Sunrise Analysis: Debt-Management Service Providers

A Report to the Governor and the Legislature of the State of Hawai‘i

Report No. 08-04
February 2008

THE AUDITOR
STATE OF HAWAI‘I

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai‘i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.

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Hawai‘i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

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OVERVIEW

Sunrise Analysis: Debt-Management Service Providers

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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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Submitted by

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Foreword

This “sunrise” report on debt–management service providers was prepared in response to a provision in the Hawai‘i Regulatory Licensing Reform Act, Chapter 26H, Hawai‘i Revised Statutes, that requires the Auditor to evaluate proposals to regulate previously unregulated professions or vocations.

In House Concurrent Resolution No. 46 of the 2007 legislative session, the Legislature requested an analysis of House Bill No. 184 that proposes to enact the Uniform Debt-Management Services Act developed by the National Conference of Commissioners on Uniform State Laws. This evaluation, conducted by Rachel N. Hibbard, consultant, presents our findings and recommendations on whether the proposed regulation complies with policies in the licensing reform law and whether a reasonable need exists to regulate debt-management service providers to protect the health, safety, or welfare of the public.

We wish to express our appreciation to the Department of Commerce and Consumer Affairs and other organizations and individuals that we contacted during the course of the evaluation.

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Chapter 1

Introduction

This report on the proposed regulation of providers of debt-management services responds to a "sunrise" provision of the Hawai'i Regulatory Licensing Reform Act—Chapter 26H, Hawai'i Revised Statutes (HRS). The sunrise provision requires that, prior to enactment, legislative bills proposing the regulation of previously unregulated professions or vocations be referred to the State Auditor. The Auditor must assess whether the proposed regulation is necessary to protect the health, safety, or welfare of consumers and is consistent with other regulatory policies in Chapter 26H, HRS. In addition, the Auditor must examine probable effects of the proposed regulation and assess alternative forms of regulation.

House Bill No. 184 of the 2007 legislative session proposed to enact the Uniform Debt-Management Services Act (the uniform act) developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL). The Legislature requested an analysis of this proposal in House Concurrent Resolution No. 46 of the 2007 legislative session. The purpose of the uniform law is to provide guidance to and regulation of the debt counseling/settlement industries. It is a comprehensive statute that regulates providers of credit counseling and debt settlement services to Hawai'i consumers by requiring, among other things, good faith practices, registration with the Department of Commerce and Consumer Affairs, a surety bond, a toll-free communication system, disclosures in advertising, prerequisites for providing goods and services, and penalties for non-compliance. House Bill No. 184 would also repeal Chapter 446, HRS, which prohibits for-profit debt adjusters, who act as intermediaries between a debtor and creditor, from doing business in Hawai'i.

Background on Debt-Management Service Providers

Debt management services generally cover two broad types. One type of service provides consumers with budget counseling and assistance in paying off debts over time. These services are provided by *credit counselors*. The other type of service helps consumers consolidate and manage their debt by facilitating agreements with creditors to settle for less than the full amount of the debt. These services are provided by *debt settlers*. The general objective of both types of services is to help consumers resolve their debts without resorting to bankruptcy.

House Bill No. 184 (the uniform act) covers both types of services. The bill defines *debt-management services* as "services as an intermediary between an individual and one or more creditors of the individual for the purpose of obtaining concessions," but does not include legal services provided by a licensed attorney, accounting services provided by a certified public accountant, or financial planning services provided by a licensed financial planner.

"Debt management" encompasses two distinct services

The debt-management services described in the uniform act cover two separate occupations: credit counseling and debt settlement. Each has its own methods for assisting consumers in financial distress and its own business model.

Credit counseling

Credit counselors help consumers learn to budget, enroll them in debt management plans (DMP) where appropriate, and forward consumers' money to creditors. The goal of a debt management plan is to help a consumer repay the full amount owed to creditors, generally within 50 months, through small but regular payments. Consumers forward their entire repayment contribution to a credit counselor, who then disburses it to the appropriate creditors. Creditors often give concessions to consumers, such as reducing interest rates or forgiving late fees, in return for these steady repayments, however small they may be.

Credit counselors earn their money by receiving "Fair Share" payments from creditors and charging fees to consumers. Fair Share revenue is a percentage of the amount repaid to a creditor. Historically, the Fair Share amount ranged from 12 to 15 percent of the consumer's monthly repayment, but in recent years has dropped to less than 6 percent. Fees to consumers typically include establishment fees and sometimes monthly maintenance fees. Credit counselors operate almost exclusively as non-profit tax-exempt organizations, in part because many states, like Hawai‘i, prohibit "debt adjustment" activities except where performed by non-profit organizations.

Debt settlement

Debt settlers, on the other hand, act as go-betweens for consumers and their creditors. They negotiate with creditors to settle debts for less than the full amount owed; consumers then save their money until a lump-sum payment can be made to all creditors and the debt is satisfied. When payment occurs, creditors consider the debt to be either "settled for less than full amount," "paid," or "settled." Unlike credit counseling agencies, debt settlement companies generally do not control a consumer's funds. Debt settlers also earn their money through charging fees to consumers; but unlike credit counseling agencies, debt settlement companies are organized exclusively as taxable, for-profit entities.

History and background of the professions

Debt settlement is a practice that has occurred almost as long as debt has existed. However, "credit counseling" as currently used has been going on since the 1950s, and today's style of debt settlement became prevalent in the late 1980s.

Credit counseling

The first credit counseling agencies were created in 1951 with the advent of the National Foundation for Credit Counseling (NFCC), which was established to promote financial literacy and help consumers avoid bankruptcy. The NFCC initially began as a collection agency for Sears, J.C. Penney, and other major creditors to help recover money lost to bankruptcy.

Another major credit counseling organization, the Association of Independent Consumer Credit Counseling Agencies (AICCCA), was founded in 1993 to promote industry-wide standards of excellence and ethical conduct. AICCCA members favored telephone delivery of debt management programs, a business model which is now used widely in the credit counseling industry, via the internet.

The third and largest national organization, which serves both credit counselors and debt settlers, is the American Association of Debt Management Organizations (AADMO). AADMO's mission is to promote and ensure the continued operation and viability of credit counseling and debt management organizations, which include: consumer counselors, personal finance educators, credit and debt information publishers, debt pooling organizations, debt negotiators, debt adjusters, credit counselors, and consumer lawyers.

