



The Modernization of Credit Counseling as a Response to the Debt Settlement Industry

The Debt Resolution Plan™:
A Service Extension for the DMP
Unqualified and Disqualified

A Report by AAA Fair Credit Foundation
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EXECUTIVE SUMMARY

On February 17, 2010, the nonprofit credit counseling agency AAA Fair Credit Foundation announced it was commencing the provision of less than full balance (LTFB) debt relief programming for consumers in Utah. Speaker of the House David Clark (Regional President of Zions Bank) and Attorney General Mark Shurtleff sponsored the press conference. Together they applauded the implementation of the LTFB Debt Resolution Plan (DRP Certified™) as a consumer safe response to the problematic debt settlement industry. On June 8, 2010 in a cover story in USA Today, “Drowning in Credit Card Debt? Debt Settlement Can be Tricky”, reporter Sandra Block recognized the modernization initiative in Utah as a “new alternative”.

Currently, 18 of 19 callers seeking help from nonprofit Credit Counseling Agencies (CCAs) fail to qualify for traditional full balance Debt Management Plan (DMP) programming. Rather than have those consumers fall into the hands of for-profit Debt Settlement providers, the Debt Resolution Plan is a “DMP unqualified” next step. After the debtor has failed the DMP full balance “means test” and eclipses 120 days delinquent the three essential activities of the Debt Resolution Plan methodology commence – qualifying, quantifying, and certifying.

1. **Qualifying:** algorithmically analyze the debtor’s financial facts with the Responsible Debt Relief (RDR™) algorithmic assessment tool to determine the debtor’s viability for a Debt Resolution Plan (DRP Certified™) or bankruptcy and fully disclose the pros and cons of each.
2. **Quantifying:** establish the debtor’s maximum repayment capacity in a structured, standardized and achievable 36-60 month resolution program that is a simple extension of traditional and universally accepted consumer credit counseling pro-rata distribution methodology.
3. **Certifying:** gathering appropriate documentation for presentation to the creditor verifying the clients’ Responsible Debt Relief (RDR™) algorithmic assessment score and stated financial disclosures to encourage active collector participation once the debt has charged off.

These fundamental and obvious steps are necessary prerequisites to placing a debtor in a LTFB debt resolution plan at any legitimate credit counseling agency in America.

The DRP Certified™ program preserves the safety and soundness of banking by incorporating a reliable third-party debt assessment at the initial stage of the analysis.

The result of a decade of research and development with leading scholars, authors and leadership in the financial services industry, the DRP Certified™ plan is poised to position

nonprofit CCAs with a safe and effective way to compete with for-profit debt settlement providers in our effort to address the full spectrum of consumer debt challenges with education and practical assistance.

- Our response to debt settlement providers serves the primary tax-exempt purpose of CCAs: to safely counsel financially-distressed consumers and properly guide them in the challenging process of regaining their financial stability.

Our goal is to honor the fundamental intentions of the Schumer-McCaskill Debt Settlement Consumer Protection Act by establishing a two-tier service strategy (DMP/DRP) working actively with recovery operations without threatening on-going collection operations or voluntary Fair Share support.

The particulars of a less-than-full-balance repayment plan using an “assessed, verified and certified” methodology, as detailed in this report, demonstrates that nonprofit credit counseling agencies may honorably and effectively serve both our mission for debtors and our obligation to creditors.

- The “safety and soundness” of banking collection and recovery operations are protected from debtor abuse by a comprehensive qualifying and certifying process eliminating “Pandora’s box” concerns about viable payers posing as near-bankrupt.

BACKGROUND

Resolving excessive consumer credit card debt can be a troubling and challenging experience for consumers, CCAs and Attorney providers. Those challenges are compounded by risky alternatives like debt settlement. Failure rates, the choice of inappropriate servicing and a myriad of marketing issues have led to the current crisis over debt settlement regulation. The Debt Resolution Plan was developed as a safe and sound extension to current, regulator-approved DMP plans and has no relationship to or place in the debt settlement debate.

The Debt Resolution Plan with its effective assessment math and resolution mechanics is currently piloting in Utah and enjoys enthusiastic support from leadership in banking, banking oversight and consumer protection. Prior to launching the program individual meetings were held with Utah Governor Gary Herbert, Utah Attorney General Mark Shurtleff, Utah Department of Commerce, and the Utah Bankers Association. AAA Fair Credit Foundation President and CEO, Preston Cochrane, has personally met with and presented the DRP Certified™ program to officials from the Federal Reserve Bank, Office of the Comptroller of the Currency, Consumer Credit and Compliance Department from the

Utah Department of Financial Institutions, Association of Credit Counseling Professionals and the Association of Independent Consumer Credit Counseling Agencies.

