Research on Credit Counseling and Consumer Debt Relief Solutions

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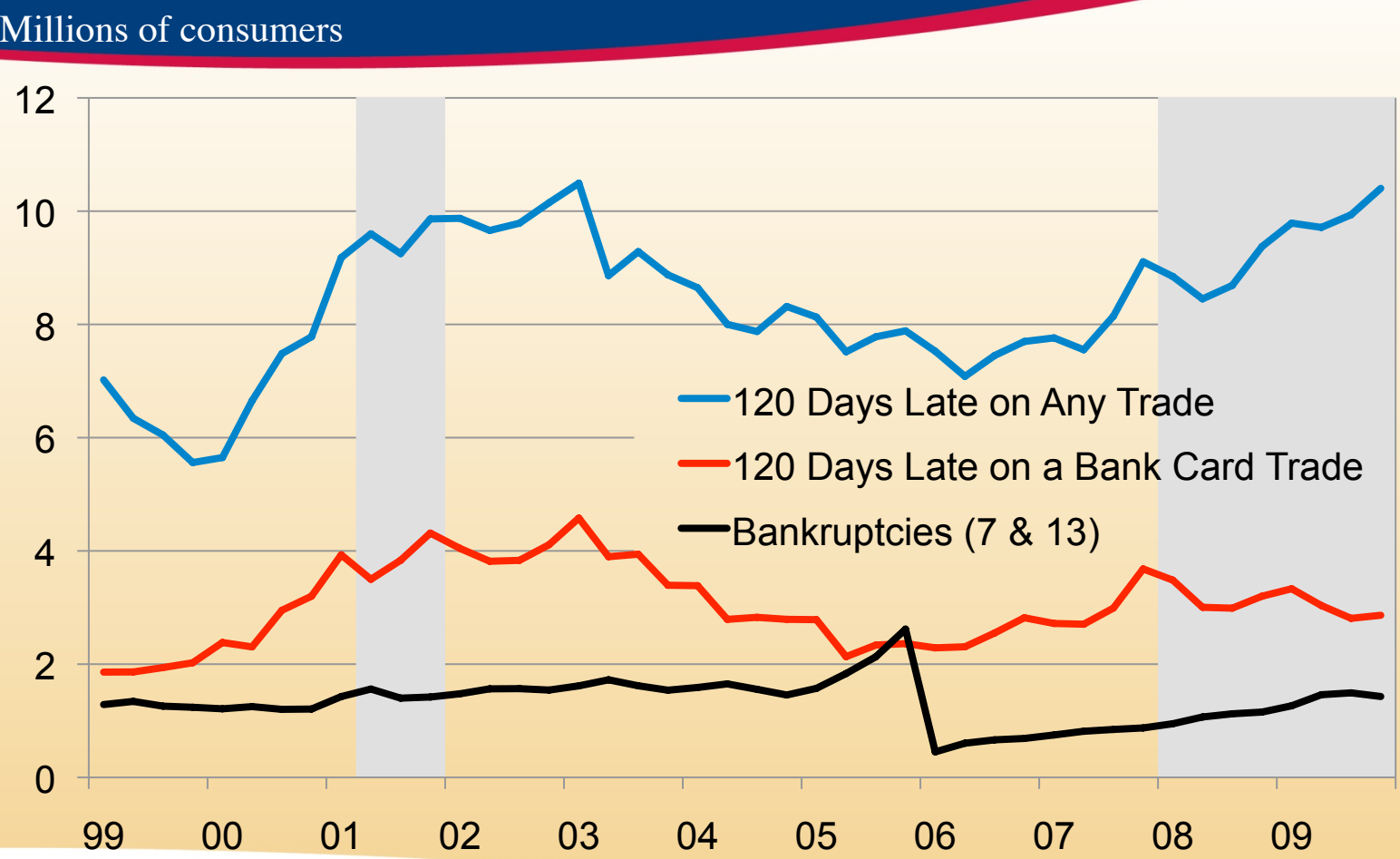
Dealing with Debt is a Major Issue for Tens of Millions of American Households

- **The value proposition behind saving $1 to get a 1% return vs. paying down debt at a 20% return is pretty straightforward**

- **But, for millions of consumers, debt problems are acute and require solutions beyond just payback on the original terms**

- **1.5 million households filed for personal bankruptcy in 2011, but……**

The Large Majority of Distressed Consumers Don't File for Bankruptcy



Source: AOUSC, TransUnion TrenData & authors' calculations

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Options Available to Financially Distressed Consumers

- Informal Bankruptcy (default => balance chargeoff)
- Formal Bankruptcy – Chapters 7 & 13
- Bilateral Workouts between borrower & lender
- Third-party assisted solutions
  - Debt Management Plans – arranged by credit counselor
  - Debt Settlement Programs – arranged by settlement company (so far)

