Issue Briefs

2009-5 Family Financial Education

UW Extension Cooperative Extension

Understanding the Role of Consumer Credit Counseling

There are dozens of nonprofit providers of consumer credit counseling in Wisconsin. Some are local agencies, others part of a national network. Some credit counselors work on 24 hour hotlines, others hold office counseling over regular business hours. Regardless of the format, however, financial educators need to understand the role of counselors as a complement to traditional educational programming. Counselors can help people manage acute problems and manage credit appropriately, including the use of specialized repayment strategies.

Functions of Credit Counseling

Credit counselors help lenders get over the so-called "creditor's dilemma" especially for consumers with multiple credit cards. Each creditor would likely benefit if they all the creditors could agreed to work out a debt repayment solution. Failure to come up with alternative payment options means it is likely all the creditors will lose more money. But no one lender has the incentive to offer a workout--the one lender who does make a deal will take a loss, while the other lenders will be more likely to be paid since the borrower has less to pay now. So every lender waits for the others to make a deal first. Credit counselors introduce a neutral third party who has proven credible for all the lenders involved. That counselor can negotiate a 'fair' deal for all the lenders collectively, making all lenders better off. The counseling agency develops a trusted relationship with creditors through repeated interactions where they prove their reliability.

For the consumer the counselor may also be a more trusted intermediary relative to the lender/creditor. The consumer may not be able to reveal their full budget and ability to pay to the lender for fear of provoking the lender to impose higher repayments. The consumer may feel they can disclose more information to the counselor compared to the lender. This results in fuller picture of the household balance sheet and budget and makes developing options more effective. A more honest and detailed accounting of income and expenses as part of a budgeting exercise can make lenders and the consumer better off by reassuring the lender that any negotiated settlement of debt was the best deal possible given the borrower's ability to pay.

Outgrowth of regional credit bureaus

Many consumer credit counseling agencies started as community nonprofits with names such as CCCS of "your town". CCCS stands for Consumer Credit Counseling Service and many agencies still use these names. As the name implies the agencies provide services related to budgeting and advice to people in trouble. These agencies began as outgrowth of local credit bureaus. Just as local bureaus have consolidated into large national agencies, CCCS agencies have also consolidated. Many have become national in scope and a few have even changed from nonprofit structures to for-profit enterprises.

National Foundation for Credit Counseling (NFCC), Inc.

Founded in 1951 the NFCC is a national membership organization that connects qualified nonprofit credit counseling agencies who are invited to become a member. NFCC is both a platform to connect nonprofit credit counseling agencies as a network and also a credentialing body which provides training and certification to agencies and individual counselors. Currently there are about 100 NFCC member agencies with 850 offices in the U.S. These agencies served over 3 million consumers last year.

Each NFCC member agency is identified by the NFCC member
seal:

NFCC maintains agency accreditation procedures and databases as well as a counselor certification program. NFCC is based in Silver Spring, MD and can be reached at (800) 388-2227, or at www.debtadvice.org.

In addition to NFCC credentials other designations agencies may have counseling certification from the Association for Financial Counseling Planning and Education (AFCPE) www.afcpe.org, NeighborWorks America (www.nw.org), the Council on Accreditation (COA) or the International Standards Organization (ISO).

Debt Management Plans

The primary tool of the credit counselor has historically been the voluntary debt management plan or DMP. This is the classic program designed to help a borrower organize multiple debts across multiple lenders to work out a repayment solution. Historically the counselor could re-negotiate bills due and result in a lower monthly payment and accelerated settlement of back debts. Some DMP plans involve the consumer making payments directly to the counselor each month--one simple check. Then the counseling agency divides the payment among creditors according to the initial DMP schedule.

The counseling agency receives a share of the repayment funds as compensation. Creditors used to return to the credit counselor about 12 percent of debt payments it helped to facilitate through DMPs. In recent years "fair share" payments have declined dramatically and are now as low as 3 percent. Meanwhile the costs of services have increased leaving agencies in a financial bind. Some credit counselors have suffered from issues of fraudulent use of funds. This triggered actions by the Federal Trade Commission (FTC) and a series of public education materials.[i]

This shift in the industry and resulting 'clean up' of credit counseling agencies with poor practices also helped accelerate consolidations of CCCS agencies, as well as many agencies renaming themselves and moving toward regional and national scale.

Critiques of Credit Counseling

While millions of borrowers have received help from credit counseling and the use of DMPs, the industry is not without dogged critics. Legal observers note that the DMP is a voluntary agreement and much less stringent than a consumer might receive through legal proceeding or bankruptcy. Counselors also fail to explore the root causes of the creation of the debt and are unlikely to detect or report issues of lender exploitation or fraud. One study shows that just 6 percent of credit counseling clients are referred to legal assistance while 35 percent are enrolled in a debt management plan (Michelle White, 1998). More recently agencies have been accused of engaging in overly aggressive marketing, including costly television advertisements. The costs of this marketing ultimately results in more direct to consumer fees or pressure to serve more clients with fewer program resources.