Membership in these national organizations is voluntary, and membership standards differ. There are currently over 1,000 credit counseling organizations across the country.

Debt settlement

Although lenders have been practicing debt settlement for thousands of years, the modern debt settlement model emerged in the late 1980s and early 1990s. Its impetus was the unprecedented level of consumer debt following bank deregulation. In the wake of loosened lending practices and the economic recession that followed, banks were forced to write off more and more consumer debts. In an effort to recoup these debts, banks established debt settlement departments to negotiate a reduction of outstanding balances with consumers. In this way, banks hoped to recover at least some of their funds, which would otherwise be lost entirely if the consumer became bankrupt. Settlements generally ranged from 25 to 65 percent of the outstanding balance.

In the 1980s and early 1990s, third-party debt settlement became popular but was conducted on a commercial (not consumer) level. By the late 1990s, consumer debt reached an all-time high and a number of debt-settlement companies, many of them unscrupulous, sprang up in a short period of time, attracting scrutiny by the Federal Trade Commission. Negative publicity in the industry prompted some of the more ethical entrepreneurs from the commercial industry to establish more reputable companies to negotiate debt settlement for consumers.

Debt settlers have several national organizations that support and promote their interests. The International Association of Professional Debt Arbitrators (IAPDA), established in 2000, provides industry training and certification of debt settlement practitioners. The United States Organization for Bankruptcy Alternatives (USOBA), created in 2004, supports the debt settlement industry and develops standards and best practices. The Association of Settlement Companies (TASC) was established in 2005 to fight "unfair and ambiguous debt management legislation" in Texas, and has since expanded to encompass all 50 states.

Current regulation of debt-management service providers

Debt-management service providers are not actively regulated in Hawai'i, although Chapter 446, HRS, prohibits "debt adjusting" by for-profit persons or organizations.

As discussed further in Chapter 2, most states have laws concerning some aspect of debt-management. Like Hawai'i, many states have stand-alone laws that do not require active regulation. Only two states have no legislation covering debt-management services. Just over half of all states actively regulate a variety of debt-management service providers by requiring registration, certification or licensure. Four states have enacted the Uniform Debt-Management Services Act (UDMSA), and four (including Hawai'i) have introduced it for legislative consideration.

Proposal To Regulate Debt-Management Service Providers

House Bill No. 184 of the 2007 Regular Session mirrors the Uniform Debt-Management Services Act (UDMSA) developed by the NCCUSL in 2005. Although almost every state has some legislation pertaining to debt adjusting, debt management, debt pooling, debt settlement, and credit counseling, statutes vary considerably in their scope and content. The UDMSA is the first national effort to provide uniform laws governing both credit counseling and debt settlement services.

Impetus for the Uniform Debt-Management Services Act

According to NCCUSL, the history of debt counseling and management services is checkered with numerous abuses and statutory efforts to counter such abuses in many states. Debt management service providers have been criticized for their efforts to steer debtors away from bankruptcy when it may have been more advantageous and less costly for debtors to file for bankruptcy. Many states, like Hawai‘i, prohibit for-profit debt management services, but permit non-profit debt counseling services. A continuing controversy is whether for-profit services should be allowed if regulated.

Changes to the federal Bankruptcy Code in 2005 constituted further impetus for the introduction and promotion of the uniform act. The amendments, which apply in every state, require that individuals seeking to file for Chapter 7 bankruptcy must now present evidence of having received budgeting and credit counseling from an approved credit counseling agency; an additional instructional course on personal finance management must be completed as a prerequisite to obtaining a discharge of the individual’s debts. The advent of these changes means that more consumers are expected to seek the services of certified debt managers. Proponents of the uniform law cite the changes as a reason for the increasing urgency for states to adopt a uniform approach to governing debt-management services.

Description of the act

The UDMSA is a complex and comprehensive piece of legislation. It regulates credit counselors and debt-management service providers in Hawai‘i by requiring that they register with the state Department of Commerce and Consumer Affairs (DCCA). Services may not be provided to a consumer in Hawai‘i unless the provider is registered. The regulatory scheme does not apply to certain businesses or professions such as banks, judicial officers acting under court orders, title insurers, escrow companies, or persons who provide bill-paying services if the provision of debt-management services is incidental to their business.

Registration requires submission of detailed information concerning the service, including its financial condition, the identity of principals, locations at which services will be offered, a form for agreements with debtors, and business history in other jurisdictions. To register with the State, an applicant must, among other things:

- pay an application fee and obtain a $50,000 security bond;
- maintain a trust account, to be inspected on demand. Payments for creditors must be kept in a trust account maintained exclusively for that purpose. There are strict accounting and periodic reporting requirements for these funds;

- provide evidence of insurance. A service must have an effective insurance policy against fraud, dishonesty, theft and the like for at least $250,000;

- provide evidence of not-for-profit and tax-exempt status if applicable; and

- disclose all names the applicant conducts business under; the name and address of each officer and director who owns at least 10 percent of the company; information about the five most highly paid employees' compensation; each director who is an affiliate of the applicant; and the applicant's past five years' history of debt-management services.

An applicant must also provide:

- audited financial statements;

- evidence of accreditation by an independent accrediting organization approved by the administrator;

- a copy of all consumer agreements and disclosures; and

- criminal background checks (at the applicant's expense).

A yearly renewal is required.

The act also sets forth provisions concerning prerequisites for providing services, prohibited acts and practices, penalties, and more. Among other things, the UDMSA:

- allows states to choose whether to allow for-profit, taxable not-for-profit, or tax-exempt not-for-profit entities to register; and whether to allow all entities to provide all services, or only some entities to provide select services;

- allows for reciprocal use of applications in states that have adopted the UDMSA, if the law is substantially similar. In that case, the service may offer proof of registration in the other state, to satisfy Hawai'i's registration requirements;

- requires a provider to maintain a toll-free customer-service communications system;

- sets out the form and content requirements for debt-management agreements (contracts with consumers). To enter into an agreement with a debtor, providers must disclose fees and services to be offered and the risks and benefits of entering into such a contract;

- allows for, and sets limits on, the imposition of fees and other charges;
- prohibits the provider from soliciting voluntary contributions and provides for the acceptance of other certain voluntary contributions;
- addresses advertising; and
- provides individuals with the right to sue providers who violate the act.

The act also prohibits the following: misappropriation of funds in trust accounts, settlement for more than 50 percent of a debt with a creditor without a debtor's consent, gifts or premiums to enter into an agreement, and representation that settlement has occurred without certification from a creditor.

