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There Is Another System Out There
To Which Many People in Financial Trouble
Turn For Relief

Consider the case of the couple who find themselves in financial trouble with which they cannot cope without some help. They are sitting and watching television late at night, and discussing their various and interrelated financial, personal and domestic problems. They are struck by a series of ads that promise a magic credit card and a loan secured by a second mortgage on their house that will pay all of their past due debts; they have tried all of that and know it will not help. And then onto the screen comes a lawyer promising the end of garnishments, car repos and house foreclosures and a breathing spell, and then relief from their debt problems. As they are writing down her telephone number, on comes an ad for a debt counseling service; that ad calls bankruptcy a "ten year mistake," and urges people in financial trouble to try their non bankruptcy alternative for getting out of debt. They look at each other in confusion.

They call a friend of a friend who works in the office of their congresswoman and she says, "Chapter 7 bankruptcy gets rid of all of your credit card and medical debts, but you have a good chance of losing your car and I'm not sure what happens to your house. Chapter 13 bankruptcy helps you keep your car, and can help with back payments on your house, but you might have to pay some of your salary in the future to use Chapter 13. Either kind of bankruptcy will probably mess up your credit report and make it hard for you to get credit in the future. Some debt counseling services are good if you just need budgeting advice or if you have enough money to pay all of your bills, but just need time; they cannot help at all with your car or your house if you are behind and they will not stop a garnishment, car repossession or a home foreclosure and they may not even help you with your credit report. Many debt counseling services are terrible, be careful and be sure you get to one of the better ones."

About a million and a half people filed for bankruptcy in 2001 and about that same number started a debt management plan, the Chapter 13-like product of the consumer debt counseling industry. Another million people obtained financial counseling from the debt counseling industry but did not begin a Debt Management Plan. The demographics of the people who seek relief in the debt counseling industry look very much like the demographics of the people who seek relief in the bankruptcy system. The debt counseling industry is dominated by several very large telephone and computer based providers such as Genus, Cambridge, Pro Fina and Ameridebt, which claims to have 100,000 clients in its Chapter 13-like program; About a third of clients enrolled in debt management plans are served in person by a Consumer Credit Counseling agency, an affiliate of the National Foundation for Consumer Credit, which dominated the industry until the mid 1990's. Several of the larger CCCS affiliates have merged in the last several years and some are now providing services by phone and computer in addition to in person. Money Management International, which is a merger of the Houston and Phoenix CCCS programs is the largest of these with approximately 45,000 debt management plans.

When the couple call, write or visit a debt counseling organization office or website, they will be asked to provide information about their debts and their income and their expenses. In the better counseling sessions, the counselor will evaluate the data and determine whether they need advice only, a debt management plan or needs to be referred to another professional including an attorney. Some agencies refer clients who are clearly candidates for bankruptcy to a lawyer referral service or private bankruptcy referral network and some never recommend bankruptcy.

If their debt is small enough relative to their revenue and expense structure then the couple may be advised how to budget themselves and sent on their way. The amount of counseling and education provided to those "advice only" clients varies enormously. Some charge a fee for this service. Not all non NFCC affiliated debt counseling organizations provide this service. Thirty five percent of the people who visit an NFCC affiliate fall in this category.

About one third of the people who visit the offices of NFCC members or Ameridebt choose to begin a debt management plan (or Consumer Debtor Program at Ameridebt), a voluntary repayment program administered by the agency. After analyzing the client's financial situation and looking for ways to enhance income and reduce living expenses, a repayment plan is set up for all creditors. At first, these payments are almost always less than the creditor's usual minimum payment requirement, but during the course of the plan, as smaller balances become paid in full, the remaining creditors can expect an increase in their payments. A requirement of the NFCC's DMP is that the client not incur any further debt while in the program and that all unsecured debts be placed in the program. NFCC affiliates require that the client surrender all credit cards to the counselor although some NFCC affiliates allow the client to keep one such card for "emergency" or business use. Others do not require the surrender of such cards and are willing and anxious to develop a DMP with just one or two or less than all of such debts. Payments to creditors pursuant to DMP programs of NFCC affiliates totaled approximately TWO AND ONE HALF BILLION DOLLARS ($2,500,000,000) in 2000 and it is estimated that payments to creditors pursuant to DMP programs for all debt counseling agencies are approximately EIGHT BILLION DOLLARS ($8,000,000,000). In the past a significant number of creditors have waived or reduced interest during the DMP period; recently fewer creditors provide such concessions. The client sends a set amount to the NFCC member which disburses it among the creditors in the predetermined amounts after it corresponds with those creditors.

