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MEMORANDUM

November 11, 2003

To: Consumer Debt Counseling Drafting Committee
From: Michael Greenfield
Subject: Proposed Legislation by NCLC/CFA

To follow up on their report last April, the National Consumer Law Center and the Consumer Federation of America are engaged in drafting a model bill to regulate consumer credit counseling agencies. I just received a Summary of the contents of that proposal, which is not yet ready for release. The author requested that I have it distributed to members of the Committee.

SUMMARY OF NATIONAL CONSUMER LAW CENTER (NCLC) AND CONSUMER FEDERATION OF AMERICA (CFA) RECOMMENDATIONS FOR DEBT MANAGEMENT AND DEBT SETTLEMENT LAW

November 2003

As documented in the April 2003 report by the National Consumer Law Center and the Consumer Federation of America, “Credit Counseling in Crisis”, the primary abuses in the credit counseling industry are:

- Deceptive and misleading practices,
- Excessive Costs, and
- Abuse of Non-Profit Status.

Many, but not all, of these problems are exhibited by a new generation of credit counseling agencies that aggressively sell debt management plans and harm consumers with improper advice and deceptive practices.

We believe that greater regulation of this industry as well as the debt settlement industry is necessary to curb abuses. New laws should be focused on “fixing” key problems. Gaps in existing laws, such as state unfair and deceptive acts and practices (UDAP) and credit repair laws, allow abuses to occur without effective recourse for consumers.

In addition to these underutilized and rarely enforced existing laws, there is a critical need to enact new laws specifically aimed at preventing abuses in the credit counseling marketplace. Below is a summary of the key provisions that we believe must be included in new laws. We will have specific language for these proposals available soon. **Please note: This document is an outline of NCLC/CFA recommendations. It is not exhaustive and is subject to change as we draft specific language for these proposals. In addition, although we believe that new regulation should cover debt management and debt settlement services, this outline mainly addresses debt management issues. We are still in the process of developing more detailed recommendations to deal with abuses in the debt settlement industry. We also understand that NCCUSL has not yet decided whether it will address debt settlement issues.**

SCOPE:

The law should apply to all agencies, organizations and persons who engage in debt management services (as defined by the law to include agencies that receive money from consumers for the purpose of distributing funds to a consumer’s creditors in partial or full payment of obligations) and debt settlement (as defined to include agencies that assist consumers in obtaining debt forgiveness or in restructuring debt). Limited exemptions may be allowed only for attorneys performing their duties as attorneys rather than as debt management or settlement providers, banks involved in certain activities to assist

customers and escrow agents. There should be no exemption due to an agency's non-profit or tax-exempt status.

Non-profit agencies that offer debt management and debt settlement services must comply with all state and federal laws regulating non-profits and tax-exempt organizations. We reiterate the strong recommendation in our report that the I.R.S. and state charity regulators improve and increase enforcement of these existing laws.

We also recommend very limited exemptions from certain provisions of the law for agencies that do not charge consumers for services. For example, agencies that do not charge any fees (including both mandatory and voluntary fees) may be exempted from certain record keeping requirements.

REGISTRATION AND BOND REQUIREMENTS:

We do not believe that an onerous licensing requirement is advisable. Without proper enforcement resources, extensive licensing requirements will most likely unfairly burden legitimate organizations, particularly small agencies.

We recommend a limited registration system requiring an agency to register as a debt management or debt settlement provider in each state where it is doing business. Only agencies that are properly registered may perform services in that state. States may charge reasonable fees for registration. At the time of filing for registration, all agencies will be required to furnish a cash or surety bond. There should be a uniform minimum and maximum bond amount requirement with the actual amount determined based on agency size and other relevant criteria.

DISCLOSURE PROVISIONS:

Consumers should receive clear, streamlined disclosures that will alert them to areas of greatest possible abuse. In no event should disclosures be considered as a substitute for substantive regulation.

The following written disclosures should be given to consumers before initial enrollment for any service with the agency:

- Percentage and amount of funding the agency receives from creditors (as defined).
- Disclosure of any other financial arrangement the agency has with any lender or other provider of financial services.
- Disclosure of the various types of services offered by the agency.
- A statement that debt management and debt settlement plans are not suitable for everyone and that consumers can request information about other options, including bankruptcy. **(This disclosure must appear in all advertisements as well).**

- A statement that debt management and debt settlement plans do not include secured debt, including a brief description of the most common types of secured debt such as mortgages and car loans.
- Existence of the surety bond.
- Statement that the agency cannot require donations. **(This statement must appear in all advertisements as well).**

The following disclosures should be given to all consumers before initiating debt management or debt settlement services:

- Full disclosure of all services to be provided and any up-front and ongoing fees to be charged for services (“**fees**” includes both mandatory and voluntary fees).
- An estimate of the length of time required to complete services, the types of concessions offered by major creditors, and estimated amounts of concessions throughout the entire period of the plan.