Responsible Debt Relief Institute has expanded the discussion of means-tested debt concession plans with federal regulators including the Department of Treasury, Office of Comptroller of the Currency, Federal Reserve, and the Consumer Financial Protection Bureau. Our shared objective is to demonstrate the precision of the Responsible Debt Relief (RDR™) algorithm in estimating the expected consumer payment performance on “impaired” unsecured loans. The third-party RDR™ assessment system is designed to empirically estimate household debt capacity as the basis for restructuring less than full balance loan payment plans.

CREDIT GRANTORS AND THE CREDIT COUNSELING PROCESS

Less than 25 percent of all counseled individuals are placed in a DMP. The services provided by CCAs under the terms of a DMP contract are provided by the agency directly to the consumer. Any contact with or distribution of funds to credit grantors on behalf of debtors enrolled in DMPs is incidental to the overall counseling and educational process. When administering debt management relief services, credit counseling agencies fulfill a four-part role:

1. Agent
2. Advocate
3. Counselor
4. Educator

Each of these duties insures that the debtor’s best interest is served with payment management, assistance, impartial guidance and ongoing financial education.

FOR CONSUMERS

On a nearly daily basis the national media reports on the excessive costs and broken promises that consumers endure at the hands of aggressively marketed for-profit debt settlement services. New regulations from the Federal Trade Commission and the Debt Settlement Consumer Protection Act of 2010 (Schumer-McCaskill bill) are intended to protect consumers who are deeply in debt and desperately looking for legitimate solutions.

Many Debt Settlement operators are aligning with attorneys and utilizing other regulatory evasion tactics in an effort to continue providing their services.

The Schumer-McCaskill bill advocates referrals to nonprofit CCAs without understanding that the only less than full balance (LTFB) “policy” recognized by card issuers is the 60/60 Plan as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

- We have not been able to locate one CCA that has successfully recommended or utilized this limited “option” since it was made law five years ago. There is, therefore, no benefit to consumers. There is law and policy, but there is no benefit.

The fact that Congress remains unclear that CCAs only provides full-balance DMP services sheds light on why CCAs are the last resort instead of the first call for LTFB debt relief.

Debt Settlement has flourished not because of its superior services and honest marketing. Debt settlement flourished because it addressed an urgent need and had no competition from credit counseling. Viewing Debt Settlement through the lens of a cost-benefit analysis, personal and economic costs are as high as they can get with literally no benefit. The exact opposite is true with LTFB services through credit counseling.

- Consumer safety and proper counseling at low cost is the hallmark of legitimate nonprofit credit counseling.
- Nonprofit CCAs abide by state fee caps for nonprofits insuring that operational costs to consumers for services will be reduced.

FOR CREDITORS

Determining the costs and benefits to creditors unfortunately provokes an anecdotal debate about consumer behavior.

Those who believe that consumers are intrinsically well meaning good people, believe LTFB programming has enormous benefits.

Those who believe that consumers will “beat the bank” and “rate shop” if given the slightest opportunity to flagrantly do so believe the LTFB programming through nonprofit credit counseling will produce no benefits and cost the bank huge losses through diminished collections.

Until the advent of the RDR™ assessment product, a reliable utility for assessing a consumer's precise debt repayment capacity did not exist¹. Six years in development, the RDR™ assessment and verification approach has evolved into a sophisticated process that not only assesses consumer repayment capacity, but also provides the consumer with online interfacing to verify the accuracy and precision of the facts. With the addition of the DRP Certified™ gathering of supporting documentation to verify and certify the financial disclosures used in the RDR assessment, collectors are challenged to formulate a new response.

Presuming that DRP Certified™ is the first credible assessed, verified and certified LTFB resolution program; what would be the benefit to collectors?

With the passage of BAPCPA in 2005, the agenda of the creditors has been clear; keep consumers out of bankruptcy and in so doing staunch the losses from Chapter 7 discharges. The latest bankruptcy data reveals that these desired outcomes have not happened.

