Asking the Wrong Question: A Critique of the Debt Settlement Industry's Data Analysis

October 2020

Every few years, since 2012, the debt settlement industry has released a report asserting its worth to consumers.[1] The reports are commissioned by the American Fair Credit Council (AFCC), a trade association representing the debt settlement industry. They are prepared by an accounting firm or independent scholar and are based on data provided by some of the industry's largest members. Not surprisingly, each report states that debt settlement results in an economic benefit for consumers. But that is not the whole story. A closer examination of the AFCC reports reveals that the data does not support the conclusion.

BACKGROUND ON DEBT SETTLEMENT

To understand the problem with the AFCC reports, it is necessary to understand the debt settlement process.

The typical consumer enrolling in debt settlement is hoping to resolve multiple accounts with different creditors. According to the AFCC's most recent report, the average is 6.68 accounts worth a total of roughly $30,000.[2] This can be called the consumer's debt "portfolio." It takes time to negotiate settlements with each creditor and some will never be settled. As a result, even consumers that remain in the debt settlement program (many drop out), will only settle part of their debt portfolio. According to the latest report, after 36 months, the average consumer had settled about half of their accounts.

Until a debt is settled, the balance due may continue to grow with the accretion of interest, penalties, and other account charges. Any settlement ultimately arranged is to pay a portion of the then-current balance. Debts that do not settle may continue to grow. Consumers may also be sued while still in the debt-settlement process, resulting in post-judgment interest and wage garnishment or other collection methods.

The consumer must also pay to participate in a debt settlement plan. For each debt settled, the debt settlement company will charge a fee calculated as a percentage of the enrolled amount of the debt. Another fee is a monthly service charge imposed by a bank (selected by the company) for maintaining the special savings account that debt settlement companies typically require. The consumer may also owe taxes on any debt forgiven by a creditor.

PROBLEMS WITH THE AFCC REPORTS

The AFCC reports find that debt settlement provides an economic benefit for consumers. They reach that conclusion based on *account* level data showing the average savings for settled accounts ($1,700 after fees, according to the latest report). But that does not take into account the interest, penalties and other charges that accrue on the debts that do not settle. Nor does it consider other, less tangible costs, such as the stress of dealing with debt collection phone calls and lawsuits while waiting for debts to settle.

To determine whether debt settlement provides a net economic benefit to consumers, it is necessary to measure the impact at the *portfolio* level for all consumers who enroll, not just those who settle at least one debt.

For example, according to the latest report, the average consumer saves about $5,800 on settled debts after fees. But if the other debts that did not settle grow by more than $5,800, then the consumer has suffered a net loss and comes out of the process owing more than they started. That is the opposite of the advertised goal of debt settlement and would mean debt settlement is economically harmful to consumers.

The negative impact of debt settlement will be even more apparent for consumers who do not settle any debts. But the reports exclude these consumers.

The AFCC reports are flawed because they neither address the impact of debt settlement at the portfolio level nor the impact on consumers who do not settle any debts. As a result, the conclusion that debt settlement is economically beneficial is unsupported.

We call on the debt settlement industry to release a complete dataset, with a current balance for all debts in each consumer's portfolio—even those that have not settled—so an independent researcher can perform a comprehensive analysis of the true economic impact on consumers.

***For questions, please contact National Consumer Law Center staff attorney Andrew Pizor at* 202-452-6252 or apizor@nclc.org.**

ENDNOTES

[1] *See* American Fair Credit Council, (collection of reports).

[2] Will S. Dobbie, Financial Outcomes for Debt Settlement Programs, at 1 (May 2, 2020).