



Review of Briesch Debt Settlement Study: Economic Factors and the Debt Management Industry

“Today, millions of hardworking Americans are finding themselves imprisoned by debt. In response, a rogue industry has stepped in, offering consumers false hope, charging tremendous fees, and leaving them in a worse financial situation.”

“Our mission is clear: to hold unscrupulous businesses accountable; to rein in a renegade industry; and to ensure that people are not victimized when faced with financial hardship.”

**NEW YORK ATTORNEY GENERAL ANDREW CUOMO AS HE ANNOUNCED
NATIONWIDE INVESTIGATION INTO DEBT SETTLEMENT INDUSTRY, MAY 7, 2009.**

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Overview

Several prominent debt settlement companies have been touting a study conducted by Richard Briesch PhD, an Associate Professor with the Cox School of Business at Southern Methodist University. The study, “Economic Factors and the Debt Management Industry,” compared debt settlement programs (DSPs) sold by debt settlement companies with debt management programs (DMPs) offered through Consumer Credit Counseling Services (CCCSs). In this study, Dr. Briesch stated that “the consumer welfare analysis suggests that DSPs create the greatest consumer welfare of any approach” (Briesch, 2).

While the title suggested a study of the debt management industry, the study was actually focused on the debt settlement industry. The sole set of data used in the study was supplied by Credit Solutions of America, a leading debt settlement company. Dr Briesch acknowledged that the study “examines only a single company over a single time period” (Briesch, 23). The study was published only at www.creditsolutions.com at the time of our review, which led us to believe that the study was commissioned by Credit Solutions. The conclusions in the study heavily favored the debt settlement industry, an expected result considering that any debt settlement company would have a vested interest in such an outcome.

Six key findings are stated as a part of the study.

Study Findings

1. The first key finding of Dr. Briesch’s study was that accurate measures of consumer completion and cancellation cannot be calculated from the data (Briesch, 2). It is true that a comprehensive study on the success rates of debt settlement companies has not been published. Debt settlement companies do not readily release success rates, which would make such a study very difficult to conduct. However, there are measures of success that have been released by regulators of Credit Solutions and other debt settlement companies.

For example, when the Federal Trade Commission (FTC) shut down National Consumer Council, the court appointed receiver found that only 638 out of 44,844 consumers actually completed their settlement plans (FTC 2005). That is a completion rate of 1.4%. A calculation of a completion rate from the sole settlement company’s data used in this study (Credit Solutions) would have been equally possible. It is unclear whether Dr. Briesch was supplied with a complete set of data, since completion rate information is normally a closely guarded secret of debt settlement companies.

While completion rates were not provided, the cancellation rate was discussed. Additionally, the raw DSP cancellation rate (60% over two years) and the speculated cancellation rate (85% within one year) that were noted in the study are compared to mobile telephone and cable television companies rather than with CCCS organizations (Briesch, 2). Comparisons with cancellation rates of CCCS organizations should have been made since that was the stated intent of the study. Instead, DSPs were compared with 2 of the worst 5 industries for consumer complaints. According to the Council of Better Business Bureaus (BBB), mobile telephone companies led all consumer complaints in 2008, while cable and satellite television companies ranked fifth in complaints for all consumer categories (BBB 2008).

US BBB
2008 Statistics
Sorted by Number of Complaints

Industry Description	Complaints	Complaint Rank
Cellular Phones Service & Equipment	35,361	1
Auto Dealers-New Cars	26,723	2
Banks	20,935	3
Internet Shopping	19,186	4
Television – Cable, CATV & Satellite	18,020	5

* Source: Council of Better Business Bureaus

If the study lists a cancellation rate for DSPs of 85% within one year, then we are to assume that there were additional cancellations after one year. That would imply that the average DSP completion rate must be less than 15%.

The study stated that cancellation data could not accurately reflect value generated by the company because it did not contain information quantifying offers received or debt repaid (Briesch, 2). Basing value on the offers received by a customer is an intangible benefit, since no measurable benefit is received by the client unless a portion of debt is actually forgiven.

