M E M O R A N D U M

January 14, 2008

To: Observers and Other Interested Persons
From: Michael M. Greenfield, Reporter, Uniform Debt-Management Services Act
Subject: Action of Standby Committee

During the process of enacting the Uniform Debt-Management Services Act in Colorado and elsewhere, trade associations representing entities that provide credit-counseling and debt-settlement services urged legislators to make changes in the Uniform Act. Last spring the Uniform Laws Commission agreed to convene the Act's Standby Committee to consider the desirability of making changes to the Uniform Act. The Commission scheduled a meeting for November 17-19, 2007, and in advance of that meeting received submissions from several Observers, including:

American Association of Debt Management Organizations (AADMO)
The Association for Debt Settlement (TASC)
United States Organization for Bankruptcy Alternatives (USOBA)
Cambridge Credit Counseling (CCC)
CareOne Services (COS)
Money Management International (MMI)

After the meeting the Conference received submissions from
Association of Independent Consumer Credit Counseling Agencies (AICCCA)
Carl Felsenfeld (representing Cambridge Credit Counseling)
Credit Advisors Foundation (CAF)

The Standby Committee considered each of the submissions received before the meeting and heard presentations at the meeting from each of the Observers mentioned above, as well as numerous other representatives of credit-counseling agencies and debt-settlement companies.

The proposed changes fall into several not-entirely discrete categories: provisions of the Act that are alleged to be difficult or impossible to comply with; provisions that are alleged to represent sub-optimal policy; and provisions that are alleged to be poorly drafted. The Standby Committee responded most favorably to proposals in the first and last categories. In all, the Committee has recommended more than twenty changes to the Act. It has transmitted those recommendations to the NCCUSL Executive Committee for further action, which is expected in due course. This memorandum describes the actions of the Standby Committee. A companion document to this memorandum is 2005 Final Act with Changes Recommended by Standby Committee in 2008, which contains the full text of the Act (and comments), showing the changes recommended by the Standby Committee.

The Act requires providers to obtain insurance that has certain characteristics, but providers have found it difficult or impossible to obtain insurance with those characteristics. Several Observers urged that the required insurance be permitted to have a deductible, variously proposing that it be $5,000, $10,000, and 5% of the provider's net worth. The joint submission of TASC/USOBA recommended permitting a single nationwide policy of $1,000,000 instead of $250,000 per state. MMI had a less drastic proposal to reduce the amount of insurance, to $50,000 per state. (Under the TASC/USOBA proposal, if every jurisdiction were to adopt the Act, the proposed requirement would entail the equivalent of less than $20,000 per jurisdiction.) AADMO objected to the requirement that the insurance be payable to the state, because insurers will not write that policy. AADMO and TASC/USOBA both objected to the requirement that the insurance not be subject to cancellation without the permission of the administrator. And several observed that not all entities that rate insurance companies use an A-B-C system.

Proposals reducing the amount of insurance would weaken the protection the insurance is designed to provide, and the Committee did not embrace either of them. The Committee has, however, recommended that the Act's insurance requirements be modified in the following respects:

- to permit a deductible of up to $5,000
- to require that the insurance be payable *for the benefit of* the state and its residents, instead of payable *to* the state and its residents
- to permit ratings of insurance companies to be provided by any rating agency approved by the administrator
- to change the cancellation provision from requiring the permission of the administrator, to requiring notice to the administrator

These changes appear in each of the sections that describe the requisite insurance (§§ 5(b)(4) (initial registration), 11(b)(5) (renewal of registration), 14(a)(1) (alternative to the required bond)).

In connection with obtaining registration to do business, the Act requires a provider to supply numerous items of information. Among this information is a criminal-records check, including fingerprints. This information comes from a third party, and the timing of the receipt of the information is beyond the control of the provider. Observers noted that this may result in undue delay in completion of an application for registration (or renewal of registration). In response, the Committee has recommended that the applicable sections (§§ 9(b) (initial registration), 11(b)(4) (renewal of registration)) be amended to give the administrator the discretion to permit temporary registration when there is excusable delay in obtaining the criminal-records information.

AADMO, TASC/USOBA, as well as AICCCA and MMI (in submissions that were nearly identical to each other), suggested eliminating the fingerprint requirement, or at least narrowing the group of persons for whom a provider must obtain a criminal-records check. The criminal-records report is required for persons who are "authorized to access the trust account." In response to a concern that this would require the criminal-records check on every employee who could view the account, the Reporter will add language to Comment 5 and Comment 13 that clarifies that "authorized to access the account" means "authorized to initiate transactions in the account."