Personal Bankruptcies: 2005	2,078,415
Personal Bankruptcies: 2006	1,085,209
Personal Bankruptcies: 2007	775,344
Personal Bankruptcies: 2008	1,004,342
Personal Bankruptcies: 2009	1,344,095
Personal Bankruptcies: 2010	1,538,033

If the consumer has a genuine desire to avoid the agony of bankruptcy and the creditors likewise wish to avoid a trip to federal court, than why are there so many bankruptcies? We propose the primary reasons are:

- Lack of a reliable underwriting product by the creditors.
- Mistrust and lack of confidence in consumer hardship reporting.
- Distaste for LTFB resolutions engendered historically by dishonest operators in the debt settlement industry.

Assessed, verified and certified LTFB programming through legitimate, nonprofit, CCA solves all of these problems.

¹ www.responsibledebtrelief.org presents the facts about their assessment tool.

Based on the recent statistics reported on MSNBC, card issuers sustained an average loss of \$61,000 per person for Chapter 7 filings. Total losses in 2010 are estimated at just under \$94 billion.

It is well known and fully documented that the predominant catalyst for consumer bankruptcy is aggressive collection tactics. Losses from bankruptcy continue at record rates despite the enactment of BAPCPA. The true cost of LTFB programming to creditors is found in not utilizing state of the art analytics to mitigate the losses from the escalating number of bankruptcies.

- As fully documented in the RDR™ assessment presentation, a precision analysis that is both responsive to cost of living and taxes based on place of residence of the debtor will surely yield higher collection rates than the generalized current flat rate collection policies.

NONPROFIT CREDIT COUNSELING

In an unusual win-win-win scenario, the CCA providing a LTFB program also enjoys major benefits.

- Improved community service by providing consumer-safe low cost services to compete with and ultimately replace debt settlement.
- Additional revenue stream from consumers who would otherwise exit the counseling in the traditional binary environment of DMP or BK.
- HUD-approved housing counseling agencies might better serve homeowners by providing a unified standardized approach to secured and unsecured indebtedness to treat loan modifications and foreclosure prevention.

Current estimates of DMP qualified customers' ranges from a low of 20% to a high of 50%. Even in the best case scenario, fully two-thirds of consumers calling for immediate debt relief assistance through nonprofit credit counseling are unqualified for a traditional full-balance DMP. Two-thirds of every marketing dollar is being thrown away on individuals who cannot be helped without a LTFB program.

Consumers who fail in their DMP efforts are also left with no alternative other than bankruptcy and/or debt settlement. Legitimate CCA providers have no "counseling" capacity other than to advise that they can no longer assist the consumer. The tax-exempt status of CCA providers presumes "counseling" and educating consumers. Providing debt relief programming only when the consumer has the resources to pay full balance may be

the letter of the law, but it certainly is not the spirit of it. Every CCA that has considered this programming agrees that it is desperately needed and an essential part of the core mission of every legitimate nonprofit CCA to counsel, educate and assist.

THE DEBT RESOLUTION PLAN (DRP CERTIFIED™)

DRP Certified™ provides a “safe-harbor” for the consumer to be straightforward and proactive in their efforts to resolve financial concerns. A controlled and supportive environment encourages consumers to disclose their true and sincere financial concerns and thus be receptive to real solutions to real problems.

The pros and cons of bankruptcy filing – and value of DRP Certified™ - come into crystal clear focus when considering the consequences for military, law enforcement, licensed financial services personnel and others whose security clearance, promotion or employment may depend on an unblemished credit history without the black mark of bankruptcy.

By extension, anyone who is in the early years of their career development may find the cost of bankruptcy to be many times the debt savings when considering lost employment opportunity or lost advancement consideration due to negative marks in their credit history.

Nonprofit Consumer Credit Counseling is the appropriate “gateway” to legitimate partial payment debt relief services like DRP Certified™ because the DMP is the first and essential 100% of balance “means test”.

- Nonprofit, tax-exempt 501(c)(3) credit counseling agencies that are fully accredited and licensed offer a trusted consumer assistance model that financial institutions already rely on.
- ONLY after a consumer has proven to be unqualified for a DMP or has been disqualified from a DMP and have charged off due to a worsening financial condition can they qualify for DRP Certified™ programming after they have been qualified through the RDR™ assessment, neutralizing aggressive marketing concerns.
- The credit counseling agency provides counseling on the consequences of less than full balance alternatives in a disclosure experience that is compliant with debt relief regulations promulgated by the Federal Trade Commission and/or the State’s Attorney General.

Once the debtor has demonstrated they cannot qualify for full balance DMP services and have eclipsed 120 days delinquent, they have effectively been “means tested” and qualified for other alternative programming.