2. Dr. Briesch found that “the firm had mean, median and mode settlement offers at or below 50% of the original debt” (Briesch, 2). This finding was conditional on the consumer receiving an offer or settlement and completely ignores the least fortunate clients, defined as those that did not receive any offer whatsoever. Excluding those that received no settlement offers from this measurement produced flawed results that were heavily skewed in the favor of the debt settlement firm. A statement released by New York Attorney General Andrew Cuomo confirmed that results have been overstated. The firm supplying the data used in Briesch’s study, Credit Solutions (CSA) has been sued by Cuomo’s office. According to Cuomo’s statement, “CSA promised a sixty percent reduction in its consumers’ outstanding debt, but an average of one percent of consumers received that savings.” This finding represents the approximately 18,000 New York residents that enrolled with Credit Solutions between January 2003 and September 2008 (Office of the Attorney General of the State of New York, May 19, 2009).

Dr. Briesch added that his research “suggests that the firm is generating significant consumer benefits” (Briesch, 2). Once again, an offer is not a tangible benefit.

3. The study’s third finding was that tremendous value was generated by the company “as more than 57% of the clients have offers to settle at least 70% of their debt” (Briesch, 3). This finding still focuses on the perceived value of an offer rather than the tangible benefit of a completed offer.

4. Dr. Briesch was absolutely correct on his fourth finding. He stated that “the debt settlement company has an increasingly higher value to customers with higher account balances and higher total debt, but lower number of accounts” (Briesch, 3). Every debt settlement company that we reviewed for comparison required a minimum of \$10,000 in unsecured debt before providing

services. We can only assume that any percentage based fee system does not produce the desired profits on debts below this \$10,000 threshold. Also, a higher number of accounts would lead to a higher risk of the customer facing legal action. Therefore, a lower number of accounts could reduce the risk of judgments.

5. CCCS fees and payments for a consumer account were stated to possibly exceed 29% of the consumer debt once fair share payments are taken into account (Briesch, 3). If a 29% fee structure were an accurate representation of CCCS charges, such a fee would indeed be exorbitant. Fair share is a voluntary payment made by creditors to help support the educational and counseling programs of CCCS organizations. It is equivalent to a grant and may be commensurate to the volume of mutual clients. It is not paid by any client, and instead subsidizes the cost of such programs in such a way that clients pay less. Dr. Briesch suggests that fair share is a client fee. This is inaccurate since fair share is not paid by clients and many clients receive benefits through credit counseling while no fair share is paid. At any rate, fair share and charitable grants reduce client fees rather than to serve as an addition as Dr. Briesch has implied. Clients of CCCS benefit from these creditor subsidies to offset the cost of the program. Alternatively, DSPs are solely funded by customers.

Based on common industry practices for CCCS and debt settlement companies, an accurate analysis suggests that the above stated finding is grossly misleading. We examined actual fee estimates supplied by debt settlement companies. Some rounding in the following data has occurred to protect the privacy of actual clients.

An actual contract with United Debt Counseling estimated that a settlement of just over \$50,000 in debt could be made in 32 months. Assuming that the client successfully completed the program in that timeframe, they would have paid \$1,600 in monthly fees plus 35% of the savings. United Debt Counseling based their estimate on proposed offers of 60% savings. Accordingly, this client would have paid over \$10,500 as a percentage of the savings. When added to the \$1,600 in monthly fees, client fees total over \$12,100 to settle \$50,000 in debt.

This same client enrolled in a debt management program with Vision Credit Education following a counseling session that I personally conducted. Repayment was expected to take 58 months. Assuming the client successfully completed the program in that timeframe, they would have paid \$1,682 in fees over this period.

In this case, the debt settlement program cost was over \$10,400 higher than what the nonprofit credit counseling agency's plan would cost. This client was specifically chosen since actual contracts are on file from both the debt settlement company and the credit counseling organization. It should be noted that a \$300 termination fee is also specified by the debt settlement company whereas no such fee is charged by the credit counseling organization. Since the study concluded that cancellation rates for DSPs are at least 85%, most DSP clients would be charged that termination fee.

