debt settlement companies, released a report that claimed to assess the outcomes of debt settlement services by the industry. This report, "Options for Consumers in Crisis: An Economic Analysis of The Debt Settlement Industry," was commissioned by the AFCC, and fails to demonstrate that debt settlement leaves consumers better off and in fact overstates the benefits of debt settlement for the consumers studied. The report is also sometimes referred to as the "Regan Report" because it was conducted by a forensic accounting consultant, Greg Regan. It reviewed data from the nation's three largest debt settlement companies.

CRL reviewed the report and found the following flaws:

- The report does not answer the most important question: Do clients typically end up less in debt after participating in a debt settlement program?;
- The report credits debt settlement companies for saving consumers penalty fees that *debt settlement companies tell consumers to incur*, overstating the amount saved*;*
- The report also fails to account for fees charged by the debt settlement company for the service, which offsets some savings from settlement; and
- The report does not address either the likelihood of success or the cost of failure.

Missing the Forest for the Trees: Why the AFCC report doesn't show debt settlement leaves consumers better off.

The analysis in the AFCC study only reports outcomes at the account level rather than the client level. Since clients typically enroll multiple accounts of varying amounts in a debt settlement program, this assessment fails to accurately consider whether consumers are ultimately better off having opted to enroll in a debt settlement program. The AFCC report does not answer the most important question: *Do debt settlement clients typically end up "debt-free" or at least have a substantial share of their debts settled?*

AFCC has not disclosed data on a number of critical factors including: (1) the percentage of debt settlement clients that end up "debt free" as advertised; (2) the percentage of clients that have had a substantial share (at least 70%) of their debts settled; (3) the amount of overall debt that is settled (and how much remains unsettled) for the typical client; (4) the percentage of clients that end up deeper in debt due to assessed fees and accretion of account balances over time; (5) of those clients who end up debt free, the actual savings achieved after taking fees and accumulated interest and late payment fees into account; (6) the percentage of debt settlement clients that end up filing for bankruptcy; and (7) the percentage of clients sued by their creditors.

Consequently, the AFCC report does not measure debt settlement's actual benefit or harm to consumers.

On the matters it does address, the AFCC report overstates the benefit to consumers.

The AFCC report claims to analyze the economic consequences of participating in a debt settlement program. In doing so, the report touts the benefit of these programs over other debt relief alternatives. However, the way the report overstates its findings is problematic and confusing, in at least two respects.

First, the AFCC report misrepresents the actual benefit to consumers. According to the AFCC calculation, the debt settlement company is given credit for the penalty interest and default fees that result from the company's own direction to the consumer to default on his or her debts. The debt settlement companies should not be credited for the accretion that results from their own instruction. For clarification, consider the following example:

A Client enters a $1,000 debt into a debt settlement program. The client defaults on the debt as required by the debt settlement company, then incurs $250 in default penalties and fees from the creditor (amount owed now totals $1,250). Assume the debt settlement company settles the debt for $800.

When determining the benefit to the consumer, most observers would look to the amount by which the original debt is reduced – $200 in the above example (before the debt settlement company's fees). The AFCC report, however, argues that because the debt increased to $1,250 before it was reduced by the debt settlement company, the $250 in default charges should be tacked on to the savings to the consumer. Thus the report indicates a total debt reduction of $450 when the settled amount was only $200 less than the original amount enrolled.

Second, many of the positive statistics in the report overstate the benefit to the consumer because they don't reflect the fees charged by the debt settlement companies for their services. These service fees typically range from 20-25% of the original debt enrolled. So, to apply this to the example above:

If the debt settlement company charged the client a 20% fee to settle the $1,000 debt, the client would pay a $200 service fee to the debt settlement company, plus the $800 settlement amount, for a total of $1,000.

If the debt settlement company collects a $200 fee, the client winds up no better off than had he paid the $1000 debt himself and, in fact, is likely in a worse position as the required defaults will continue to damage his credit and he remains at risk of lawsuits initiated on any debts that remain outstanding.

Thus, many of the claims in the AFCC report's – such as, debt settlement clients as a group "have realized $3.15 in Debt Reduction for every $1.00 of fees" – are highly misleading and substantially overstate the benefit to clients even on those debts that are settled.

The AFCC report does not indicate the percentage of clients in its data set that have all of their debts successfully settled through a debt settlement program. It is likely many clients do not successfully settle their debts, and it is difficult (if not impossible) for consumers to predict their likelihood of completion ahead of time.

The AFCC report states that the average debt settlement client enrolls 6 accounts for a total of approximately $30,357 (or approximately $5,060 per account). Setting aside account maintenance fees and potential tax liability on settled debt, the Center for Responsible Lending found that the average debt settlement client needs to settle 4 of 6 accounts to have a positive change from their original financial position (accounting for maintenance fees and tax liability, the number rises to 5 of 6 accounts).

AFCC has failed to disclose the percentage of clients who settle 5 of 6 debts through their programs. Prior to the advance fee ban, DS companies rarely achieved this result for their clients. No data published today suggests that this has changed. Moreover, the AFCC report reveals no way for any client to predict whether he or she is likely to come out ahead or fall further behind after enrolling in a debt settlement program.