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MEMORANDUM

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To: Observers and Others Interested in the Uniform Debt-Management Services Act
From: Michael Greenfield, UDMSA Reporter
Subject: Proposed Revisions and Request for Comments

In 2005 the National Conference of Commissioners on Uniform State Laws adopted the Uniform Debt-Management Services Act to regulate those who provide debt-management services. In October 2010 the Federal Trade Commission amended its Telemarketing Sales Rule, bringing the business of debt-management services within the scope of the Rule. Several of the provisions of the amended Rule are inconsistent with provisions in the Uniform Act, and to that extent the Rule preempts the Act. For states that may be considering whether to enact the Uniform Act, it would not be wise to adopt a law that will be preempted at the time of enactment. For states that already have enacted the Uniform Act, it is desirable to modify the preempted provisions and make the Act consistent with federal law. These concerns prompted the Standby Committee for the Uniform Act to recommend that the Conference approve amendments to the Act at its annual meeting in July 2011, to eliminate the inconsistency with federal law. This memorandum explains the proposed amendments and is accompanied by a red-lined draft of the Act showing those amendments. The Standby Committee welcomes your comments and suggestions, which will be most helpful if received by March 10.

The FTC regulation imposes rules in three areas:

(1) required disclosures;
(2) a ban on receipt of compensation before the consumer has received a demonstrable benefit; and
(3) regulation of trust accounts.

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The disclosure requirements in the FTC Rule are not identical to those in the Act, but it is possible for a provider to comply with the requirements of both the Rule and the Act. The Standby Committee believes the Act's disclosure requirements remain sound, and therefore it is not recommending changes in the Act's disclosure requirements. The Committee is, however, recommending amendments to the Act in connection with the timing of compensation and in connection with trust accounts.

With respect to fees, the changes are prompted by the FTC's ban on advance fees. The principal change, for all providers, is with respect to timing. No change would be made to the Act's fee caps, but Section 23(d)(2) would be rewritten, to prohibit the collection of any fees before the consumer and at least one creditor have agreed to a modification of a debt and the consumer has made a payment toward satisfying the modified terms of the debt. For credit-counseling entities, this would preclude receipt of fees until a consumer has made a payment pursuant to a plan that has been accepted by the consumer's creditors. Until then, a provider would not be permitted to receive a set-up fee or a monthly service fee. The limits on the amount of the set-up and monthly service fees would not be changed.

For debt-settlement entities, Section 23(d)(4) would not permit collection of a set-up fee, because the set-up fee is an advance against the total fee and is banned by the FTC Rule. For the same reason, the amended Act would not permit collection of monthly service fees. A provider would be able to receive a settlement fee (subject to the 30% cap) on the same basis that a creditor receives the amount of its settlement. If the consumer is paying a creditor the agreed settlement amount in one lump-sum payment, the provider may receive its entire settlement fee for that debt at the same time the creditor receives the settlement. If the consumer is paying the settlement in installments, then the provider may receive its settlement fee in the same number of installments and in the same ratio that each payment to the creditor bears to the total settlement amount to be paid that creditor. For example, if a settlement agreement calls for the consumer to pay a creditor $4,000 in four installments of $1,000, the provider may receive one-fourth, but no more than one-fourth, of its total settlement fee at the time of each payment to the creditor. If the settlement agreement calls for the consumer to pay installments of $1,000, $1,000, and $2,000, the provider may receive no more than one-fourth of its settlement fee when the first payment to the creditor is made, one-fourth when the second is made, and the remaining half when the third payment is made.

Concerning trust accounts, Section 22 would be revised to remove the provider from the administration of a trust account. Subsection (c) would require that the person administering a trust account not be the provider or an affiliate (defined in Section 2) of the provider. Other changes in Section 22 would make the Act consistent with the FTC Rule, and the section would be slightly reorganized.

The Federal Trade Commission Act does not apply to not-for-profit entities, and so the Telemarketing Sales Rule does not apply to not-for-profit entities that provide debt-management services. The Uniform Act differs, as it applies to both for-profit and not-for-profit entities. One of the basic principles of the Uniform Act is that there should be a level playing field for all who provide debt-management services. The Standby Committee therefore concluded that the proposed amendments to the Act should apply to not-for-profit entities as well as for-profit entities.