Another hidden cost also exists for the client who successfully completes a settlement program. Unlike the CCCS plan which repays debt in full, debt settlement plans are subject to taxation for forgiven debt. A client who successfully settles \$50,000 in debt for a 60% savings will receive Form 1099-C listing \$30,000 as "amount of debt cancelled." That \$30,000 is added to the

taxpayer's taxable income, which could result in an additional federal income tax liability of \$7,500 for a client in the 25% tax bracket, or \$8,400 for the 28% tax bracket. This client may have paid over \$19,500 in fees and taxes just to settle, versus an average of \$1,682 in fees when completing a program with a typical CCCS.

To be fair, United Debt Counseling makes a larger percentage of their fees for clients who actually successfully settle at least one debt. Most debt settlement companies including the one studied by Dr. Briesch have a much different fee structure that places more of the client fees on the front end of the settlement plan. Those companies are more likely to make money on unsuccessful clients.

A typical settlement plan for the client with \$50,000 in debt would result in approximately \$7,000-10,000 in debt settlement fees using the front-loaded fee structure. This is based on average DSP fees of "somewhere between 14 and 20 percent" that were used in the study. Based on the 2-4% set up fee range and estimated service fees of 15-25% that were listed in the study, this client may have faced \$1,000-\$2,000 in set up fees and \$7,500-\$12,500 in service fees (Briesch, 12). Based on these figures, total fees may have been between \$8,500 and \$14,500.

Since Credit Solutions' data was used in Dr. Briesch's study, we decided to estimate the fees that would have been paid by this client according to that company's fee structure. Credit Solutions reportedly charged 15% of the total debt balance according to an ABC News Nightline report on July 24, 2009 (Hinman and Leamy). Their fee calculation as 15% of total debt would mean that this client would have paid \$7,500, most of which would have been charged upfront.

We concluded that Dr. Briesch's fifth finding was unsubstantiated and inconsistent with readily available industry figures. The documentation that we reviewed also contradicted the implications of that finding.

6. Dr. Briesch found that reasonable upfront fees by DSPs should be allowed. He cited that DSPs generate value and incur expenses. Most striking was his finding that "this fee structure is similar in nature to the one used by CCCS, attorneys and other service providing firms (Briesch, 3). Based on the figures provided in this study, upfront fees would have been \$1,000-\$2,000 for a settlement plan (2-4% of the debt balance). The average CCCS setup fee mentioned in the study was \$25 (Briesch, 11). I certainly disagree that \$25 is comparable to \$1,000 or more.

An upfront fee of around \$2,000 could be comparable to a bankruptcy attorney's fees. However, some Chapter 13 plans allow for the attorney to collect fees monthly rather than all upfront. Raleigh, NC-based bankruptcy attorney John T. Orcutt advertises a "Debt-Buster" bankruptcy plan where a client may pay an upfront fee of less than \$390 according to his website. Of that, \$274 was a filing fee, not an attorney fee (Orcutt).

Sam Gerdano, executive director of the American Bankruptcy Institute was quoted by CNN Money in a 2005 report about increasing bankruptcy fees. According to Gerdano, a typical Chapter 7 filing cost about \$1,000, and a Chapter 13 filing would start at a base of \$2,500 (Sahadi 2005).

Our conclusion is that there is some truth to the bankruptcy attorney comparison for upfront fees. However, the comparison between CCCS and DSP upfront fees is grossly improper and dramatically contradicted by the very figures supplied in the study.

The finding that Dr. Briesch found most important was that CCCS and debt settlement companies “increase consumer welfare over the alternative of the consumer paying off their debt using a fixed payment of 2% of their original debt every month.” He went on to state that “DSPs increase consumer welfare much more than CCCSs when the payments can be made over three years instead of five years for CCCSs” (Briesch, 5). No substantiation was made for how DSPs were found to create greater consumer welfare.

We concluded that this finding is based on claimed welfare, not actual benefits received by clients. This finding also ignores the negative welfare or consequences of DSPs. These include high fees, increased risk of legal action, increased borrowing costs and other negative repercussions of ruined credit. The resulting credit damage can cause denials of rental applications, higher insurance costs, denials of life insurance applications and even reduce employment options.

Study Recommendations

Dr. Briesch did make recommendations for regulators of debt relief providers.