Objectives of the Analysis

1. Determine whether there is a reasonable need to regulate debt-management service providers to protect the public's health, safety, or welfare.
2. If it is determined that there is a reasonable need to regulate debt-management service providers in Hawai'i, then determine whether for-profit entities should be prohibited from providing credit-counseling or debt-settlement services, or both.
3. Assess the probable effects of regulation and the appropriateness of alternative forms of regulation.
4. Make recommendations as appropriate.

Scope and Methodology

To assess the need to regulate debt-management service providers as proposed in House Bill No. 184, we applied the criteria set forth in Section 26H-2 of the *Hawai'i Regulatory Licensing Reform Act*. The Legislature established these policies to ensure that regulation of an occupation occurs only when needed to protect consumers. Since regulation is an exercise of the State's police power, it should not be imposed lightly. Its primary purpose is not to benefit practitioners of the occupation, who often seek regulation for reasons that go beyond consumer protection. For example, some practitioners believe licensing will enhance their profession's status and upgrade their occupation.

Policies and principles of regulation in Hawai'i

Hawai'i's "sunrise" law, Section 26H-6, HRS, requires the Auditor to assess new regulatory proposals that would subject unregulated professions and vocations to licensing or other regulatory controls against the regulation policies set forth in Section 26H-2, HRS. These policies clearly articulate that the primary purpose of vocational or professional regulation is to protect consumers by stating that:

- The State should regulate professions and vocations only where reasonably necessary to protect consumers;
- Regulation should protect the health, safety, and welfare of consumers and not the profession;
- Evidence of abuses by practitioners of the profession should be given great weight in determining whether a reasonable need for regulation exists;
- Regulation should be avoided if it artificially increases the costs of goods and services to consumers, unless the cost is exceeded by the potential danger to consumers;
- Regulation should be eliminated when it has no further benefit to consumers;
- Regulation should not unreasonably restrict qualified persons from entering the profession; and
- Aggregate fees for regulation and licensure must not be less than the full costs of administering the program.

We were also guided by *Questions a Legislator Should Ask*, a publication of the national Council on Licensure, Enforcement and Regulation (CLEAR). According to CLEAR, the primary guiding principle for legislators is whether the unregulated profession presents a clear and present danger to the public's health, safety, and welfare. If it does, regulation may be necessary; if not, regulation is unnecessary and wastes taxpayers' money.[1]

In addition to the regulatory policies in Chapter 26H, HRS, and the guidance from CLEAR, we also considered other criteria for this analysis, including whether or not:

- The incidence or severity of harm based on documented evidence is sufficiently real or serious to warrant regulation;
- Any other alternatives provide sufficient protection to consumers (such as federal programs, other state laws, marketplace constraints, private action, or supervision); and
- Most other states regulate the occupation for the same reasons.

Burden of proof

In assessing the need for regulation and the specific regulatory proposal, we placed the burden of proof on proponents of the measure to demonstrate the need for regulation. We evaluated their arguments and data against the above criteria. We examined the regulatory proposal and assessed whether the proponents provided sufficient evidence for regulation. In accordance with sunrise criteria, even if regulation *may* have *some* benefits, we recommend regulation only if it is *demonstrably* necessary to protect the public.

Types of regulation

As part of our analysis, we assessed the appropriateness of the specific regulatory approach put forth in the proposed legislation. There are three common approaches to occupational regulation:

- *Licensing*, the most restrictive form of occupational regulation, confers the legal right to practice to those who meet certain qualifications. Penalties may be imposed on those who practice without a license. Licensing laws usually authorize a board that includes members of the profession to establish and implement rules and standards of practice.
- *Certification* restricts the use of certain titles (for example, social worker) to persons who meet certain qualifications, but it does not bar others from offering such services without using the title. Certification is sometimes called *title protection*. Note that government certification should be distinguished from professional certification, or credentialing, by private organizations. For example, social workers may gain professional certification from the National Association of Social Workers.
- *Registration* is used when the threat to the public's health, safety or welfare is relatively small or when it is necessary to determine the impact of the operation of an occupation on the public. A registration law simply involves having practitioners enroll with

the State so that a roster or registry is created and the State can keep track of practitioners. Registration can be mandatory or voluntary.

Finally, in addition to assessing the need for regulation and the specific legislative proposal, we considered the appropriateness of other regulatory alternatives. We also assessed the cost impact on the proposed regulatory agency and the regulated professions.

To accomplish the objectives of our analysis, we researched literature on debt management, including credit counseling and debt settlement, and the providers of such services; relevant state and federal law; the proposed legislation and its national uniform equivalent; regulation in other states; and regulation provided by private organizations. We also examined the estimated cost of the regulatory program and regulatory fees.

We reviewed complaints data from the Department of Commerce and Consumer Affairs including the Office of Consumer Protection (OCP), Regulated Industries Complaints Office (RICO), Professional and Vocational Licensing Division (PVL), and Division of Financial Industries (DFI); the Department of the Attorney General; and the Better Business Bureau.

We conducted interviews with state legislators and the National Conference of Commissioners on Uniform State Laws, Legal Aid Society of Hawaii, Hawaii Alliance for Community-Based Economic Development (HACBED), Department of Commerce and Consumer Affairs, debt-management service providers and bankruptcy attorneys in Hawai‘i, and representatives of national credit counseling and debt settling organizations. In addition, we obtained input from other states that regulate debt-management service providers.

The assessment was conducted from June 2007 to December 2007.

Chapter 2

Debt-Management Service Providers Should Be Regulated

This chapter presents our findings and recommendations on the proposal to regulate debt-management service providers as proposed in House Bill No. 184 of the 2007 legislative session. We conclude that regulation is warranted, but the bill as proposed should not be enacted. Instead, the National Conference of Commissioners on Uniform State Laws' (NCCUSL's) changes to the Uniform Debt-Management Services Act released in January 2008 should be made to the bill before enactment.

Summary of Findings

1. Regulation of debt-management service providers is warranted. The potential risks to consumers' welfare posed by unscrupulous credit counselors or debt settlers is serious, and recent changes to federal bankruptcy legislation mean that more consumers are likely to seek these services. Hawai'i's current statute is outdated and does not provide sufficient protection, and alternative forms of protection are not adequate.