In addition to persons who have access to a trust account, the criminal-records check is required as well for every officer of a provider. The rationale for extending the requirement beyond those with access to the trust account is to help give the administrator a basis for confidence that the provider will comply with all the requirements of the Act (see § 9(b)(4), to be renumbered 9(c)(4)). Consequently, the Committee does not recommend any change to the group of persons covered by the criminal-records-check requirement.

Section 28(a)(14) prohibits a provider from representing that it is a not-for-profit or tax-exempt entity unless it is properly operating as a not-for-profit entity. AADMO urged the Committee to delete this prohibition because it may force a provider to defend against a too-easily-made allegation that it is not properly operating as a not-for-profit. The Committee believes that this risk is overstated, in part because the burden of establishing a violation of the prohibition is on the person asserting the violation. More importantly, the Committee believes that a provider that seeks to benefit from representing that it is a not-for-profit or tax-exempt entity must stand up to that representation, at least with respect to representations by which a provider seeks to attract business or project an image. Since not all representations are made to the public, the Committee has recommended amendment of section 28(a)(14) to confine the prohibition to representations that are designed to reach the individuals a provider seeks to serve. With respect to representations made in other contexts, the Act would not subject the provider to liability (though other law might).

TASC/USOBA urged the Committee to create a new category of employee, certified debt specialist, to differentiate debt-settlement employees from credit-counseling employees. The Committee decided to recommend this change, adding a new definition to section 2(6). The definition parallels the definition of "certified counselor." The Act would then impose identical duties on debt-settlement providers as on credit-counseling providers, but debt-settlement providers would discharge those duties through the services of certified debt specialists rather than certified counselors. To implement this change, the Committee has recommended amendments to:

- section 6(9) (to require that in the application for registration the applicant who is a debt-settlement provider must supply evidence that its counselors are certified debt specialists)
- section 16 (to require that a debt-settlement provider make certified debt specialists available for telephone consultation)
- section 17 (to require that a debt-settlement provider furnish education and financial analysis through the services of a certified debt specialist)

Section 9(b)(1) (to be renumbered 9(c)) requires the administrator to deny registration if the proper fee is not submitted. AADMO presented the example of an applicant for registration who submitted an application fee that, unknown to the applicant, had recently been increased. Though the Committee was skeptical that any administrator would act on an application without first giving the applicant an opportunity to submit the proper fee, it has recommended that this requirement of mandatory denial of registration be dropped. The requirement in section 9 actually is duplicative of section 4, which makes payment of the (correct) fee a prerequisite to registration.

The Act requires certain disclosures in advertising (§ 30) and before a provider enters an agreement with an individual (§ 17). These disclosures are in the nature of warnings, and the Act requires the same disclosures of both credit-counseling providers and debt-settlement providers. Some of the disclosures are accurate for one type of provider but not the other. Therefore, the Committee has recommended changes in those two sections to enable each kind of provider to make disclosures that are accurate for its business model. AICCCA/MMI alleges it is impractical for a credit-counseling provider to make all the required disclosures in a Yellow-Pages ad, but, as revised, section 30 requires credit-counseling agencies to add but a single sentence, 15 words.

Section 19 requires a provider to notify an individual when a creditor rejects concessions proposed by a provider. AADMO and TASC/USOBA both described the back-and-forth negotiation process that typically occurs when a provider communicates proposals to a creditor. Asserting that a counterproposal necessarily is a rejection of the proposal that preceded it, they said it was unrealistic and counterproductive to require a provider to inform an individual of every counterproposal (i.e. rejection) by a creditor. In response, the Committee has recommended that section 19(d)(3) be amended to require that provider notify the individual only upon a creditor's "final" decision to reject a proposal.

These Observers, along with AICCCA/MMI, suggested several changes to the portions of sections 17 and 19 that require a provider to supply certain information before forming an agreement with an individual and in the agreement itself. They asserted that the provider cannot know which creditors will respond to a proposal and on what terms. The Act, however, requires the provider to supply this information only to the best of the provider's belief (§ 17) or the best of the provider's reasonable belief (§ 19). The rationale for the disclosure requirement in these sections is to prevent the individual from being misled as to the extent to which the agreement with the provider will be addressing the individual's problems. If the provider does not provide this information, then the individual is being asked to "sign here, just trust me to take care of you." The Committee is not comfortable with this situation. TASC/USOBA argued for change because a debt-settlement provider cannot know which creditors ultimately will assent to a settlement. To repeat, however, these sections only require honest, reasonable conduct on the part of the provider. And to the extent a debt-settlement provider advises an individual to cease paying his or her bills, a change in these disclosure requirements is even less desirable. The Committee decided not to recommend any change to the disclosures in sections 17 and 19.