1. The first recommendation was for relief of litigation and calls from creditors when the client was making satisfactory progress in accredited DMPs (Briesch, 5). While this sounds like a noble recommendation, it may not have much of an effect. Clients who make satisfactory progress in a DMP do not normally face litigation or calls. Dr. Briesch did not suggest that the same protection be afforded to clients making progress in a DSP.
2. Dr. Briesch also recommended that DSPs be able to “set up trust accounts for their clients that have very specific limitations on disbursements (i.e., approved payments to creditors, approved fees to DSPs, payments to consumers for cancellation or new hardships, etc.)” (Briesch, 5). DSPs already have in-house trust accounts. As these in-house accounts are difficult to police, external trust accounts would certainly be preferable. Consider the Hess-Kennedy fiasco in which thousands of account holders had to apply for refunds through a court appointed trustee. That firm and related businesses were shut down due to fraud. Assets of Hess Kennedy and the related companies had to be seized in order to partially repay those who put their faith in the settlement company.
3. Briesch’s third recommendation is to “require full disclosure of all fees consumers directly or indirectly (e.g., “fair share” payments, grants from creditors, etc.) pay” (Briesch, 5). This is an excellent suggestion until you examine the types of payments that he feels consumers make. He makes no mention of informing a client that their fees could total \$12,000 or more through DSPs. What he implies is that a grant or fair share received by a CCCS organization is a consumer fee. A consumer fee is an amount paid by a consumer for a service. Fair share payments and grants from creditors are not consumer fees. They actually offset much of the cost of DMPs and fund additional educational efforts, thereby reducing client cost. Even so, CCCS organizations do readily disclose both verbally and in their client agreements that many creditors voluntarily

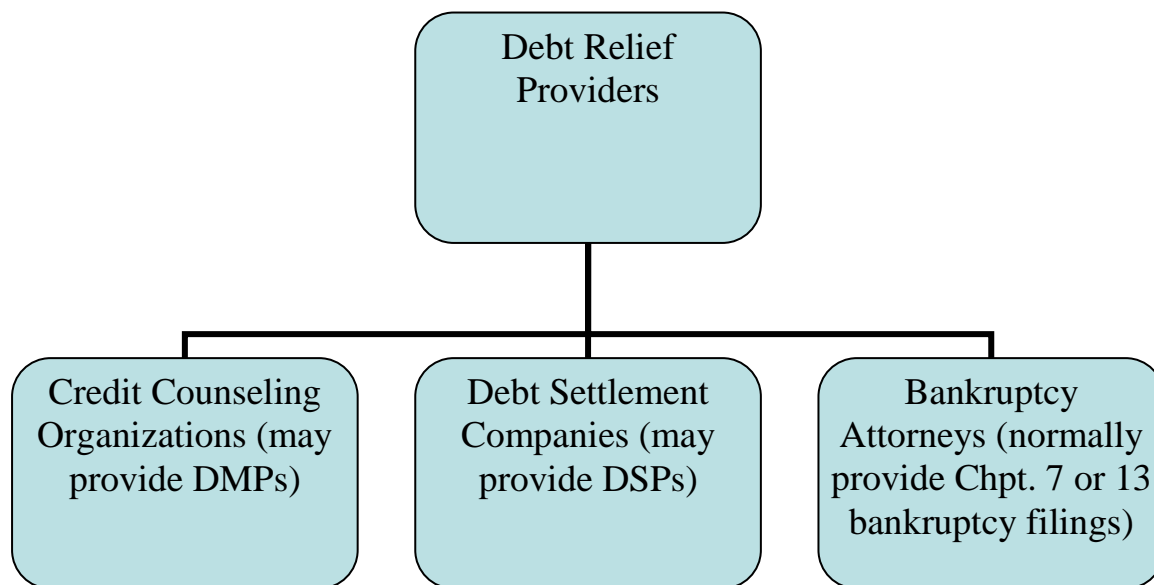
provide financial support. DSPs on the other hand do not receive fair share payments or grants from creditors to support their programs, leaving DSP customers to fund 100% of the cost of such plans plus the marketing and profits of DSP companies.

4. The final recommendation was to “provide guidance of how companies can accurately measure program effectiveness” (Briesch, 5). We agree completely. If consumers were educated on the actual success rates of various debt relief providers, they would be able to make much better choices. To answer his question, receiving offers for all enrolled debt do not constitute program completion. Paying off all debt according to the terms of the DSP would constitute program completion, as does paying off all debt according to the terms of a DMP. Otherwise, a CCCS could claim program completion just by gaining creditors’ acceptance of repayment terms and without any payments actually made. Completion must be tied to actual repayment of debt.