The fee for this DMP service varies enormously. Historically, creditors that receive payments were asked to voluntarily return fifteen percent of their receipts under the DMP to the debt counseling agency. For years most large creditors agreed to return between twelve and fifteen percent of their receipts to the debt counseling agency. Recently, creditors have reduced the amount they return and the fees paid directly by the clients have increased. Most agencies charge a set up fee and ask for a "voluntary" payment of between $20.00 and $50.00 per month or charge on a per creditor basis. (See Chart)

Critics of the Debt Counseling Industry maintain the following:

1. They are pawns of the credit card industry and are simply an "outpost" for their collection departments. The credit card companies should just offer to people who fit the profile the same treatment that would be offered if they went to a debt counselor.
2. They put too many people in DMP programs.
3. The failure rates are excessive, particularly in the DMP program.
4. Most debt counseling organizations are virulent in their hatred of bankruptcy and they do not direct people to bankruptcy even when it is clear that the clients need it.
5. The system has a financial incentive to get people into debt management plans whether they need it or not.
6. They cannot stop foreclosure, repossession and garnishments.
7. They have an incentive to get money paid to unsecured creditors when the clients would be better off using that money to save a house or a car.
8. The counselors are not sufficiently well trained.
9. They do not clearly publicize the way they are paid.
10. They charge too much for the service they provide.
11. They are unable to get recalcitrant creditors to back off.
12. They are unable to provide discharge of debt.
13. There is no real difference in credit report in paying all the bills through a debt management service than there is in taking a bankruptcy.

How will the couple decide whether to file bankruptcy or to utilize the debt counseling industry? L**et's use five prototypes to help answer this question:**

> **Couple 1** has more than enough money to pay their bills, but just wants some reasonable prices and effective budgeting advice.
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> **Couple 2** has enough money to pay its current operating expenses and a good amount to take care of their past bills, but too many of their creditors are demanding full payment of past due bills and the default interest rates are eating them alive. They also need some budget counseling.
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> **Couple 3a** lives in an apartment, does not own a car and has enough money to pay its current living expenses, but not enough to pay old credit card and large hospital bills.
>
> **Couple 3b** lives in an apartment, does not own a car and has enough money to pay its current living expenses, but not enough to pay old credit card and large hospital bills. The couple has a judgment against them for money obtained by false pretenses by use of a statement in writing that was materially false.
>
> **Couple 4** lives in a house and owns a car. They are several months behind on their house payments and their car payments, and are in danger of losing both. They had enough money to pay the current house and car payments, and their other current living expenses, and perhaps enough to make up their past due house payments.

Couple 1 must hope there is a debt counseling service that is reasonably priced and effective, or that they have a church or other resource available to provide this service.

Depending upon the size of their debts and their income, and their personal philosophy, they may wish to pursue a bankruptcy.

Couple 2 has two choices; they may consider a Chapter 7 or Chapter 13, depending on what assets they wish to protect and what types of debts they need to discharge; a debt counseling service may be able to accomplish the following:

1. Cajole creditors to reduce default rates.
2. Put the debtor on a 100% installment plan for catching up and paying all unsecured debts.