Section 28(a)(10) prohibits compensation of employees on the basis of a formula that uses the number of individuals they induce to enter plans. This is designed to remove any incentive to form plans without regard to whether the plan is appropriate for the individual and whether the individual is likely to complete the plan. COS was concerned that the prohibition might be interpreted to prohibit compensation on the basis of the number of individuals who complete plans. This latter compensation scheme is not inconsistent with the language of the Act, and the Reporter will add language to Comment 7 to validate the practice.

To better implement the original intent of the Act, the Committee recommends several changes in the language the Act. The Act contains provisions that are stated to be applicable either to "agreements" for debt-management services or to debt-management "plans." The quoted terms are defined terms and apply to both credit counseling and debt settlement. The term “plan,” which requires a schedule of payments by the individual, does not encompass a debt-settlement program in which an individual makes a single lump-sum deposit at the outset of the program. To bring this business model within the coverage of several additional provisions of the Act, the Committee has recommended that the term “plan” be replaced by the term “agreement” in sections 4(d), 17(d) and (g), 18(d)(2) and (f)(1), and 28(a)(5)(B)(i).

The Act recognizes the distinction between a tax-exempt entity and a not-for-profit entity. Unfortunately, especially in light of the diminishing number of tax-exempt providers, the drafting made it impossible for a state to restrict registration to entities that are not-for-profit but not tax exempt. The Committee has recommended revision of section 5(b) and the Legislative Notes to that section, to refine the choices available to states that adopt the Act. Several Observers urged the Committee to eliminate the option of restricting registration to not-for-profit or tax-exempt entities, especially in light of the activities of the Internal Revenue Service, but the Committee believes that the matter should be left to each state for decision.

Section 20 gives an individual a right to cancel an agreement for three days after it is formed and requires the provider to give a standard-form disclosure of this right. The required disclosure does not accurately reflect the provider’s obligation to refund fees, so the Committee has recommended revision of the language to correct this drafting error. Some Observers apparently believe that the individual must use a certain form if he or she wishes to cancel. The Act imposes no such requirement, and any manner of record notice suffices. The individual need not use the form that the provider is required to supply. Note also that the provision in section 20 requiring refund of all fees applies only with respect to the cancellation during the three-day period. Though the individual may terminate the agreement at any time (see § 19(d)(1)), section 20 does not address the question of refund of fees when the termination occurs after the three-day window closes. That matter is governed by section 19(d)(1).

TASC/USOBA observed that section 22, describing the trust account that certain providers are required to maintain, could be interpreted to mean that a provider holds in trust money that it receives as fees for its services. This was not the intent of the section, and the Committee has recommended a rearrangement of the language to avoid this interpretation.

In addition to the foregoing proposals on which the Committee acted favorably, Observers have made dozens of other suggestions. The most far-reaching is a change in the fee caps. For credit-counseling providers, AADMO and AICCCA/MMI proposed increasing the set-up fee from $50 to $75 or $100 and changing the monthly service fee from $10 per creditor to “a reasonable fee” with a floor of $20 per month. The Committee notes, however, that the Act contains a provision for annual adjustment of dollar amounts to reflect inflation. The Committee received no evidence that providers are unable to comply with the limits stated in the Act. AICCCA/MMI and CAF observe that many providers reduce or eliminate fees based on the individual’s ability to pay and the only way they can do this is if they are able to capture the expenses of serving these individuals through the fees charged other individuals. The Committee encourages this service but is apprehensive of the likelihood that some providers will charge the maximum fees to all individuals with little or no relief for those who cannot pay. It decided not to recommend changes in these fees.