In addition to the changes prompted by adoption of the federal law, the Standby Committee is recommending three others:

(1) more explicit regulation of lead generators;
(2) abandonment of the optional language by which a state adopting the Act may bar for-profit entities from providing debt-management services; and
(3) reorganization of the provisions on termination of an agreement to provide debt-management services and the refund obligations that ensue.

Lead generators have been the focus of several enforcement actions by the FTC pursuant to its general authority under the FTC Act and by attorneys general under their state laws. To resolve any doubt whether lead generators are regulated by the Uniform Act, the amendments propose a definition of "lead generator," and modify Section 31, which proscribes deception, to cover lead generators.

At the time the Uniform Act was being debated and drafted, it was a controversial question whether for-profit entities should be permitted to provide debt-management services, and the Conference decided that the decision should be left to each state. That controversy has abated: every state to have enacted the Uniform Act has permitted for-profit entities. The same is true of states that have enacted or revised their non-uniform legislation. The Standby Committee is not aware of any state that since 2005 has acted to bar for-profit entities from providing debt-management services. This consistent pattern has prompted the Standby Committee to recommend removal of the language in the Uniform Act by which states could limit the debt-management-services business to not-for-profit entities.

Provisions authorizing the unilateral termination of an agreement appear in Sections 20 and 26. A refund obligation appears in Sections 20, 22, and 26 and is stated in differing terms. To unify the treatment of these topics, the right of a provider to terminate and the right of a consumer to terminate are to be consolidated in Section 20. That section also states the refund obligation. Section 22 (regulating the trust account) continues to contain a refund obligation on the part of the person administering the trust account.

A brief catalog of the proposed amendments follows. It presupposes familiarity with the amendments to the FTC's Telemarketing Sales Rule.

- Section 2: addition of a new definition, "lead generator," and renumbering of the succeeding paragraphs; revision of the definition of "trust account," to relocate the substantive limits on trust accounts to section 22;
- Sections 4, 5, and 9: deletion of language by which states could implement a decision to ban for-profit entities from providing debt-management services;
- Section 19: (d) deletion of requirement that an agreement provide for a right of termination by the individual, along with the consequences of termination, because those matters are to be governed by Section 20; (e) modification of the provisions on powers of attorney, to conform to the FTC Rule;
- Section 20: completely rewritten to (1) eliminate the 3-day right of cancellation and return of all advance fees, because the FTC Rule prohibits the receipt of advance fees and (2) consolidate the provisions for termination by the individual (which had been in Section 19) and termination by the provider (which had been in Section 26);
- Section 22: revised in content, to conform to standards of the FTC Rule, and reorganized in structure;
- Section 23: (1) to conform to the FTC's ban on advance fees, deletion of the provision permitting a debt-settlement entity to collect a set-up fee and monthly fees; (2) revision of subsection (d)(4) to permit a debt-settlement company to receive compensation on the same schedule that a creditor receives the money that settles a debt; (3) revision of the timing rules to permit a credit-counseling entity to receive a set-up fee and a monthly fee only when the individual starts making payments in the plan;
- Section 26: emptied of all content, this section is now "Reserved";
- Section 28: revision of subsections (a)(2)-(3) to conform to the new limitations (in Section 19(e)) on the use of powers of attorney; amendment of subsection (a)(7) to include lead generators within the prohibition against paying referral fees to a person that has a stake in the outcome of the debt-management services resulting from its referral;
- Section 31: addition of a new subsection to prohibit lead generators and others who supply a provider with services from engaging in an unfair, unconscionable, or deceptive act or practice;
- Section 34: expansion of subsection (b)(4) to authorize the Administrator of the Act to take action against a provider when a lead generator, person administering a trust account, or person to whom a provider has delegated its duties refuses to cooperate with the Administrator;
- Section 35: deletion of subsection (e), dealing with the remedy in the event of a provider's failure to comply with the individual's three-day right of cancellation, because the right of cancellation has been eliminated;
- Throughout the Act, changes in language and cross references, to conform to the changes described above.