MEMORANDUM

To: Don Clark
From: Allison Brown, Attorney, Division of Financial Practices
Re: Telemarketing Sales Rule – Debt Relief Amendments, Comments to Be Placed on the Public Record
Date: June 16, 2010

On Thursday, June 3, 2010, representatives of the industry groups The Association of Settlement Companies ("TASC") and the United States Organization for Bankruptcy Alternatives ("USOBA") met with FTC Commissioner Ramirez, her attorney advisor, and FTC staff members to discuss the proposed debt relief amendments to the Telemarketing Sales Rule.[1]

The representatives stated that debt settlement is a legitimate service that provides substantial and ethical services to consumers. They also said that the industry groups support a very substantial part of the proposed rule. However, they stated that the industry groups have serious concerns about the proposed ban on advanced fees.

The representatives emphasized that the data they have submitted in the course of the rulemaking proceeding show that substantial value is being created for consumers. The representatives stated that TASC members settled $1.1 billion in debt last year. The representatives also stated that debt settlement is an emotional product and can result in extremely positive or negative responses from consumers. The representatives further stated that an advance fee ban would put all industry members out of business, and it is a labor-intensive and process-intensive business.

The representatives stated that not all consumers are suitable for debt settlement, and they do a budget analysis of each consumer as part of the intake process. They said that generally:

- consumers who can afford to pay 3-4% of their debt amount each month should make the minimum payments on their credit cards;
- consumers who can afford to pay 2-2.5% of their debt amount each month should enter credit counseling/debt management plans;
- consumers who can afford to pay 1.5-2% of their debt amount each month should enter debt settlement; and
- consumers who can afford to pay 1.5% or less of their debt amount each month should file for bankruptcy.

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[1]In attendance from TASC were: Andrew Strenio, Sidley Austin LLP; Andrew Housser, CEO of Freedom Debt Relief and TASC Board Member; Robert Linderman, General Counsel of Freedom Debt Relief and TASC Vice President; and Wesley Young, Legislative Director of TASC. In attendance from USOBA were: Jonathan Massey, Massey & Gail LLP; John Ansbach, Legislative Director of USOBA; and Samuel Brunelli, Team Builders International.

In attendance from the FTC were: Commissioner Ramirez, Janis Kestenbaum, Lawrence Wagman, and Allison Brown.

With respect to the fee structures that debt settlement companies generally use, the representatives stated that debt settlement companies employ different fee models, but many charge 15-20% of the consumer's debt amount, collected in equal installments over 18-24 months. The representatives stated that the law drafted by the Uniform Law Commission, adopted in various forms in several states, allows debt settlement companies to charge 17% of the debt amount over 18 months. The representatives stated that this framework is a better model for fee limitations than the FTC's proposed advance fee ban.

The representatives said that before the companies negotiate settlements, they provide budgeting advice to consumers and provide consumers information about their rights with respect to debt collection. These services cost money, and they need to collect fees to support them.

The representatives said that although interest and fees are added to consumers' debts while they are in the program, about 50-60% of consumers are already delinquent on their debts when they contact the debt settlement company. Also, once the consumer has been delinquent for six months, there is a reduction in or cessation of fees and interest that is added to the debt balances.

The representatives stated that Freedom Debt Relief has 600 employees – 130 are in sales/enrollment; 160 are in customer service; 150 conduct negotiations; and the remaining 160-170 are in various other support roles, including information technology and human resources. The representatives said that debt settlement is a high-touch business; they average nine customer interactions per month, and no company will be able to capitalize all of the up-front expense that these interactions entail.

The representatives said that another problem with an advance fee ban is that a contingency fee model would result in a power shift to the creditors; creditors would know that the negotiator would not get paid anything until a settlement occurs; thus, the creditor would offer smaller debt reductions because it would believe that the negotiator would take any settlement in order to get paid. The representatives said that creditors are advocating for the advance fee ban in this proceeding and in state legislatures because it would help them financially.

The representatives said that the better debt settlement companies engage in significant consumer education about debt collection, and there would be little incentive to engage in such education if an advance fee ban is imposed. In addition, companies would have the incentive to get as many people as possible enrolled in the program; even if 80% drop out, the company would receive some fees eventually, but this structure would hurt consumers.

The representatives said that they typically spread the fees over half of the program; they do not spread the fees over the entire projected life of the program because at the outset, they do not know how many months it will take consumers to finish the program. One survey, conducted by QSS, reported that half of the consumers who finish the program complete it in two years or less. If early-completing consumers were scheduled to pay fees over three years, the companies would not be able to collect the entire fee due.

The representatives stated that in Freedom Debt Relief's program, of those who dropped out before completion, 52% received more in debt reductions than they paid in fees, and 75% received at least one settlement. They also stated that statistically, most dropouts occur in the first 4-5 months. The representatives stated that the number one reason that consumers drop out of the programs is that they are harassed by creditors.

The representatives recommended that the Commission adopt a safe harbor from the advance fee ban for companies that are providing value to consumers. The representatives described the proposal, set forth in full in a letter submitted on April 28, 2010 and posted to the public record, as including a safe harbor for companies that meet the following standards:

- mandatory refunds: company provides 100% refund of fees within the first 30 days; and, up until the first settlement occurs, refunds of all fees, less a monthly fee in approximately the amount allowed to be charged by credit counselors in the state;
- company provides more in debt reduction than it collects in fees, as verified by an independent auditor; and/or
- company allows consumers a choice between a flat fee structure and a contingency fee structure.

The representatives stated that they have determined, through financial modeling based on Freedom Debt Relief's data, that if they had to operate under an advance fee ban, it would take them five years before they were cash-flow positive.

The representatives stated that they take the self-regulatory role very seriously. A USOBA representative stated that they undertake background checks of member companies; they engage in a secret shopper program; they suspend a company from membership upon the first violation of their standards and terminate the company upon the second violation; and, finally, in the last 30 days, they instituted a "zero tolerance" policy for use of government imagery in debt settlement advertising. A TASC representative said that the association has strong self-regulatory guidelines and has expelled six or seven companies in the past two years for violating its guidelines.

The representatives made the following statements in closing:

- there is a great deal of good in the proposed rule; the problem is the advance fee ban;
- it is risky to impose an advance fee ban, as a pure contingency fee model has no track record in the debt relief industry;
- these issues are compounded because the Commission does not have authority over nonprofits, which comprise a significant share of the debt relief marketplace; and
- if the Commission overshoots and imposes an advance fee ban, legitimate and illegitimate industry members will go out of business, and there will be no way to reconstitute the businesses to try a less restrictive approach.