For debt-settlement providers, the Act caps fees at 30% of the savings achieved by the provider (as measured by the excess of the initial debt over the settlement amount). TASC/USOBA urged that the cap be 20% of the final amount of debt in a plan and payable during the initial period of the plan. They would provide, however that the fee would be adjusted at the back end when necessary to prevent the aggregate of amounts paid to creditors and to the provider from exceeding the principal amount of debt covered by the agreement. The Committee decided not to recommend these changes either. It continues to believe that the basis for calculating a fee should be the amount of debt at the outset of an agreement. That is the debt the individual brings to the provider. Any increase in the amount of that debt may be a result of advice given by the provider and should not result in an increase in compensation. To incentivize the provider to achieve the best possible settlement, the Committee believes that the compensation should be measured by the settlement savings, i.e. the benefit provided. And given the relatively high risk that, for whatever reason, there ultimately will be no settlement, the Committee believes that the compensation should come primarily after the provider has produced the benefit to the individual. Nevertheless, the Act recognizes and accommodates a provider’s need for cash flow by providing for a set-up fee and a monthly service fee, both of which are to be credited against any settlement amount that the provider has earned. The Committee has received no information that leads it to change these underlying principles governing compensation caps.

AADMO and AICCCA/MMI proposed changes in several of the remedies provisions, specifically, the minimum damages of $5,000, compensation for non-pecuniary harm, the size of the administrative civil penalty, treble damages for violating the fee cap, and liability for unintentional violations. The Committee considered the rationale for each of these provisions in its drafting of the Act and has received nothing to indicate the desirability of changing its conclusions. The basic purposes of the remedies are to provide compensation for actual injury and to provide incentives to compliance even if noncompliance causes little or no easily provable actual injury to an individual. As to liability for "technical" violations, the Committee notes that section 35 provides a defense if a violation is unintentional and occurs even though the provider has maintained reasonable procedures designed to prevent the violation. The remedies provided in the Act are consistent with remedies provided in other consumer-protection legislation.

AADMO proposed that the Act be limited so as not to encompass debt-management services in connection with business debt. As drafted, the Act applies only to acting as an intermediary between an individual and his or her creditors. Though not defined in the Act, "individual" means a natural person, not a business entity. Compare the definition of "person" (§ 2(12)).

Section 28(b)(7) prohibits a provider from selling products not directly related to debt-management services. AADMO and COS proposed relaxing this so that providers may offer beneficial products (such as memberships in wholesale clubs and tax-preparation services). They suggested that other products be available so long as the provider secures the separate assent of the individual. The policy underlying the prohibition is prevention of deception, inducing individuals to purchase items of little value or items that they do not realize they are purchasing. The suggested solution has been tried under the Truth-in-Lending Act with respect to the ancillary purchase of credit insurance, and it has been a miserable failure, as recognized by the Federal Trade Commission. Sales practices override any separate-signature requirement, and contracts continue to be packed with credit insurance. The Committee is unwilling to replicate this failed approach and declined to recommend any relaxation in the ban.

Section 28(d) prohibits a provider from receiving compensation for education or counseling, other than for counseling required in connection with a government-sponsored program. AADMO and AICCCA/MMI proposed lifting this prohibition. Education and counseling are part of the services mandated by section 17(b) before a provider supplies debt-management services and for which a provider receives a fee under section 23(c)-(d). If the educational services go beyond the minimum required, section 23(c) gives the administrator discretion to grant the provider permission to impose an additional charge. If there is never any agreement between the provider and the individual, the provider may charge for educational services (§ 23(d)(4)). The Committee does not believe any change in these provisions is desirable.

Section 3(b)(2) provides an exemption from the Act for entities that do not receive compensation for their services, either from individuals or their creditors. AADMO and AICCCA/MMI sought to broaden this exemption to encompass entities that receive compensation only from creditors. As revealed in the comments to section 3, the exemption is designed to cover family members, social workers, or others who assist individuals in paying their bills without compensation for that assistance. Anyone providing debt-management services on a large-scale basis is likely to be managing large sums of money, and the Committee believes they should be subject to the trust fund and other regulations of the Act.

AADMO proposed shortening the period for which a provider must retain records (§ 27(c)), correctly noting that the period may be as long as ten years (five years after the end of a plan, which may last as long as five years). The statute of limitations (§ 37(b)) for an action by the administrator is four years, and the Committee believes it is appropriate for the provider to retain records until the expiration of the statute of limitations. See the comment to that section. Addressing the burden of retaining records, section 27(c) explicitly permits retention in electronic form.