Frequency of Unsecured Credit Workout Options as Reported to a Credit Bureau

Workout Option (Remarks Code)	Number of Accounts Reported as of May 2011	Number of Consumers Reported as of May 2011	Arrangement between Consumer and…
Debt Management Plan (MCC)	3.3 million	1.6 million	Credit Counselor
Partial or Modified Payment Agreement (PPA)	150,000	145,000	Lender
Account Settled for Less than Full Balance (SET)*	14 million	10 million	Debt Settlement Company or Lender or Collection Firm

Note: *If accounts in collection were included in the table, the number of accounts with a SET remarks code would increase to 18 million and the number of consumers to 12 million. Source: TransUnion, LLC, as cited by Wilshusen, Philadelphia FRB

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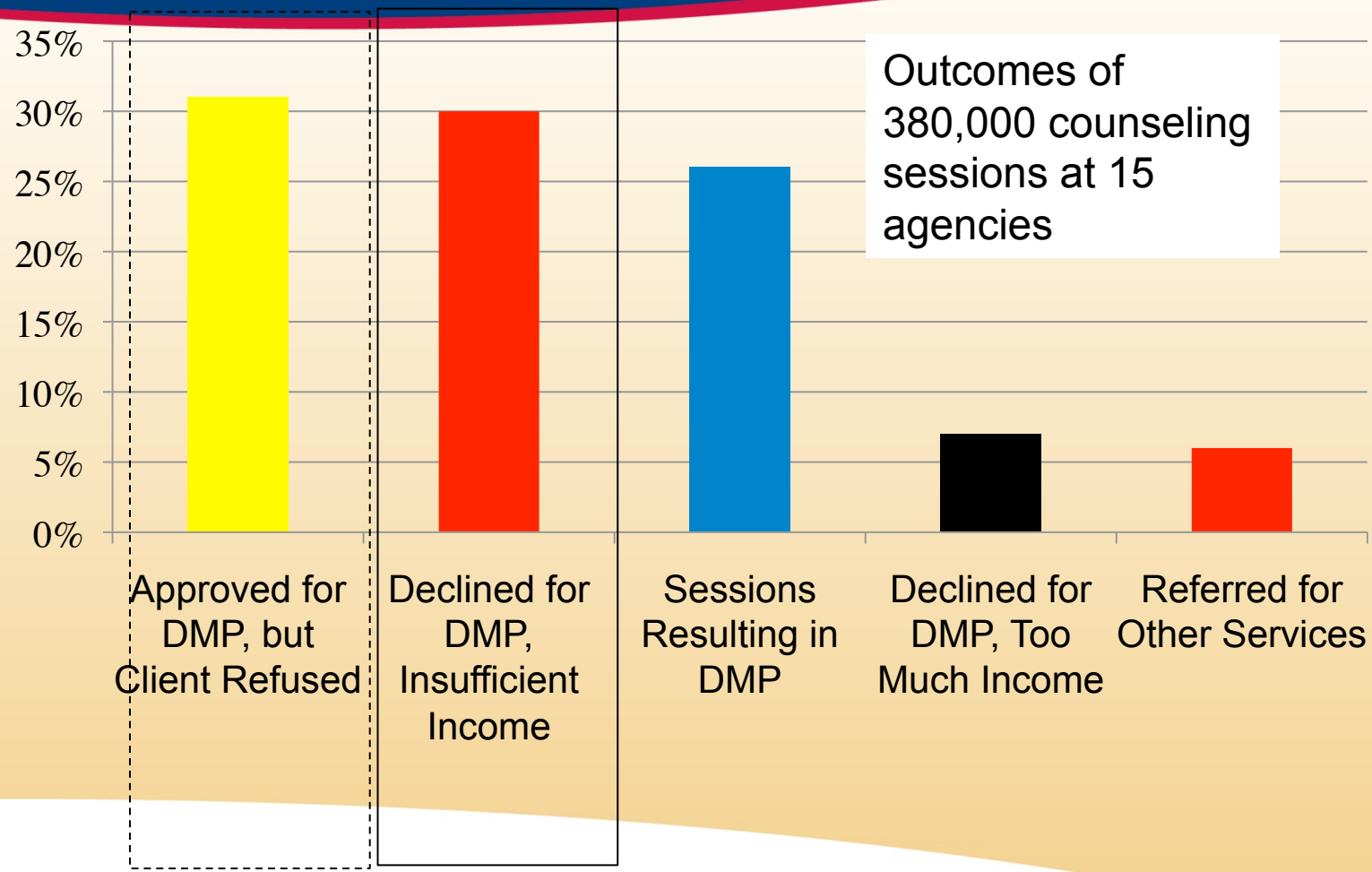
So, Demand for Debt Relief is Strong …
But, the Credit Counseling Industry is in Turmoil