- a) The household debt capacity assessment conducted by the nonprofit Responsible Debt Relief Institute empirically evaluates whether the consumer’s net cash flow is adequate for qualification in the Debt Resolution Plan or is so low that bankruptcy is the appropriate option. The RDR™ algorithm calculates the net-cash flow of the household (individual or family) by estimating the adjusted gross income, calculating federal and state tax liabilities (based on state of residence, household structure, homeownership status, tax filing status, and the household budgetary allowables as specified by the Bankruptcy Court), and deducting other household expenses such as transportation, medical care, and court mandated payments such as child support and back taxes. The proportion of outstanding unsecured debt that can be repaid is based on the available free cash flow and length of the amortization schedule, net of service fees. Hence the final, verified RDR score precisely estimates the amount of unsecured debt that can be repaid by bankruptcy eligible consumers. The assessment proceeds as follows:
 - a. The consumer may opt in for an approximately 30-minute Responsible Debt Relief assessment anchored in Federal cost of living guidelines specific to their zip code. (Fee: \$45)
 - (Or)
 - b. The consumer may opt in for a consultation with bankruptcy counsel.
- b) The RDR™ assessment results are presented to the debtor and the CCA for review.
 - a. Consumer opts into the DRP Certified™ Debt Resolution Plan.
 - (Or)
 - b. Consumer opts into Bankruptcy.
 - i. Although a debtor may qualify for a DRP, bankruptcy is still an option because consumers qualified for DRP are by definition “near bankrupt”.

DRP Certified™ is specifically keyed to an achievable 36-60 month time frame to maximize the potential success for the consumer giving comfort to consumer protection authorities that the consumer is paying for services that may actually avert bankruptcy.

PRECISION, STANDARDIZATION AND DECISIONING

Responsible LTFB programming administered through legitimate nonprofit credit counseling agencies has several key characteristics that differentiate it from traditional debt settlement. The particulars detailed here address the fundamental and persistent flaws in the for-profit debt settlement model.

1. **PRECISION:** A precision analysis is the first step to properly counseling the debtor on the range of available options. The modernization of credit counseling services is meant to correct the “all or nothing at all” inefficient binary of “DMP or Bankruptcy” options. A LTFB option presents an underwriting and certification methodology that has historically – and tragically - had no place in the work of debt settlement providers. Ironically, the same lack of a precision assessment methodology characterizes internal programs fielded by the lenders themselves, (e.g. 60/60 plans, Call to Action) offering universal responses to individual needs and widely varying circumstances. The resulting imprecision works to the disadvantage of the credit grantor, the debtor, and the economy.

The Responsible Debt Relief Institute has innovated the first of a new breed of algorithmic assessments intended to (a) qualify and triage the debtor into an appropriate service; and (b) quantify in exact percentage the debtor’s repayment capacity based on clearly defined and universally accepted federal guidelines.

For the DMP unqualified and DMP disqualified debtor, this methodology provides precise data to aid in stratifying counseling recommendations:

- Call to Action (CTA) and 60/60 programming with the collection department
 - Less Than Full Balance consideration through the CCA
 - Chapter 13 or Chapter 7 Analysis for referral to pre-bankruptcy counseling
2. **STANDARDIZATION:** The second challenge facing all credit counseling agencies is reconciling the often very different and conflicting plans offered by the top creditors as each internal collection department operates on a unique set of guidelines. The competitive “race to the bottom” that often ensues may temporarily work to the advantage of an individual collection department, but ultimately works to the disadvantage of the debtor who is unable to navigate competing and unrealistic demands. A standardized and balanced approach to the recovery department that treats all creditors equally, similar to the Chapter 13 methodology, does not exist in

the informal credit counseling environment. The assessed and certified approach to LTFB has proved to be a credible and valuable standard.

3. **DECISIONING:** The third and most difficult duty in effective counseling is the personal, non-arithmetic evaluation of what program best serves the debtor's needs – and the debtor's wants. Although the debtor may qualify for bankruptcy that may not be a choice the debtor wants to make. Similarly, even though the credit grantor may wish to handle the debtor on an internal program, it may not be in the debtor's best interest when that choice is evaluated in the context of a multitude of other creditors that may also be owed equal or greater amounts. There cannot be a more desperately needed adjustment in credit counseling programming than upgrading the decision making process for debtors beyond DMP and Bankruptcy.