Couple 3a appears to be a prime candidate for a Chapter 7 bankruptcy. They need the discharge that bankruptcy provides, but they do not need the special help that Chapter 13 provides, so there is little *legal* reason to commit a portion of their future income to their unsecured creditors as Chapter 13 requires. Unless they have strong personal convictions and would rather have a Chapter 13 on their record, Chapter 7 seems the best choice. Since most credit reporting services make no distinction between Chapter 7 and Chapter 13, it would seem unlikely that they would want to attempt repayment.

Couple 3b can discharge their potentially nondischargeable debt only in a Chapter 13 and cannot do so in a Chapter 7 proceeding. Depending on the size of the debt and its proportion to their entire debt structure, they may choose Chapter 7, but it is unlikely.

Couple 4 is a prime and simple candidate for Chapter 13 bankruptcy. They need the discharge that only bankruptcy can provide; they need to restructure the debt on their car and they need time to catch up on their house payment. Budget counseling services are not useful because:

1. They cannot provide the discharge of debts for less than full payment.
2. They cannot restructure the debt on the car and allow them to keep the car.
3. They cannot keep the home mortgagee from foreclosing on the mortgage while the people catch up.

Chapter 7 is not useful because:

1. It cannot restructure the debt on the car and allow them to keep the car.
2. It cannot keep the home mortgagee from foreclosing on the mortgage while the people catch up.

The Current Status of the Debt Counseling Industry and a Bit of History

After avoiding the limelight for thirty years, debt counselors are finally receiving the scrutiny and evaluation that their importance to the public requires. Consumer Reports, CBS Marketwatch, NPR and USA Today have recently presented thoughtful analyses of the industry; Business Week took a shot at the entire industry and the Washington Post excoriated Ameridebt, Genus and Cambridge, three very large relatively new players. Demand for consumer debt counseling is on the upswing. Consumer debt remains extraordinarily high; the economy is in a nosedive.

New entrants, which rely solely on telephone or internet counseling and some of whose services and costs are suspect are advertising widely and taking over the market share of older players. The share of the market belonging to NFCC affiliates has been reduced from approximately eighty per cent in 1996 to between twenty and thirty per cent in 2001.

The most recent draft of proposed bankruptcy legislation requires debtors to visit a debt counseling agency before filing a bankruptcy petition. All are watching the proposed legislation to determine if it will create more than a million new customers who will need to pay dollars to a debt counseling agency to obtain an entry pass into the bankruptcy court. This would result in a huge new revenue source for the industry.

For the past several years creditors have been cutting the dollars they pay to debt counselors forcing them either to transfer costs to the debtor, reduce expenses or go out of business. This has put the squeeze on those in the industry that have tried to offer worthwhile services to the people who need them. Payment for the service or "Fair Share" was once set at 15% and although many creditors paid less or paid nothing many of the major creditors paid close to 15% at one time and the industry average was around 12%. Citicorp, Discover, Providian, Household, Fleet and Capital One, and Chase have all significantly reduced the percentage they pay and the industry average is now about 7%; First USA and MBNA have developed and implemented proprietary evaluation mechanisms according to which the creditor pays debt counseling agencies on a sliding scale that rewards agencies that bring value to the creditor.

In response to these very significant revenue reductions merger mania has set in among the old line debt counseling agencies.

In addition to the reduction in payments to debt counselors many creditors have reduced or eliminated the interest rate reductions and other concessions they had formerly provided to debt counseling customers who entered into debt management plans. This reduction in concessions has made DMP's less attractive and less valuable to the consumer.

The National Foundation for Consumer Credit (NFCC), the trade association or foundation of members that represents many of the traditional agencies is in tumult. For a number of reasons including its failure to make the case for effective counseling either with the creditors or with the public, the market share of NFCC affiliates has fallen precipitously. Not surprisingly, NFCC has recently tried to transform itself and recently revised its By Laws and hired a new President. The future of the NFCC is uncertain. Three other trade organizations have either emerged or have recently stepped up their efforts, and at this crucial juncture the industry has no real spokesperson or representative.