Current Economic Climate

The study focused heavily on the deteriorating financial situations of millions of households. It cited increases in bank charge offs and unemployment as evidence of economic recession. The economic climate of the late 2000s is formally accepted as a recession, and the study does confirm that the economic climate is one of financial turmoil.

The study incorrectly classifies services that provide debt reduction as debt management programs (Briesch, 7). Debt management is a service that assists with improving credit ratings, reducing interest and other fees while building healthy consumer habits. Debt settlement is a service that negotiates lower payoffs on delinquent and defaulted debt. This blurring of the line contributes to the confusion of consumers, regulators and the media alike. The following chart shows the correct classification of debt relief providers:



A further blurring of the line has occurred with the introduction by JPMorgan Chase of newly available benefits through CCCSs known as the “less than full balance” (LTFB) option, or 60-60 rule as referenced in the study (Briesch, 2). This option is not readily encouraged by many

CCCSs though due to the lack of similar programs by other creditors and the negative consequences (negative credit rating) to the client that can result. These are some of the same types of negative consequences that normally result from a DSP, with the exception that litigation would not result from acceptance of such a plan through CCCS. Briesch identified this blurring of the line as “making a stronger case for the strong value of DSPs to consumers” (Briesch, 11). However, he fails to acknowledge that DSPs were not gaining prior approval for a LTFB plan in order to prevent judgments. Furthermore, DSPs would have to slash their fees in order to bring them in line with CCCSs if they were to be taken seriously as a strong value.

Overview of Consumer Alternatives

Case-by-case hardships were mentioned as one alternative that clients may pursue to handle their own debt repayment strategy. These are sometimes possible for clients who can prove that a damaging life event qualifies them for such assistance, yet they expect to be able to exit the hardship plan within six months.

The possibility of lawsuits was also examined, and falls within the description of what Robert Hall calls “Informal Bankruptcy” (Hall, 12). Briesch stated that there exists a dilemma in which even though creditors might collectively be better off by working with account holders, that a single creditor might benefit more by “initiating legal judgments to be the first one in line” (Briesch, 9). Indeed an updated study submitted to the FTC by The Association of Settlement Companies (TASC) stated that “in terms of number of clients receiving a lawsuit on at least one account, we found a range from 6% to slightly over 10%, with most reporting around 7%” (TASC, 2).

Briesch made positive recommendations that could improve debt settlement programs. External trust accounts (Briesch, 13) would be preferable to having clients send in monies directly to the settlement company. While not specifically mentioned in the study, the current stockpiling of money from so many clients invites fraud and embezzlement. This risk can be compounded by the comingling of large amounts of funds for such long periods of time. DSPs could reduce this risk to clients by requiring authorization by the client to release funds from the account. However, such an agreement would still be subject to the release of exorbitant fees that is currently standard in DSP contracts.

Also protection from creditors was mentioned as a valuable recommendation to improve the chances of clients completing DSPs. Again, any protection from creditors would likely not be granted to DSP clients as long as debt settlement company fee structures retain their vastly excessive costs. Clients who seek to avoid legal action should either select a program that allows them to get back on track with monthly payments to their creditors or gain legal protection from creditors with the assistance of a licensed attorney familiar with bankruptcy filings.

Finally, Briesch identified that DMP and DSP clients can still be adversely affected by creditor calls (Briesch, 13). What was not identified was that DSP clients will be subject to a substantially higher volume and frequency of calls on average due to their lack of prior plan acceptance by creditors. DMP clients however notice dramatic reductions in calls on average as a majority of their creditors accept DMP terms.

Analysis of Data

An analysis of data was completed in order to determine the consumer welfare received by DSP clients. Frequency and amounts of settlements were compared with the frequency and amounts of offers.