CHARGE-OFF: THE GREAT DIVIDE

The dreaded “charge-off” event has historically been avoided at all cost on the basis that long-term credit damage that ensues from charge-off was not worth the short-term economic relief enjoyed by the debtor. When questioned about the issues of credit damage in relation to charge-off accounts, Craig Watts, Public Affairs Director at FICO stated, “when the FICO scoring model sees an indication on the credit report of settled account or charged-off, it classifies them in an identical manner – as a severely negative item. Holding everything else on the credit report constant, there is no difference in how the scoring algorithm treats a card account that has been settled for less than the amount owed, and a card account that has been charged-off.” Therefore, any effort to avert charge-off for the purpose of preserving a good credit rating is misplaced.

Recovery departments are the operational entities that handle debts that have eclipsed the six-month delinquency timeline and have proceeded to charge-off status. Our response to debt settlement must by definition target the traditional turf of debt settlement providers - post charge-off.

TESTED OPERATIONAL REALITY

For-profit debt settlement operators have created a billion dollar industry in the “recovery” environment where banks, debt collection attorneys and collection agencies have the regulatory freedom to accept LTFB resolutions. The question is not “can LTFB be accomplished?” The correct question is, “who should best assist the debtor in LTFB

assessment and planning?” The answer is clearly accredited nonprofit credit counseling agencies. Armed with a precise and standardized analysis of the debtor’s repayment capacity, credit counseling agencies provide a multitude of advantages to both the debtor and the creditor in the post charge-off recovery environment.

Unlike the agreements that drive the DMP process, the LTFB arena continues to exhibit debt settlement hangover with continuing “lump sum” and policy driven “short term” payment demands. This is how our alternative debt resolution plan operates:

- **Repayment Percentage:** The RDR™ Score is a constant assessed by the Responsible Debt Relief Institute. It quantifies, on a monthly basis, what the debtor can repay after reasonable living expenses as defined by the Federal government.
- **Repayment Term:** Recovery departments may respond with alternative resolutions for lesser amounts or shorter timeframes. That is their right and it is our obligation to bring those offers to the attention of the debtor and counsel that debtor on the value and viability of those responses based on their assessed and certified financial reality.

Again, every rational banking and regulatory authority that has taken the time to fully understand the realities of the LTFB agenda we are advocating with the Debt Resolution Plan and the Responsible Debt Relief Institute has seen its merit and asked, “Why aren’t you already doing this?”

Below are the critical steps to LTFB resolutions:

1. Assessment
2. Counseling debtor regarding charge-off consequences
3. Educating the debtor about the challenges inherent in the resolution process
4. Refer DRP unqualified or disqualified consumers to bankruptcy counsel
5. Disclosure of credit, tax and other consequences
6. Preparation of the plan
7. Presentation of the proposed plan to creditors
8. Process returned creditor proposals (or)
9. Present creditor alternatives to the debtor
10. Managing plan administration (or)

11. Assist consumers with their bankruptcy filing if less than full balance strategy is unworkable and client is sued by creditors
12. Provide ongoing financial counseling and money management education

CONCLUSION

Many credit counseling practitioners have asked "why" we have gone down the path of less than full balance programming. There is greater receptivity to the necessity of this modernization today than there was a year ago when we began testing this option. There are still many challenges to institutionalizing this programming for regular day-to-day credit counseling operations. Going forward we believe adoption from the entire credit counseling industry is critical to make the plan work for the benefit of consumers, creditors and nonprofit credit counseling service providers.

CCAs utilize the same pipeline and processing methodology as traditional Debt Management Plans to administer debtors in the DRP pipeline. There is no need to reinvent the wheel. DRP Certified™ administered through nonprofit credit counseling simply modernizes their programming with a less than full balance option for unsecured debt.

The DRP methodology gives nonprofit CCAs a new tool that aids the consumer in determining what they can pay while assisting the creditor's recovery process with a transparent assessment of the consumer's true financial position.

Many classes of consumers from military to law enforcement to financial services providers lose their security clearance, their promotion or their license when they file for bankruptcy. This program will provide to those classes of consumers an opportunity to avoid bankruptcy and seek mathematically sound and orderly debt relief, without bankruptcy, administered through trusted nonprofit credit counseling agencies.

Concerns exist for debt distressed consumers who pay fees for services and then a "change of circumstances" worsens their finances and disrupts the program. How will the consumer be protected from the risk of loss in that scenario? The answer is they won't. Will some consumers fail? Yes. Will some consumers have wasted money and have delayed their bankruptcy? Yes. Will some consumers have invested in their future and lost? Yes. Will they have done so senselessly or as a result of deceptive marketing or solely for the sake of profit? No.

There is no doubt that the programming being tested through AAA Fair Credit Foundation is the safest less than full balance debt relief program currently available to consumers.