Since debt-settlement providers typically do not hold funds of their customers, TASC/USOBA proposed that the bond requirement and several other prerequisites for registration not apply to debt-settlement providers. These requirements, however, are not limited to concern about the trust account. Rather, they serve the broader purpose of enhancing the likelihood of compliance with the Act. The bond is available as a source of compensation for injury caused by any violation of the Act, not just injury caused by misconduct in connection with a trust account. Therefore, it is an appropriate requirement for debt-settlement providers. Similarly, the rationale for the requirement of audited financial statements (§§ 6(a)(11), 11(b)(3)) and information about a provider's board of directors (§ 6(6), (15), (16)) and compensation of officers (§ 6(17)) is not limited to protection of the trust account. Rather, as with the criminal-records check, it extends to providing the administrator with a basis for confidence that the provider is capable of and is likely to comply with all the provisions of the Act.

Several Observers expressed concern about their ability to make some of the disclosures required in order for a provider to obtain registration or renewal of registration. For example, section 6(10) requires a description of the provider's three most commonly used education programs. This does not mandate that a provider use at least three such programs, and a provider that uses only one or two complies with this disclosure requirement by disclosing information about the one or two. Similarly, section 11(b)(6) requires disclosure of the total amount of money a provider received pursuant to plans during the preceding year. As Comment 4 (to be renumbered 5) suggests, a provider that receives no money pursuant to plans need only disclose that fact.

Sections 19(e) and 28 (a)(2)-(3) permit a provider to obtain a power of attorney authorizing it to settle a debt on behalf of an individual for up to 50% of the principal amount of the debt, which is defined as the debt at the inception of an agreement for debt-management services. The Act prohibits a provider from settling for more than 50% of this amount unless the provider secures the individual's consent at the time of the settlement. TASC/USOBA proposed enlarging this power of attorney to permit settlement for up to 50% of the amount of the debt at the time of the settlement. This is consistent with their focus elsewhere on the size of the debt at the time of settlement. The Committee, however, continues to believe that the appropriate time for applying the 50% limit (and other limitations) is the inception of the agreement, not the time of settlement.

Several Observers (CCC, COS, Felsenfeld) have urged the Committee to create special provisions for what are known as 60/60 plans. These are arrangements fostered by the Bankruptcy Code, which calls for a reduction in the allowable amount of a creditor's claim if the creditor unreasonably refuses to negotiate an alternative repayment schedule proposed by an approved credit-counseling agency on behalf of a debtor. The plans get their name because the offer must be made at least 60 days before the filing of the bankruptcy petition and must provide for payment of at least 60% of the debt in monthly installments (typically over 60 months). These plans resemble the plans traditionally offered by credit-counseling agencies in that they call for periodic payments to a provider, which forwards payments to the creditors. They differ from traditional debt-management plans because the 60/60 plans call for full satisfaction of the debt upon payment of something less than the full principal amount of the debt. To that extent, 60/60 plans resemble debt-settlement plans, and that is how the Act treats them.

The Observers suggested treating 60/60 plans as credit-counseling plans or carving them out for separate treatment altogether. None of the Observers, however, supported the request with persuasive reasons. One Observer objected to being stigmatized as a debt-settlement provider and argued that if the Act treats providers of 60/60 plans as debt settlement, a provider would not be able to offer those plans in states that permit credit counseling but prohibit debt settlement. This fear is unfounded, because no state can dictate how another state treats 60/60 plans. The classification under this Act, once adopted by a state (State A), should have no effect on how 60/60 plans are treated under the law of a state that has not adopted the Act (State B). The law of State B would determine whether a 60/60 plan is, for purposes of State B, to be treated as debt settlement or credit counseling.

With respect to the Act, all providers, be they debt-settlement providers or credit-counseling providers, are under the same obligation to provide counseling and budget analysis. All providers are required to make disclosures, which differ only slightly depending on whether the provider is a credit-counseling entity or a debt-settlement entity. All providers are obligated to use contract forms that observe the Act's provisions on mandatory terms and prohibited terms. None of the Observers has persuasively suggested any reason why 60/60 plans should not be treated as debt settlement. The Committee has not been persuaded to recommend any change in treatment for 60/60 plans.

The various submissions of Observers contained numerous other proposals. The Reporter has read and considered each of them. So have individual members of the Committee. The Committee as a whole considered as many of them as time permitted, but was not able to review all of them at the November meeting. Of the additional proposals it considered, the Committee decided not to recommend adoption. Of the proposals that the Committee did not have time to consider at the meeting, most are drafting suggestions of the kind considered during the drafting of the Act in 2003-05. They are less appropriate for consideration by a standby committee, whose charge is less plenary than the charge to a drafting committee.

The Committee extends its appreciation for the efforts of all the Observers who made recommendations to improve the Uniform Act and to all who invested the time and resources to attend the meeting.