Our conclusion is that the analysis is seriously flawed since it only examines a subset of data supplied by a single debt settlement company. Furthermore, the data specifically excludes clients who did not receive at least one settlement offer. There cannot be any reasonable conclusion drawn from the analysis since it does not examine comprehensive data supplied by multiple providers of DSPs and DMPs. Furthermore, no audit of the data is available to confirm that it is accurate and complete. There is no way to confirm that the random sampling of the firm's data was truly random. A truly scientific study would have required validation of data before it was examined. As evidence of a lack of this validation, all 6 of the findings contain the word "seem" or "implies" rather than stating concrete conclusions.

Calculation of Consumer Welfare

Briesch concluded as a result of his consumer welfare analysis that "DSPs create the greatest consumer welfare of any approach" (Briesch, 2). This analysis "only examines a single company over a single time period and does not contain educational measurements or other behavioral measurements after the clients exit the program" (Briesch, 23).

The consumer welfare analysis specifically ignores:

- True completion rates
- Long-term client success
- Benefits of educational and counseling activities
- The financial cost of debt relief options
- Litigation risk comparison between debt relief options
- Short and long-term impact on credit scores, including the impact on future borrowing costs

While some of these components may be difficult to obtain accurate figures for, there are enough documented studies that have been published as a result of proper research in which some acknowledgment could have been made of these other components. The conclusion that DSPs created the greatest welfare ignored the most important measures of success, and instead focused primarily on the proportion of debt repaid for those who actually did receive offers to settle. If that reduction in debt was the most important metric involved in calculating consumer welfare, then bankruptcy would have been found to have provided greater consumer welfare than DSPs even without considering the higher costs for DSPs.

Conclusion

While referred to as a study, the white paper “Economic Factors and the Debt Management Industry” fails to examine a proper set of data in order to make appropriate determinations of efficacy of debt relief options. It prematurely and improperly promotes DSPs as the preferred option for debt relief. When consumer protection agencies and other regulators are asked about DSPs, the almost unanimous response is that debt settlement companies do not keep their promises, charge high fees and are rarely if ever the best choice. We tried to find one single reputable study that comes to similar conclusions of this study and none could be found. What we did find was another study that similarly was only found on Credit Solutions’ website that also heavily favored debt settlement.

Our impression of this study was that Briesch did a phenomenal job of trying to legitimize what New York Attorney General Andrew Cuomo characterizes as a “rogue industry” (Office of the Attorney General of the State of New York, May 7, 2009). By omitting the majority of important factors from consideration and by studying a very limited set of data, Briesch was able to supply Credit Solutions and every other debt settlement company with an official-looking study that touts debt settlement companies as the best providers of debt relief. However, we have highlighted the limitations of this study, many of which were identified by Dr. Briesch, and provided evidence that directly and substantially contradicts the study conclusions.

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Boy Scouts of America, Baltimore Area Council, Executive Committee
Columbia Forum, Board of Directors
Columbia Foundation, Board of Directors
Columbia Festival of the Arts, Board of Directors & Founding President

Mid Maryland Private Industry Council
Howard County Economic Advisory Council
The Columbia Bank, Community Advisory Committee
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Kenneth Long is President of Fiscal Progress, Inc. as well as President and Vice Chairman for Vision Credit Education, Inc. He serves as a regional coordinator for the North Carolina Saves campaign. Long is also a co-founder of the Wake EITC Coalition.

Long is a graduate of the University of North Carolina at Chapel Hill with a B.A. in Industrial Relations. He subsequently received his Certificate in Nonprofit Management from Duke University.

Long has achieved the Accredited Credit Counselor and Accredited Financial Counselor certifications through the Association for Financial Counseling, Planning and Education. Long originally achieved the Certified Credit Counselor designation through the National Institute for Financial Education. Long is also a Certified Housing Counselor with training received through The Association for Housing Counseling.

In addition to years of nonprofit leadership, Long has been an innovator in the field of volunteer tax return preparation programs. He assists volunteer associations and nonprofit organizations who seek to integrate credit counseling and asset-building programs with free personal income tax preparation. His approach to using free credit reports as both an incentive and a screening tool for placement into asset-building programs has been shared with members of the National Community Tax Coalition, the EITC-Carolinas Initiative of MDC, Inc. and nonprofit groups across the Carolinas.

EXPERIENCE

Vision Credit Education, Inc., Chapel Hill, NC 2005 – present
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