WRITTEN CONTRACT REQUIREMENTS:

Written contracts must be provided to all consumers enrolling in debt settlement or debt management plans. The agency may not begin performance of any services until the consumer signs the written agreement and is provided a copy. In addition, if the transaction is negotiated in a language other than English, written translations in that language must be provided.

All contracts must contain a right to cancel without obligation within a prescribed period of time after initial enrollment. A separate notice of the right to cancel must be provided at the time the contract is signed.

Agencies must promptly notify consumers if any creditor refuses the proposed plan or requires a monthly payment higher or lower than the payment disclosed in the initial agreement.

All contracts must include a mutual cancellation provision allowing either party to cancel with proper notice at any time with no further obligation. The consumer has the right to receive a refund of any and all fees not yet expended by the agency at the time of cancellation.

All contracts must include a full disclosure of services to be provided and all fees that will be charged. The initial contract must include a full list of creditors to be included in the plan and an estimated schedule of payments, including amount of payments and due date. The contract must also state that debt management and debt settlement plans do not

include secured debt, including a brief description of the most common types of secured debt such as mortgages and car loans.

ADDITIONAL PROVISIONS

Suitability: Before enrollment in any debt management or debt settlement plan, each consumer must be evaluated to determine his/her suitability for the plan. An agency may only initiate services with consumers who have a reasonable ability to make the payments required by the plan. In order to make this assessment, agencies are required to evaluate the consumer's household budget, including types and amounts of debt.

Counselor Qualifications: Only counselors certified by an independent accreditor may provide debt management or debt settlement services.

Fee Limits: Agencies may not impose any fees other than those described in this law. **"Fees" include aggregate fees collected from the consumer including mandatory charges and any other "voluntary" fees.**

The fee limits described below apply to debt management services. We will develop separate fee limit proposals for debt settlement.

- Agencies may not charge more than \$50 for an enrollment, up-front or consultation fee. Monthly fees, if any, must be reasonable. (**Note: In the current market, we believe that agencies should charge no more than a reasonable percentage of the consumer's monthly debt payment and in any case no more than \$25/month. The fee should be considerably lower for consumers with relatively small amounts of debt**). Charging a first month's consolidated payment as an enrollment or up-front fee is prohibited.
- If fees are charged for any services other than debt management and debt settlement, these fees must be reasonable.

In addition to the above fee limits, the following provisions apply to both debt management and debt settlement services:

- Agencies must promptly remit all consumer payments to creditors as required in the debt management or settlement plan.
- Agencies must not commingle trust accounts established for consumers with operating accounts.
- Agencies must hold all funds received from or on behalf of consumers in separate trust accounts.
- Agencies have an explicit fiduciary duty to consumer clients.

- Agencies must have meaningful consumer education alternatives available and must inform all consumers of these options.
- Consumers have the right to receive account status information upon request. Regardless, agencies must send summary information about accounts on a regular basis. Agencies must keep consumer account information confidential and share only with the consumer.
- Agencies must ensure that protections are provided for consumers who sign up for services electronically and/or pay by electronic transfer.

Record Keeping: All agencies will be required to keep records listing, among other data, the numbers of consumers on debt management or debt settlement plans, the total amount of debt for each consumer, the length of the plan, and numbers of consumers who dropped out of plans, reasons for withdrawal, and records of fees charged to consumers, including both mandatory and voluntary fees received. Agencies that charge no fees for services will be exempted from certain record keeping requirements. Records must be submitted as a condition of annual re-registration with the appropriate state agency. All records must be retained for a minimum of six years.

PROHIBITED PRACTICES:

- False and/or deceptive advertising is prohibited.
- Agencies are prohibited from paying referrals to customers who bring in new customers.
- Agencies are prohibited from purchasing debts from consumers and other third parties.
- Agencies may not make loans to consumers. Agencies may not profit in any way or receive any compensation from referring consumers to lenders and other creditors.
- Agencies may not compensate employees or contractors based on any formula that provides commissions or incentives tied to the numbers of consumers enrolled in debt settlement or debt management plans.

REMEDIES

- Any contract not in compliance is void and unenforceable.
- Consumers have a private right of action to enforce the law, including provision for actual damages, treble or appropriate statutory damages, attorney's fees, and injunctive relief.

- Any violation is also a violation of the state UDAP law.
- Public enforcement actions and penalties are also provided.
- Consumer waivers are invalid.