The contents and effectiveness of the debt counseling process are under attack. The articles about Genus, Ameridebt and Cambridge have pointed out how little they offer debtors during their short telephone interviews, how much the debtor pays them and how often the debtor ends up applying for a new loan at an affiliate of the counseling agency. In the event of the enactment of the legislation, the office of the United States Trustee is poised and ready to develop and advertise a rule regarding the process by which a debt counseling agency may qualify in order to meet the bankruptcy court requirements. Indeed, even prior to the enactment of the legislation one major player, Pro Fina lists itself on its web site as "approved by the U.S. Trustee."

The industry was created upon the notion that borrowers and lenders would benefit if:
(1) debtors learned a bit about use of credit and budgeting;
(2) debtors could deal with all of their debts at one place; and
(3) creditors would provide concessions to borrowers who entered such a program.

In spite of this notion the quality of counseling and the notions of "education" have remained unexamined. A few of the more client sensitive agencies have been concentrating on strengthening the educational component of their contacts with clients at the budget counseling sessions and in follow up contacts with participants. Two excellent examples are the St. Louis CCCS which stresses individual educational counseling sessions and the Austin CCCS which stresses group sessions. A vast majority of even the well intentioned agencies are far behind; they have neither a well developed curriculum for the counseling session nor adequate mechanisms to insure quality. There is, in fact, a fundamental difference regarding the definition of "education" between the creditors and the best of the agencies. Creditors and many agencies see education as taking place outside of the counseling session through visits to various service clubs whereas the best of the agencies take the position that the counseling session is the primary educational endeavor and the most important of all.

There are those who question whether the industry is worth having and simply requires greater regulation and scrutiny or whether the whole thing should be thrown out. If it is worth keeping then a new round of regulation and oversight may be required. The State of Maine recently enacted reform legislation and Massachusetts issued an interesting very negative study in preparation for legislative work. Judge William Hillman is the chairman of a study committee of The National Conference of Commissioners on Uniform State Laws that will likely recommend that a drafting committee be appointed to draft a uniform law regulating this industry.

A bit of history will be helpful to understand where the consumer debt counseling industry may be headed.

In the early 1970's, working under the auspices of the International Credit Association, retailers that made extensive use of unsecured credit cards, organized a network of agencies that would meet with their customers who were having difficulty paying their credit card bills and, when necessary, develop and implement a payment plan for those customers. The payment plan called for the customer to pay one hundred per cent of what was due to all unsecured creditors, and to send funds to the agency to disburse to those creditors. Some creditors reduced their late payment fees and their default interest rate and most accepted smaller installment payments. To meet the expenses of the debt counseling agency some creditors voluntarily returned to the agency up to fifteen per cent of the funds that were disbursed to it and called it their "fair share." Some of the agencies also received funding from the United Way and some charged the clients a fee. If the customer needed only a bit of advice, the agency provided that advice. If the customer required a bankruptcy, most agencies were unwilling to provide that recommendation or advice because they did not want to make a recommendation to the borrower that would lead to a write off of their constituents' accounts. Some agencies treated the customer as its client but most viewed the creditors as their clients. The consumer movement was suspicious of the industry because it was so closely allied with the creditors, because its quality was uneven, because it was unwilling to tell the customers about bankruptcy or other consumer rights, and finally because many of the agencies did not explain that the services were funded by the creditors. Because the industry was founded by unsecured creditors very few debt counselors deal with debt that is secured by a home or a car, or for that matter any secured debt at all.

From 1970 through the late 1980's this industry was sleepy and attracted little attention. The agencies were non-profit, called themselves Consumer Credit Counseling Services of the areas they served, and affiliated with the National Foundation for Consumer Credit, an organization created by and for the benefit of the creditors.