- Non-profit credit counseling industry has a revenue crisis rooted in a faltering business model built on 501(c)3 education agencies delivering debt recovery services
- All repayment agreements brokered between consumers and their creditors are <u>voluntary</u>
- Creditors provide a core funding source, but pay whatever they want - no contract between agency and creditor
- Creditor funding has declined for 15 years

And, this lousy business model is caught between regulatory pincers

- Many states limit counseling and DMP activity to be done by non-profit organizations only
- Can't be too business-like (efficient and bottom-line oriented) or risk losing tax exemption
- Price controls rampant across states in terms of caps on fees and up-front pricing. Also, caps on % of revenue that can come from DMPs
- CROA limits on how much agencies can coach borrowers regarding credit reports, so limited fee income opportunity

The DMP Product Currently Does Not Meet All Needs: Role for Debt Forgiveness



Outcomes of 380,000 counseling sessions at 15 agencies

Source: NFCC/AICCCA Survey

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Consumers Don't Know Who's Who in Counseling and Debt Settlement

Industry on the Brink: Credit Counseling Agencies Need to Document the Value of What They Do

- With a significant stake in client outcomes, creditors can (and have) provide funding assistance, but need empirical evidence that investment in counseling (vs. other collection tools) yields net benefits
- Consumers need evidence to build awareness and trust - and be convinced to seek counseling help earlier
- U.S. tax authority (IRS) needs evidence of education and rehabilitation value of counseling to continue tax-exemption of agencies
- Lawmakers and regulators need empirical evidence to document that counseling activities serve the public interest

We Don't Know As Much As We Should About the Education/Rehab Impact of Counseling

But, there is a reason. This sort of research is challenging.

- **"Good" counseling bundles together diagnosis, education and debt triage**
- **In the vast majority of cases, budget advice/debt relief is voluntary…. So, self selection by proactive consumers who seek counseling makes them fundamentally different from borrowers who don't seek counseling**
  - **Higher motivation of proactive borrowers makes them more likely to seek counseling and more likely to outperform observationally similar borrowers (Meier and Sprenger, 2008)**
  - **But, also some borrowers who seek counseling know they are in serious trouble even before their credit report shows it => they may underperform observationally similar borrowers**

A Word on Need for and Limits of Randomized Control Trials in Credit Counseling Studies

Randomized Control Trials are tough to sell to counseling agencies because most clients need help NOW (not with a time delay, or a less effective version of help).

- Analogy: Even in health care, they don't do many RCTs in the emergency room.

So, the bundling of education and debt triage together in counseling delivery makes it tough to do large-scale RCTs.

In their absence, we are left to acknowledge self-selection and attempt to account for it with statistical methods

Three Studies: Consumer Benefits from the Credit Counseling Experience

- **Does the counseling experience alone (no subsequent DMP) positively impact a consumer's credit profile over time?**

  2007. Elliehausen, Lundquist and Staten, Journal of Consumer Affairs

- **Can technology-assisted counseling delivery (via the telephone; Internet) be as effective as traditional, face-to-face delivery?**

  2011. Barron and Staten, Working Paper 11-11, Federal Reserve Bank of Philadelphia

- **Does a counseling DMP repayment program lead to longer-term improvements in consumer credit profiles, beyond the initial counseling session(s)?**

  2011. Barron and Staten, TCAI Working Paper

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Initial Step: The Impact of Credit Counseling on Subsequent Borrower Behavior
(Journal of Consumer Affairs, 2007)

Issue: Does the counseling alone (no DMP product) have a positive impact on clients' subsequent borrowing behavior and credit profile?

Clients in sample:

- Insufficient income to qualify for DMP product
- Too much income, or appeared able to handle on own
- Qualified for DMP but didn't agree to start

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** CRC = Credit Research Center, Georgetown University*

Study Methodology

- 5 NFCC-member counseling agencies provided data on 14,000 clients counseled during 1997 (large majority was face-to-face delivery). All clients included, minus those who signed up for DMPs.
- Trans Union provided credit report and credit score data for each client at 2 points in time:
  - March 1997 (at time of counseling)
  - March 2000 (3 years after counseling)
- TU also provided data on a matched-sample comparison group of 100,000 borrowers who did not receive counseling
  - Same 1997 risk score range as counseled group
  - Same geographic location as counseled group

Outcome Variables (3 years after counseling)

Primary metric:

- **Client credit score (i.e., FICO score equivalent as a measure of overall creditworthiness and credit opportunities in the market)**

Supplemental metrics (from the credit report) directly related to counseling session discussions:

- **Number of accounts with positive balances**
- **Total debt**
- **Non-mortgage debt**
- **# bank cards with positive balance**
- **Bank card % utilization (across all accounts)**
- **Revolving debt**
- **Number of delinquencies**