2. The cost of regulating credit counselors and debt managers should not seriously impact the cost of services, because the proposed act strictly limits the purposes and amounts of the charges to consumers. However, the cost of the regulatory program will be steep—more than $350,000 annually. An initial general fund appropriation will be needed before the program can become self-sustaining as required by law. Registration fees will be about ten times the highest fees charged in other states as high level licensing staff will be needed to administer the regulatory program. This is likely to restrict entry into the professions.

3. The proposed measure to regulate debt-management service providers is complex and likely to be difficult to administer. The NCCUSL has addressed a number of technical problems with the legislation and issued its amendments to the Uniform Debt-Management Services Act in January 2008.

Regulation Is Warranted

The impetus for House Bill No. 184 is a uniform law to regulate debt-management service providers nationwide. Although uniform legislation can have its merits, we do not recommend passage of such legislation merely because it furthers a national effort. Our primary concern is the protection of consumers, rather than the non-profit and for-profit providers, and specifically, consumers residing in Hawai‘i.

Our analysis found that in this instance, the regulation of debt-management service providers is warranted. We found that the risk to Hawai‘i’s consumers, from providers both within and outside the state, is serious; that there has been evidence of harm; and that, adding to the danger to consumers, the demand for debt-management services may be increasing due to recent changes in federal bankruptcy law.

We also found that existing alternatives to state regulation are insufficient and outdated. We therefore recommend the regulation of debt-management service providers and support passage of a uniform approach to such regulation.

Risk to consumers is serious and demand for services may be increasing

We found that the risk to consumers posed by unscrupulous providers of debt-management services is serious and the consumers prone to use such services are not likely to be savvy or be possessed of resources with which to pursue providers who have abused them. Furthermore, we note that consumers most often availing themselves of credit counseling or debt settlement services are vulnerable and susceptible to being taken advantage of. Such consumers are not likely to have the resources to mount private action against a provider who has abused them, since anyone using a credit counselor or debt settler is, by definition, already in financial trouble.

Public’s welfare is at risk due to the nature of the services

Hawai‘i statute stipulates that regulation and licensing is to be undertaken only where it is reasonably necessary to protect the health, safety, or welfare of consumers of the services. Likewise, the Council on Licensure, Enforcement and Regulation (CLEAR) suggests that regulation be imposed only where the unregulated profession presents a clear and present danger to the public’s health, safety, or welfare. Hawai‘i law further limits regulation in the form of full licensure or other restrictions to professions where the health, safety, or welfare of the consumer may be jeopardized by the nature of the service offered.

Our research revealed that the consumer debt management industry, which began in the 1950s, has had a checkered past. There have been numerous accusations of abuse. These include:

- **Engaging in misleading and deceptive practices.** This includes agencies’: failure to make customers’ payments to creditors on time; claims that fees are voluntary; failure to adequately disclose fees, and promising results that cannot be delivered. Some agencies promise they will lower consumers' interest rates, monthly payments, or overall debt by an unrealistic amount. Some make false promises to eliminate accurate negative information from consumers' credit reports.

- **Charging excessive fees.** Some agencies charge consumers as much as a month's consolidated payment to creditors to set up a debt-management account.

- **Exercising only one option, debt consolidation**. Some agencies steer consumers into debt consolidation plans that are not beneficial to the consumer, instead of offering debt and budget counseling or other services.

- **Abusing non-profit status**. Despite nearly every agency in the credit counseling industry having non-profit, tax-exempt status, some agencies virtually function as for-profit businesses. In recent years the Internal Revenue Service has been investigating bona fide non-profit statuses, and has revoked the non-profit status of a number of agencies. Furthermore, some companies use their non-profit status as a badge of trustworthiness to attract customers, who are then duped into paying large fees.

- **Failing to abide by telemarketing laws**. Where agencies are not bona fide non-profit organizations, they must comply with the Federal Trade Commission's Telemarketing Sales Rule, including the National Do-Not-Call Registry.

There is evidence of harm

Hawai‘i law requires that, when determining whether regulation of a profession is necessary, evidence of abuses by service providers are to be accorded great weight. We found that although there have been few official complaints or recorded instances of harm in Hawai‘i, there is considerable anecdotal evidence of abuse and plenty of data on complaints and harm on a national level. Furthermore, although harms committed by out-of-state practitioners are not generally given great weight in our sunrise analyses, we found that, given the prevalence of debt-management services available via the internet, complaints and harm data from around the country should be seriously considered in determining whether debt-management service providers need to be regulated in Hawai‘i.

Our inquiries found that the Office of Consumer Protection within the Department of Commerce and Consumer Affairs has received 14 complaints against debt-management service providers since 2000.

Although only two of these were against Hawai‘i providers, the consumers were all within Hawai‘i, which supports the need for a uniform approach to the regulation of debt-management service providers nationally. The nature of these complaints is shown in Exhibit 2.1 below.

Exhibit 2.1
Complaints Against Debt-management Service Providers Received by the Office of Consumer Protection, 2000 Through July 2007

Year	Nature of Complaint
2000	1. Against Hawaii Credit Counselling [sic], a **Honolulu, HI** company. Complainant felt respondent was not properly managing his debt payment program. Respondent formed a new management team to handle programs.
2002	1. Against Certified Credit Consulting, a **Pennsylvania** company. Complainant paid a partial payment of $350 for credit repair services from respondent. Complainant cancelled contract and sought a refund.
2003	1. Against Alternative Credit Solutions, a **Florida** company. Complainant said he did not sign a contract but respondent debited $556 from his checking account. 2. Against Credit Foundation of America, a **California** company. Complainant claimed respondent withdrew money from his account without signing any formal agreement. 3. Against Debt Advantage, a **Florida** company. Complainant paid respondent $437 for credit counseling service. Respondent never contacted complainant’s creditors. Complainant was not cooperative. Case was referred to the Attorney General of Florida. 4. Against Credit Foundation of America, a **California** company. Complainant stated that respondent did not render service and gave him “the run around.” 5. Against Debtas, L.P., a **Texas** company. Complainant contracted with respondent to consolidate debts and make payments through respondent. Complainant set up automatic deduction but respondent did not pay complainant’s creditors. Complainant was unable to contact respondent. Complainant’s creditors were calling for payment. 6. Against Sears Card, an **Ohio** company. Complainant was charged for another person’s service agreement by respondent. Complainant settled the dispute with respondent. Complainant later charged $10 to fix account. 7. Against Debt-Forgiveness.Us, a **Kapa‘a, HI** company. The Office of Consumer Protection investigated this company as part of an internal project[1] and referred it to the OCP’s legal staff to determine whether the respondent’s activities were in compliance with consumer protection laws. Respondent provided education and referral service. Respondent’s written representations were considered questionable. 8. Against Alternative Credit Solutions, dba Credit Foundation of America, a **California** company. Complainant stated that respondent mismanaged her account, which developed into a worse condition than before she used respondent’s services.
2004	1. Against Financial Solutions, a **Texas** company. IFCC complaint. Complainant stated that respondent misrepresented their services. Duplicate of the complaint was sent to Texas.
2005	No complaints filed.
2006	1. Against Capital One Services, Inc., a **Virginia** company. Complainant alleged respondent owed her a refund. Respondent claimed to have sent refund and that complainant cashed check. 2. Against Premier Savings, an **Arizona** company. Complainant enrolled with respondent on the premise that respondent would lower her credit card debt for an initial fee and low monthly fee. Complainant later discovered she had to work with banks on her own.
2007 (as of July)	1. Against CDS Financial Services, LLP, a **Texas** company. Narrative of this complaint stated only “Debt adjuster.”