The explosive growth of consumer credit in the late 1980's and early 1990's led to an explosive growth in the debt counseling field as well. There were many new entrants, most of which relied on phone conferences which were more convenient, cheaper and faster than face to face interviews. These telephone interviews dispensed with even the pretense that the counseling sessions provided meaningful budget advice or education. One of those new entries, GENUS, (which has split into two parts, Genus and In Charge Institute) became the largest service provider in the industry by dispensing service solely by mail and telephone. Genus was reported to be a non profit-for profit hybrid that contracted for "back office services" with an affiliated for profit corporation, appeared to be closely affiliated to certain creditors, was willing to work with fewer than all of a client's creditors, and launched an attack on the NFCC system. Genus filed anti trust actions against the NFCC and its members and the Federal Trade Commission launched an investigation of the industry. Prior to the reduction in fair share and during the time of rapid growth the debt counseling industry appeared to be very profitable and attracted a number of new entrants. Because the laws in many states are more favorable to non profit debt counseling agencies most of the new entrants were organized under non profit corporation laws. Recently the IRS recognized the importance of the tax exempt designation to debt counseling agencies and issues an instruction to its agents asking that they scrutinize these taxpayers more closely.

Non CCCS organizations such as Ameridebt, Genus and Pro Fina now have a large percentage of the field. Ameridebt claims to have approximately 100,000 debt management plans.

The enormous increase in consumer credit from 1988 to 1996 and the decision by the industry to extend credit to people who would previously have been denied credit led to a significant increase in the number of customers who could not pay their bills. Some declared bankruptcy and the number of bankruptcy debtors increased. Others visited a debt counseling agency and the number of people visiting NFCC affiliates grew even faster than the number of people filing bankruptcy. Although there were more defaults, the consumer finance industry proved very profitable and there was consolidation as well.

Educational programming at debt counseling agencies is quite varied. Most agencies respond to requests for speakers on budgeting and credit use at schools, clubs and various organizations. Some agencies provide regular group educational sessions on budgeting issues. Some provide counseling to first time home buyers. In a partnership with the NFCC and the National Council on Economic Education, ten NFCC affiliates have contracted with the National Council on Economic Education to develop and implement a very professional and excellent set of curricular materials for use by teachers between grades kindergarten and 12. These materials are available to teachers and various NFCC affiliates and NCEE affiliates have developed and funded teacher training programs. In the St. Louis metropolitan area 600 teachers have been trained. If each teacher teaches twenty five students with the materials, then over 15,000 K-12 students have the opportunity to learn. Throughout the United States over 6,000 copies of each of the four levels have been sold. That translates to 24,000 teachers. If each of those teacher teaches twenty five students then the materials have been taught to at least 600,000 students.

The consumer movement had continued to be skeptical of the debt counseling industry. The best of the industry provided real credit counseling and education, developed a loyalty to their clients and even suggested bankruptcy when it was appropriate. Some agencies had developed excellent educational programming for the public and private schools and for their clients. Those, unfortunately, were the exceptions. Many agencies looked much like collective collection outposts of the creditors. The NFCC developed an accreditation process for its members but those standards did not require sufficiently high quality standards or quality control in the counseling sessions.

Toward the end of the 1990's, profits from consumer retail lending leveled off. Consumers began paying their bills in ways that generated fewer late charges and less interest; limits had been reached on the extension of credit and on the benefits of consolidation and technology. As profits leveled off or dropped, creditors began looking more closely at the debt counseling industry they had created. Creditors realized that fair share was a significant expense item to them, that was allowing some agencies to accumulate a surplus, and was encouraging new entries into the industry. The debt counseling industry had been created in a way that encouraged agencies to put people into debt management plans since such plans generated maximum revenue to the agency. In 1999 and 2000 a number of major creditors that had been supportive of the debt counseling industry reduced or eliminated fair share contributions, and some that had provided concessions to participants in the debt management plans reduced or eliminated those benefits. This has significantly reduced revenue at debt counseling agencies.

Major creditors have also imposed new requirements for eligibility in the debt management system. At the same time Genus' success in a market dominated by non profits that were asleep at the switch induced a plethora of new entrants who provided little service at a high cost and saw the opportunity to get rich quick off of the misery of overextended credit card holders.