A report by the Consumer Federation of America suggested that another issue is counseling agencies are too focused on DMPs, saying ''multi-service agencies are a dying breed... The multi-service agencies are struggling to keep affordable counseling services for those consumers who are not enrolled in DMPs.'' As counseling agencies focus on fee generation and DMPs they may be less likely to offer general consumer education.

In recent years there has been a rise in debt settlement companies offering fee-based services. These agencies are not nonprofits and the companies aggressively advertise. This competition has spurred some counseling agencies to also spend more on advertising resulting in less differentiation between non-profits and for profit firms. Credit card issuers have exacerbated problems by working with fewer large scale agencies, and referring only the borrowers with whom they have the least prospect of finding a resolution. Critics suggest agencies too quickly push clients into poorly design repayment plans. As fewer consumers successfully complete DMPs or similar voluntary plans the value of counseling is weakened

Debt Settlement

Debt-management plans pay off owed balances in full, but with lower interest rates and lower cost terms. An alternative is to reduce the amount owed--typically through bankruptcy. But there is another option: debt settlement.

Debt settlement companies are generally for profit enterprises that negotiate debt workouts on behalf of consumers. These firms are controversial. The goal is less related to counseling and more toward writing off debt, often for a hefty fee. Some companies charge a percentage of the total debt, others charge a percentage of the debt savings and most incur an start-up fees and monthly charges. After set up clients pay a negotiated amount for years into an escrow account that the debt-settlement company manages. Firms may encourage tactics such as intentionally not paying some current bills to force negotiations with creditors. However, creditors will continue collections calls as debt settlement has no legal protections. Lenders can even sue the client for owed amounts and seek a judgment. Often debt-settlement companies offer no legal advice leaving the client to deal with the court alone.

In the last 5 years the Federal Trade Commission has begun cracking down on settlement companies, especially if they claim to be nonprofit agencies. Debt settlement is more damaging to credit scores than debt management. It is also important to remember that debt settlement will be taxed if it is more than $600. The Internal Revenue Service offers a waiver for that tax liability by filing Form 982, but it is not an automatic reduction and some people are shocked come tax time at just how much they owe.

Bankruptcy

Chapter 7: most unsecured debts written off, but have to sell some property.

Chapter 13: a three- to five-year plan to repay debts with little or no debt written off.

Homebuyer Education – HUD Certification

Since the explosion of foreclosures in the late 2000s, there has been a large increase in mortgage default counseling. This has resulted in a blurring of the lines between traditional credit counseling and housing counseling focused on mortgage debt. Most consumer credit counseling agencies have entered the housing counseling field and in fact many have provided housing counseling for years, but at a smaller scale. Since the 1970s the US Housing and Urban Development department (HUD) has supported counseling for consumers of rental and owner-occupied housing.[1] HUD support covers only a portion of costs and there are many restrictions on the use of HUD funds for counseling.

One of the biggest networks of HUD housing counseling is NeighborWorks America (nw.org) which provides training support and certification for agencies. HUD-approved counseling agencies often engage in the same budgeting and credit reviews that consumer credit counseling will perform. Agencies will typically refer clients to work with a mortgage lender or in some cases work collaboratively with the client and lender. Housing counselors may recommend credit counseling but will usually not set up a DMP at the same time as a mortgage default session. The homeowner's HOPE™ Hotline is one of the main ways people access these services (**888-995-HOPE™)** or the website for the Homeownership Preservation Foundation: http://www.995hope.org/

[1] See a Housing Counseling Program Description at: http://www.hud.gov/offices/hsg/sfh/hcc/counslng.cfm

Conclusions

As millions of households struggle with high debt, dropping incomes, and the aftermath of the recession of 2008-2009, credit issues are paramount. There are complicated issues of negotiating with lenders, technical legal details and specialized repayment options that community-based educators rarely will be able to address. But understanding that these services are available, and how to guide consumers to appropriate resources remains an important role for trusted professionals in the community.

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Facts for Consumers on Debt Management Plans: http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre38.shtm
and Facts for Consumers in Debt: http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre19.shtm

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The University of Wisconsin-Extension (UWEX) Cooperative Extension's mission extends the knowledge and resources of the University of Wisconsin to people where they live and work. Issue Briefs are an ongoing series of the Family Financial Education Team. This brief was drafted by J. Michael Collins, Assistant Professor in Consumer Finance and Extension State Specialist.