Source: Department of Commerce and Consumer Affairs

We also contacted the Better Business Bureau regarding complaints. The bureau's Hawai'i branch reported one official complaint regarding the credit counseling/debt-management industry over a three year period. The complaint involved a billing/collection issue, which the bureau assumes was resolved by the company even though the consumer failed to notify the bureau of the outcome.

Despite receiving very few official complaints regarding the industry, the bureau does receive a significant number of inquiries regarding credit counselors. The bureau has two business categories that cover credit counseling and debt management, about which its Hawai'i branch has received the following inquiries, as shown below in Exhibit 2.2.

Exhibit 2.2
Inquiries Regarding Debt-management Service Providers Fielded by the Better Business Bureau of Hawaii, as of July 2007

	Past 12 months (to July 2007)	Past 36 months (to July 2007)
Credit & debt counseling	586	1,323
Credit-debt consolidation services	105	250

Source: Better Business Bureau of Hawaii

The bureau also reports, anecdotally, that many inquiries and some complaints it fields pertain to companies outside of Hawai'i which consumers find on the internet.

Although official complaints against debt-management service providers in Hawai'i are relatively low, the bureau reported a significant number of complaints against these providers on a national level. Exhibit 2.3 shows the number of complaints received by the Better Business Bureau nationally in the past four years.

Exhibit 2.3
Complaints Regarding Debt-management Service Providers Received by the Better Business Bureau Nationally, 2003-2006

	2003	2004	2005	2006
Credit & debt counseling	2,630	2,127	1,286	1,635
Credit-debt consolidation services	No data available	No data available	No data available	1,708

Source: The Council of Better Business Bureaus, Inc.

Changes to federal bankruptcy law mean that demand for services may increase

In addition to the serious risk posed to consumers by unscrupulous practitioners as documented by complaints and inquiries discussed in the findings above, we found that, adding to the magnitude of potential harm to consumers, the demand for debt-management services may be on the rise.

In 2005, the federal *Bankruptcy Abuse Prevention and Consumer Protection Act* (BAPCPA) made credit counseling a requirement for individuals filing for bankruptcy. To meet this requirement, consumers must receive a briefing about the bankruptcy process with an approved non-profit credit counseling agency prior to filing bankruptcy. After bankruptcy is filed, consumers must complete a financial education course with an approved credit counseling agency as a condition to having one's debts discharged. This change in federal law means the number of consumers seeking the services of credit counselors will increase.

However, the new credit counseling and debtor education program initiated under the BAPCPA is an unfunded mandate. Although all states must comply with the federal legislation, Congress failed to provide funds to ensure quality control in administering the program. For instance, determining the qualifications of a "certified counselor" is a new burden for the administering agency, the U.S. Trustee. Due to the lack of funds to investigate the qualifications of agencies, there is little to prevent potentially disreputable debt-management service providers from being placed on the list of approved agencies promulgated by the U.S. Trustee. As a result, individuals could obtain certification from a potentially disreputable debt counselor while attempting to meet the prerequisites to file for bankruptcy.

The potential increase in demand for certified counselors, combined with a corresponding lack of federal funding to ensure quality control at a state level, further support the merits of enacting a uniform state law regulating debt-management service providers.

Existing alternatives do not provide sufficient protection

Hawai'i's sunrise statute, Chapter 26H, HRS, also requires that alternative forms of regulation be assessed when considering regulating a previously unregulated profession or occupation. We considered whether existing alternatives provide sufficient protection to consumers (such as federal programs, other state laws, marketplace constraints, private action, or supervision).

We found that the existing state statute is outdated and does not provide sufficient protection to consumers. Although some consumer protections exist in the form of federal laws, private regulatory bodies, and private action (ability to sue), there are gaps in each of these approaches. The existing alternatives to state regulation provide inadequate consumer protection given the growing demand for debt-management services by consumers facing bankruptcy, the prevalence of online debt-management services, and the vulnerability of consumers in financial trouble.

Existing state statute is not robust enough in today's climate

Chapter 446, HRS, enacted in 1967, prohibits debt adjusting by for-profit persons or organizations. Exempt from this prohibition are attorneys, non-profit organizations, employees of debtors, and persons acting pursuant to court or other authorized orders. Non-profit and charitable organizations can collect nominal sums as reimbursement for expenses in connection with providing debt adjusting services.

Chapter 446, HRS, is a stand-alone prohibition. There is no active regulatory program in place. The prohibition was enacted four decades ago and has never been amended. It provides a minimum of protection but is arguably insufficient in today's climate. The law is not proactive. A violation of the statute would have to occur before relief could be sought. For individuals on the cusp of financial disaster—precisely the sort of consumer likely to seek the assistance of a debt-management service provider—involvement in a costly court case is hardly a realistic or viable option.

Federal protection is inadequate

We also examined the sufficiency of existing federal laws in protecting unwary consumers from unscrupulous debt-management service providers. We found that there is no federal regulation of credit counselors or debt managers and that federal laws do not specifically capture credit counselors and debt settlers who operate as non-profit entities.

Two federal laws provide a minimum of consumer protection in this area; however, both are limited in their applicability to debt-management service providers. Specifically, the Credit Repair Organizations Act, which was intended to address abuses in the credit repair industry, does not apply to credit counselors operating as non-profits with tax exempt status under the Internal Revenue Code (IRC) 501(c)(3). There is therefore a potential for abuse by debt-management providers operating under the guise of an IRC 501(c)(3) organization. Since most credit counseling organizations operate as non-profits, this law would primarily apply only to debt settlers.