Major creditors had incorrectly assessed Genus and its ilk when these "debt counseling mills" appeared on the horizon. These creditors assumed they would garner the same benefits from these new slick high profile, well financed "telephone counseling" agencies as they had received from the more "stodgy" "face to face" but people and service oriented CCCS agencies. These newcomers advertised "lower your interest rates and monthly payment." As a consequence, huge number of creditors' customers availed themselves of this service much to the detriment of the creditors' bottom line. Many of the people who signed up were not in such serious financial trouble as the historical customers. After the creditors evaluated the effect of the "mills'" new customers on their profitability they swung out at the entire industry by reducing fair share, reducing concessions and imposing new requirements for entry into a debt management plan. This set forth a tidal wave that continues to roll over both the new "mills" and the older agencies.

In response to the decrease in revenue and increase in costs, many agencies have been forced to reduce non income producing activities such as education and quality control in counseling; there has been a consolidation among debt counseling agencies, a move toward more efficiency and greater costs imposed directly on the customer.

The situation is an odd one and is on a very dangerous track. If those agencies that provide effective counseling and education are to have any chance of continuing to do so, progressive and efficient agencies and progressive and sophisticated creditors must create a productive dialogue and must include consumer representatives; the dialogue should be intensive, sophisticated and focus on quality; major creditors must conclude that they derive sufficient economic benefit from these service and must decide to provide sufficient funding to those agencies that provide effective services. The dialogue should lead to a method of making certain that those agencies that provide productive services are paid for those services. No such dialogue has ever taken place in this industry and none is currently scheduled. At the same time effective regulation of the debt counseling industry is necessary to keep the wolves from the door of the millions of credit card debtors who are now at risk.

If creditors, counseling agencies and consumer representatives fail to find a way to stem the reduction or elimination of the very services that give the debt counseling industry integrity, the result will be a debt counseling industry that will be little more than a collective collection outpost of the creditors. Just when Americans in financial trouble will likely need more help they will turn to a debt counseling industry that will disburse no education, low quality analysis and low quality counseling.

It does appear that there is a real need among consumer debtors for an effective debt counseling industry. It provides value for people with the following needs:

1. the consumer who needs an hour or two of informed listening and counseling and a bit of credit advice, and who can and wants to pay her creditors directly and in full and outside of the bankruptcy system;

2. the consumer who wants to try to pay her creditors in full outside of the bankruptcy system but cannot do so without the help of a third party, and who can do so without unduly endangering her car payment, house payment and basic family needs;

3. the consumer who needs effective credit and budgeting advice in a one on one setting.

If the debt counseling agencies can provide quality counseling they may be able to increase the number of people who complete debt management plans and provide the client with an information base such that she will more intelligently use credit in the future. There is no one else out there that can perform these services better. The effective debt counseling agency is a "partner" with the best of the consumer bankruptcy lawyers; they each have a service to provide. The question is whether the industry as it is configured can provide such services and to what extent the current activities of the creditors will destroy the ability of debt counseling agencies to help the consumer.

From the consumers' point of view there are several evils to be avoided. First, the counselor must see the debtor rather than the creditor as the customer; second, there must be effective counseling and education; third, when bankruptcy is indicated the debtor must be so advised; fourth, the costs imposed directly on the debtor must be small.

From the creditors' point of view there are several concerns. First, the debt counseling industry must operate efficiently from a cost point of view; second, it must not place people into debt management plans who need advice only; third, the creditor must conclude that effective counseling and education do, in fact, reduce defaults and "write offs".

The struggles within the NFCC, the effort of selected agencies to infuse education and quality control into the counseling sessions, the tools that MBNA and First USA have begun to use to evaluate and compensate the agencies and the explosion of highly advertised providers that offer minimal services at maximum price to debtors all come at a time when more and more people will need the service and when greater public attention is being aimed at the industry. There are cries for regulation at both the State and Federal level and if the stories about Ameridebt and some of its cronies are accurate then such regulation will be welcome. In the meantime it will be interesting to see whether the best of the industry will thrive, whether the worst of the industry will thrive or whether mediocrity will endure.