

OVERVIEW

Sunrise Analysis: Debt-Management Service Providers

Report No. 08-04, February 2008

Summary

In House Concurrent Resolution No. 46, the 2007 Legislature requested that the Auditor conduct a “sunrise” analysis of House Bill No. 184, which proposes to regulate debt-management service providers operating in Hawai‘i. The Hawai‘i Licensing Reform Act (Chapter 26H, Hawai‘i Revised Statutes) requires that bills proposing the regulation of previously unregulated professions or vocations be referred to the Auditor for sunrise analysis prior to enactment. The Auditor is to assess whether the proposed regulation is necessary to protect the health, safety, or welfare of consumers and whether the regulation is consistent with other regulatory policies in Chapter 26H. In addition, the Auditor must examine probable effects of the proposal and assess alternative forms of regulation.

Debt-management service providers seek to help consumers in financial trouble resolve their debts without resorting to bankruptcy. Generally there are two types of providers: *credit counselors*, who operate as non-profits, provide consumers with budget counseling and assistance in paying off debts over time; and *debt settlers*, who operate for a profit, help consumers consolidate and manage debts by facilitating agreements with creditors to settle for less than the full amount of the debt. The latter are banned in Hawai‘i under Chapter 446, HRS. The regulation of both professions has been promoted since 2005 by the National Conference of Commissioners on Uniform State Laws (NCCUSL) via its Uniform Debt-Management Services Act.

House Bill No. 184 is modeled after NCCUSL’s uniform act. The bill proposes to repeal Chapter 446, HRS, and regulate both credit counselors and debt settlers by requiring that they register with the Department of Commerce and Consumer Affairs (DCCA). To register, an applicant must, among other things, pay an application fee; obtain a security bond; maintain a trust account that can be inspected on demand; and disclose a variety of information regarding business and employees’ names. Applicants must also provide audited financial statements; copies of all consumer agreements and disclosures; criminal background checks; and evidence of insurance, accreditation, and not-for-profit and tax-exempt status if applicable. Penalties and recourse are also provided by the bill.

We found that the public’s welfare is at risk due to the nature of the services provided to consumers. The kind of abuses in the consumer debt management industry include agencies that: engage in misleading and deceptive practices; charge excessive fees; steer consumers into debt consolidation plans only, instead of offering debt and budget counseling; abuse their non-profit status by virtually functioning as for-profit businesses; and fail to abide by telemarketing laws. Fourteen consumers have filed complaints with the DCCA Office of Consumer Protection against two debt-management services providers in Hawai‘i, and



12 out-of-state, since 2000. While the Better Business Bureau of Hawaii has received one official complaint involving a billing/collection issue over a three year period, it has received 1,323 inquiries about credit and debt counseling services and 250 inquiries about credit-debt consolidation services over the same period.

Chapter 446, HRS, is not robust enough in today's climate to protect consumers in Hawai'i from credit counselors. Among the 48 states that regulate debt-management service providers to varying degrees, there are 22 states like Hawai'i with stand-alone laws that do not require active state regulation of credit counselors. Debt-management service providers are also regulated by a number of national organizations, but membership is all voluntary.

We concluded that the regulation of debt-management service providers in Hawai'i is warranted. The nature of debt-management services provided by credit counselors and debt settlers, whether operating as non-profit or for-profit entities, poses potentially serious risks to the welfare of consumers who are already in financial trouble. Existing federal and state laws are inadequate in protecting against unscrupulous practitioners who may operate under the guise of a non-profit organization; and banning for-profit debt settlers from operating in Hawai'i only limits consumers' choice of services. And although the estimated cost of administering the regulatory program is high and could make the entry of debt settlers operating for a profit less viable, the uniform act imposes sufficient restrictions to protect the consumer from bearing these costs.

Recommendations and Response

We recommended that both non-profit and for-profit entities be regulated as proposed in House Bill No. 184 provided that changes recommended by the NCCUSL as provided in Appendix A are taken into account and adopted prior to enactment.

The DCCA does not agree that House Bill No. 184 should be enacted. The department maintains that the bill will not provide enhanced protection to consumers but could result in a weak, possibly unfunded and under-staffed program that throws open the henhouse to the consumer predators in the industry. Instead, the department recommends that Chapter 446, HRS, be kept in place and that the antitrust provisions of Chapter 480, HRS, and unfair and deceptive trade practices provision under Section 481B-12, HRS, be used to continue to respond to the occasional consumers complaints against credit counselors operating as non-profits.

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