Similarly, although the Federal Trade Commission Act prohibits "unfair or deceptive acts or practices in or affecting commerce" and would apply to credit counseling agencies as well as debt settlers, it is unclear whether IRC 501(c)(3) organizations come under the Federal Trade Commission Act. This means that a credit counseling agency operating under the guise of a non-profit organization, but engaging in unscrupulous behavior, would not be subject to the deceptive practice prohibitions under the Credit Repair Organizations Act or the Federal Trade Commission Act.

National organizations are voluntary

We also examined the sufficiency of controls over the industry by national organizations. We found that standards are high for some organizations, but membership is voluntary; therefore reliance on national organizations falls short as a suitable form of consumer protection.

There are a number of national organizations that serve the credit counseling and debt management industries. Some of these offer their own accreditation; however, their membership is voluntary. Furthermore, although the standards are high amongst organizations that do provide accreditation, many of these industry groups nevertheless support uniform regulation of the professions. All the following organizations are involved in participating in the adoption of the Uniform Debt-Management Services Act (UDMSA) around the country:

- International Association of Professional Debt Arbitrators (IAPDA), which has developed a Certification Training Program ("Certified Debt Specialists") that complies with UDMSA certification requirements specific to debt settlement;

- United States Organization of Bankruptcy Alternatives (USOBA), which works with and lobbies legislatures that have introduced the UDMSA on issues specific to the debt settlement industry;

- The Association of Settlement Companies (TASC), which works with and lobbies state legislators who are introducing the UDMSA on issues specific to the debt settlement industry;

- Association of Independent Consumer Credit Counseling Agencies (AICCCA), which represents non-profit, tax exempt consumer credit counseling companies nationwide;

- National Foundation for Credit Counseling (NFCC), which represents non-profit, tax exempt consumer credit counseling organizations nationwide; and

- American Association of Debt Management Organizations (AADMO), which is the largest national trade association that provides members and the public with information about credit counseling.

Private action is not realistic for individuals who are already in financial trouble

Finally, we looked at the adequacy of private action as a means of alternative consumer protection. Private action means the ability to sue in court. We found that consumers in need of debt-management services—who are by definition already in financial trouble—cannot afford to mount a legal challenge against an unscrupulous debt service provider. Even with the assistance of public interest lawyers at the Legal Aid Society, we note that litigation is costly. Any situation requiring legal action, even if the service is provided for free, will cost the consumer time, energy, stress, and worry. There is no guarantee of a favorable outcome either in terms of remuneration or timeliness of a court decision. Private action, therefore, is neither a realistic nor suitable form of consumer protection.

Most other states regulate debt-management services

In addition to statutory criteria, we looked at whether the majority of states regulate debt-management service providers for the same reasons as those proposed in the current legislation. We found that most states regulate credit counselors and debt settlers, and a majority regulate some aspect of debt management.

Forty-eight states have laws concerning some aspect of debt-management. These are contained in various statutes as shown in Exhibit 2.4 below.

Exhibit 2.4
Statutes Regulating Debt-Management Services Nationwide

Name of Statute	No. States with this Statute
Budget Planner	1
Budget Service Companies	1
Collection Agencies, Debt Counselor or Credit Counselor Permits	1
Consolidating Agencies	1
Corporations and Institutions for Finance and Insurance	1
Credit Counseling and Prorating	1
Credit Counseling Services	2
Credit Service Organization	1
Debt Adjuster / Debt Adjusters / Debt Adjusting	17
Debt Adjusting / Consumer Credit Counseling Service	1
Debt Management	4
Debt Management Services	2
Debt Pooling	5
Debt Prorating	1
Financial Planning and Management Service & Debt Adjusting	1
Non-Profit Debt Management Services & Budget Planning	1
Non-Profit Credit Counseling	1
Non-profit Debt Management Services Act	1
Uniform Debt-Management Services Act (UDMSA)	4*
Unlawful Practice of Law	1
Total	**48**

*Delaware, Rhode Island, Utah, Colorado.

Source: AADMO state summary (2004) and UDMSA website

There are 22 states, including Hawai‘i, with stand-alone laws that do not require active state regulation. Only two states (Alabama and Alaska) do not legislate debt-management services at all.

Furthermore, just over half of all states (26) have laws requiring active regulation of a variety of debt-management service providers. These states require registration, certification, or licensure. Four of these states have enacted the Uniform Debt-Management Services Act:

- Delaware (effective January 17, 2007);
- Rhode Island (effective March 31, 2007);
- Utah (effective July 1, 2007); and
- Colorado (effective January 1, 2008). Colorado is the first state to treat the debt-management functions performed by consumer credit counseling agencies and debt settlement companies as distinctly different in the legislation. Colorado's act requires personnel to be "Certified Debt Specialists" for debt settlement companies and "certified counselors" for consumer credit counseling agencies.

Besides Hawai'i, the UDMSA was introduced in 2007 in Illinois, Missouri, and Wisconsin.

The fact that most other states regulate debt-management service providers, or some aspect of debt-management services, is not in itself a conclusive reason to recommend regulation. However, a majority of states recognize that the debt-management industry holds risks for consumers to warrant statutory consumer protection.

Estimated Costs of the Regulatory Program Are Steep

As part of its analysis in determining whether a previously unregulated profession should become regulated, the State Auditor must also consider whether regulation will artificially increase the cost of goods and services to the consumer; whether it will unreasonably restrict entry into the profession by qualified persons; and whether the fees imposed will cover the full cost of administering the regulatory program. We found the regulatory program will be expensive to operate but that regulation is not likely to increase costs to consumers; and although regulation will likely restrict entry into the profession, this would not be unreasonable.

Regulatory program will be expensive to operate

State law requires that where regulation is enacted, fees must cover the cost of administering the regulatory program. Although we found that the cost of operating the regulatory program would be covered by its fees, thereby satisfying Section 26H-2(7), HRS, the program would nevertheless be relatively expensive and intensive to administer.

The Department of Commerce and Consumer Affairs (DCCA) estimates that the cost of administering and enforcing House Bill No. 184 will exceed $350,000 annually. The department calculates that it would likely need three additional staff, training, and start-up costs. The department said that in view of the uniform act's "complex and far reaching regulatory and supervisory framework, [the proposed regulatory program] clearly requires high level licensing and field staff to implement and operate, and more than the usual supervisory and management oversight to administer its provisions."