Results of Evaluation Model
(after a self-selection correction procedure)

- **Counseling had a significant positive impact on an overall measure of a counseled borrower's creditworthiness—the borrower's risk score – compared to the risk scores of clients who were not counseled**
  - **Impact was greatest on borrowers with the lowest risk scores at the start (those with the least success at handling credit in the past)**
  - ***Illustration of economic significance:***

    For borrowers in the lowest 10th percentile of initial risk scores, the average score improvement over the next three years was equivalent to a 38 percent reduction in predicted likelihood of a bankruptcy or charge-off, as compared to un-counseled borrowers

Study #2: Efficacy of Technology-Assisted Delivery: Telephone, Internet

- Through the 1990s, in-person, face-to-face counseling was considered the "gold standard," BUT, it is much more resource intensive than phone or Internet counseling

- Many consumers strongly prefer the convenience of telephone or Internet delivery; <u>they won't seek counseling assistance otherwise</u>

- In times of severe financial distress (e.g., mortgage foreclosure crisis of 2007-2008), in-person counseling can't possibly keep up with demand

- But, telephone and internet counseling has heightened the skepticism of the IRS and other regulators regarding the educational value of a core counseling product: the DMP.

Project Objective

- Determine whether technology-assisted counseling (telephone; Internet) is associated with larger or smaller improvements in client financial circumstances, relative to traditional, face-to-face delivery

Sponsorship:

- Launched in 2004 as a partnership between Consumer Federation of America and American Express
- Ten participating agencies selected through a competitive application process

Primary Sample

- 60,000 clients received initial counseling in March and April 2003
- For each client, we have
  - Intake interview data from the counseling session
    - Up to 40 variables on client demographics, debts, assets, expenses, primary cause of financial problem
    - Session outcome and counselor recommendation
    - DMP details (when a plan was started)
  - Credit report variables (150+) and credit bureau risk scores at four points in time (2002, 2003, 2005, 2007)

Findings

- **Controlling for initial credit bureau info, initial credit scores, counselor experience, and counselor recommended action:**

  Delivery channel has no statistically significant influence on the client's delinquency risk score, measured four years after counseling

Study Three: Does DMP Participation Benefit Consumers?

Outcomes (dependent variables):

- Credit Score Improvement
- Incidence of Bankruptcy
- Debt Reduction

Observation Period:

- November 2007 to August 2010 (33 months, post counseling)

Data Sources:

- Five agencies again provided client and session outcome data on 29,000 clients counseled in Oct-Nov 2007, including nearly 3 years of DMP performance data
- Trans Union appended credit report and VantageScore data

Summary of Key Results

Among clients for whom the counselor recommends a DMP:

- **DMP starters look better after three years:**
  - Those who actually start a repayment program have **significantly higher credit scores and lower incidence of bankruptcy after 33 months,** compared to those who do not start.
  - A statistical selection-correction procedure => the **positive effect of DMP participation on credit scores and bankruptcy incidence is not due solely to sample selection.**
- **Time on plan and debt paydown increase with the amount of creditor reductions of interest rates.**

Summary of Study Attributes

Study attributes:

- Large samples (75,000 clients across 4 distinct samples, 15 agencies)
- Multiple time periods for counseling (spanning 1997 – 2010)
- Extended observation periods (one to four years, post counseling)
- Administrative data (no self reported data)
- Client demographics: we know a lot about individuals
- Matched sample comparison group or instrumental variables to deal with self selection
- Quasi-standardized treatment of clients

So What Do We Know? part 1

- Triage component of counseling appears to work: counseled clients "cure" (improve their credit-related profiles) faster than those who don't experience the treatment
- Does counseling change attitudes and habits? We really haven't quantified very well. But, credit profiles improve.
- Technology-assisted counseling (telephone; Internet) can be just as effective as face-to-face counseling in improving client credit profiles several years after counseling.
- The magnitude of creditor concessions is directly related to both client debt repayment and longer-term improvement in credit bureau profile

So, What Do We Know? part 2

- The many months of discipline associated with continued DMP participation, reinforced by agency follow-up contacts and educational messaging, appears to help clients improve their credit profile.
  - There **are client performance differences across agencies**, but we don't know enough about differences in agency procedures to link specific treatments to differential outcomes
  - But, the main message is this: the way that agencies handle clients seems to matter. Agency follow-up/ education services are not a commodity.

In this area there is great promise for future research

Opportunities for Future Research

Utilize Randomized Control Trial opportunities to determine how to design

- » Better products (e.g., less-than-full-balance DMP)
- » Better treatments (coaching; messaging; creative follow-ups; incorporate social networking)
- » New programs that expand client base (e.g., Borrow Less Tomorrow, aka BoLT)

Questions?

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