Furthermore, it is uncertain as to where the regulatory program would be housed within the department. If regulation were entrusted to the Professional and Vocational Licensing Division (PVL), the department estimates the program would cost $365,703. This figure combines PVL's costs ($274,864) and those of the Regulated Industries Complaints Office (RICO), which would provide enforcement activities for the program ($90,839).

Alternatively, if regulation were housed within the Division of Financial Industries (DFI), RICO would not be involved, but the department estimates the program would cost a similar amount, namely $352,746. In addition, the department estimates that either division responsible for the regulatory program would require a one-time general fund appropriation to cover the first year's operation and start-up costs (prior to the receipt of license fees).

Regulation may restrict entry into the profession, but not necessarily unreasonably

Section 26H-2, HRS, requires that regulation must not unreasonably restrict entry into the profession or vocation by all qualified persons. Although we found that the cost of the regulatory program will be steep for practitioners, this may not be unreasonable given the importance of consumer protection in this area.

The department estimates that the cost per application could range from $10,000 to $13,000. In comparison, other states charge registration fees ranging from $100 to $3,000. As provided in House Bill No. 184 (section -11), this fee would be annual. The department notes that it would be possible for an applicant licensed in one year and subsequently subject to renewal in the same year to incur an additional $10,000-13,000 fee. However, the department also notes that if the regulatory program were to be housed within the Professional and Vocational Licensing division, it is likely that registration requirements would be changed to a biennial renewal.

Application requirements under the proposed uniform act are stringent. For example, the act requires: a $50,000 bond, maintenance of trust accounts for each client, $250,000 in insurance, evidence of non-profit status (if operating as such), two years of audited financial statements, evidence of accreditation by an approved independent accrediting organization, a criminal records check, and numerous other disclosures.

One service provider in Hawai‘i thought that regulation would unreasonably restrict entry into the profession. According to that provider, “Hawai‘i is a small target market. Potential providers would probably think, ‘Why bother to go there for a limited number of clients, at additional cost?’” However, another service provider maintained that potential qualified service providers would not be unreasonably restricted because the act would allow for reciprocal registration if similar requirements are met in another state.

We found that the steep registration fees would likely limit the number of entrants into the profession in Hawai‘i, particularly considering that other states charge about $100 to $3,000 for registration. Although the UDMSA allows practitioners who are registered in other states to submit their license or registration in lieu of the prescribed application, there is no waiver of fees. As such, there is no reason why the department could not charge its own registration fee. Thus, although an out-of-state practitioner is likely to be accepted to practice in this state, he or she may still be subject to the $10,000-13,000 annual registration fee.

As described above, the proposed act has very stringent requirements for registration. However, the key terms are ”unreasonably restrict” and ”qualified persons.” We note that the requirements imposed through accreditation standards of the national bodies (for example, the National Foundation of Credit Counselors (NFCC)) are at least as stringent as those in the act; furthermore, the act itself requires such accreditation. As such, the act’s requirements would indeed restrict entry into the profession, but the restriction would not necessarily be unreasonable. We note, for instance, that doctors and other medical professionals are subject to extremely strict entrance requirements, but the risks involved warrant such high standards.

Cost of regulation to consumers is likely to be minimal

Section 26H-2(4), HRS, stipulates that regulation which artificially increases the costs of goods and services to the consumer is to be avoided except where such cost is exceeded by the potential danger to the consumer. We found that the proposed regulation is not likely to increase the cost of services to consumers, thereby meeting this statutory criterion.

As noted above, the department estimates that the cost per (annual) application could range from $10,000 to $13,000. One Hawai‘i provider said that if regulation were imposed, such costs would “surely” be passed on to consumers. Another thought that state regulation does not increase the cost of services to consumers because allowable charges are already very limited, and the new act would not impose additional hurdles to the provider. Regardless of these views, however, the uniform act places strict limits on what service providers can charge clients. For instance, a provider may not:

- Depending on the type of plan the client has agreed to, charge more than $50, or more than $400 or 4 percent of the debt in the plan, for consultation, obtaining a credit report, setting up an account, or the like;
- Charge a monthly service fee, to exceed $10 times the number of creditors remaining in a plan at the time the fee is assessed, or more than $50 in a month;
- Charge more than $100 per month for educational and counseling fees (unless otherwise approved by the administrator—that is, DCCA); nor
- Charge any fees except as permitted under section -23.

It is logical to assume that if registration costs are between $10,000-13,000 per year, debt-management service providers would be tempted to pass such costs on to consumers. However, the uniform act precludes this from occurring because it sets such strict limits on the purposes and amounts providers can charge clients. Therefore, we found it unlikely that registration costs could be passed on to consumers successfully.

The UDMSA Is Problematic

Although there is in-principle support for the regulation of debt-management service providers among stakeholders, those whom we consulted pointed out that the UDMSA as proposed has its flaws. NCCUSL's Standby Committee, which was responsible for drafting the original UDMSA in 2005, was recalled in November 2007 to address the administrative and technical difficulties states have encountered. Stakeholders are urging that passage of any proposed UDMSA be postponed until NCCUSL issues its updated version of the act. NCCUSL's amendments to the UDMSA were released in January 2008.

Technical difficulties make the UDMSA cumbersome to administer

Four states—Delaware, Rhode Island, Utah and Colorado—have enacted the UDMSA, effective on January 1, March 31, and July 1, 2007, respectively, and January 1, 2008 for Colorado.

At least two of these (Delaware and Utah) have encountered major difficulties in administering this very comprehensive piece of legislation. The difficulties reported include:

- **Registration process and background checks**. The registration process is cumbersome. It requires receipt of a lot of information as well as review of contracts to be used.

- **Insurance deductibles**. Utah found that providers are unable to obtain the $0 deductible from insurers unless they have an existing relationship with an insurance agent. Delaware has a $5,000 deductible, which providers have been able to obtain. Colorado has adopted a similar deductible.

- **Accreditation requirements for providers**. The accreditation requirement is difficult for debt settlers to obtain, because unlike the credit counseling industry, few organizations in the debt settlement industry offer accreditation.

- **Approving requirements for administrators**. Approval of accreditation providers, standards, and certification programs for "certified" counselors have been challenging for administrators.

NCCUSL drafting committee was recalled to address technical difficulties in the act

As a result of the technical difficulties experienced by states that have already enacted the UDMSA, the National Conference of Commissioners on Uniform State Laws, which originally put forth the UDMSA in July 2005, reconvened its drafting committee in November 2007 to make changes to the uniform act.

The committee considered points raised prior to the meeting as well as presentations made by various interest groups at the conference. The most comprehensive suggestions were made by AADMO, which presented 32 recommended changes to the UDMSA. In all, the committee recommended more than 22 changes, which were incorporated into a revised version of the UDMSA and released on January 31, 2008. The revised version is provided in Appendix A.

For-Profit Entities Should Be Allowed To Provide Debt-Settlement and Credit-Counseling Services Under the Act

The 2007 Legislature, in House Concurrent Resolution No. 46, asked the State Auditor to include in the sunrise analysis a determination as to "whether for-profit entities should be prohibited from providing debt-settlement services, or credit-counseling services, or both."

We found that Hawai'i's current law prohibits for-profit entities from operating a business that provides "debt adjusting" services. The UDMSA as proposed in House Bill No. 184 allows for-profit businesses to engage in both debt-settlement services and credit-counseling services. This may be indicative of legislative intention.

Our research indicates that credit counselors are unlikely to operate for a profit as there is no incentive to do so when the provider can qualify as a 501(c) non-profit. On the other hand, debt settlers, who generally operate for profit, are probably not affiliated with any of the 28 types of non-profit organizations under the Internal Revenue Code that can qualify for tax exempt status. As such, banning for-profit entities from providing debt settlement services effectively limits the consumers' choice of debt-management services in the state to its current form, that is, credit counselors.

Consumers would need protection from credit counselors, who abuse their tax-exempt status, as well as debt settlers, who commit deceptive practices prohibited under federal law. We found no real differences in the nature of the services provided by credit counselors and debt settlers to warrant regulating one occupation while banning the other from operating in the state. Both target consumers in financial trouble and charge fees for services rendered. Credit counselors control and disburse funds for the consumer, and earn their money by charging establishment fees and sometimes monthly maintenance fees, and receiving a "Fair Share" of the amount (less than 6 percent) repaid to creditors. On the other hand, debt settlers earn their money by charging a fee to consumers for negotiating with creditors for less than the full amount owed. Debt settlement companies do not control a consumer's funds. Thus there would be no basis for excluding debt settlers from the proposed regulation simply because they are operating a business for-profit. While the two occupations may be distinct, they are distinctions without a meaningful difference. Those differences should not compel the state to prohibit one and allow the other.

We therefore recommend that for-profit debt settlement companies be permitted, on the assumptions that: 1) allowing debt settlers to operate provides consumers in financial straits with additional options besides credit counselors; and 2) if such operators are allowed to do business, then they should be regulated to protect consumers.

Current law prohibits for-profits from engaging in "debt adjusting"

Under existing law, for-profit entities are prohibited from providing both debt-settlement services and credit-counseling services. Chapter 446, HRS, prohibits anyone in Hawai‘i from engaging in "debt adjusting" for a profit, and defines a "debt adjuster" as a person who engages in the business of acting as an intermediary between a debtor and the debtor's creditors for the purpose of settling, compromising, or in any way altering the terms of payment of any debts of the debtor. The law makes exceptions for attorneys, non-profit organizations, employees of debtors and persons acting pursuant to court or other authorized orders, all of whom may engage in such "debt adjusting." Non-profit and charitable organizations may also collect nominal sums as reimbursement for expenses in connection with debt adjusting services.

Some credit counselors in Hawai‘i support the idea that for-profits should continue to be banned. The sentiment is based on the assumption that consumers who utilize such services are already in financial trouble and thus in a weak and vulnerable position; for this reason, allowing for-profit entities to "help" consumers get out of debt is akin to a fox guarding a henhouse. On the other hand, other credit counselors in Hawai‘i believe that for-profit entities would be an unviable business model and therefore their regulation is a non-issue.

House Bill No. 184 as proposed already allows for-profits to engage in both debt-settlement services and credit-counseling services

Alternatively, instead of an outright ban, for-profit entities could be permitted to operate in Hawai‘i but regulated the same as non-profits under the UDMSA.

The UDMSA was written in a manner expressly intending states to choose whether or not to allow for-profit entities to engage in either debt-settlement services, credit counseling services, or both. The notes to the act, promulgated by the NCCUSL and available on its website, specifically identify language to be included or deleted in various sections depending on the intent of the legislature.

A comparison of the UDMSA and House Bill No. 184 shows that, in its current form, the Legislature opted to allow for-profit entities to engage in both credit counseling and debt-settlement services. Accordingly, only the changes in the revised version of the UDMSA are needed to the bill in order to allow credit counselors and debt settlers to operate for a profit.

Permitting for-profit providers to operate gives consumers a greater choice of services. It should be remembered that, in general, credit counselors operate on a non-profit basis while debt settlers generally adopt a for-profit business model. If for-profits are prohibited from operating, consumers will be limited to only the services available from credit counselors. Although these consumers may be especially vulnerable, if enacted, the legislation's regulatory requirements would provide them with sufficient protection.

Conclusion

Our analysis shows that House Bill No. 184 of the 2007 legislative session meets the legislative criteria for new regulation in the Hawai‘i Regulatory Licensing Act. We found that the nature of the debt-management services provided by credit counselors and debt settlers, whether operating as non-profit or for-profit entities, pose potentially serious risks to the welfare of consumers already in financial trouble. Existing federal and state laws provide inadequate protection against unscrupulous practitioners operating under the guise of a non-profit organization. We found that banning for-profit debt settlers from operating in Hawai‘i only limits the consumers' choice. While the cost of the regulatory program is high and could make the entry of debt settlers operating for a profit less viable, we found the costs are not unreasonable, and the uniform act imposes sufficient restrictions to protect the consumer from bearing these costs.

Although regulation is warranted, the Legislature should incorporate the amendments recommended by NCCUSL as a result of the November 2007 conference into House Bill No. 184. These changes address difficulties states have encountered in administering the uniform act.

Recommendations

1. We recommend that debt-management service providers be regulated in Hawai‘i. However, we recommend that the amendments to the UDMSA issued as a result of the November 2007 NCCUSL meeting be taken into account before enacting House Bill No. 184. Language is provided in Appendix A.

2. We recommend that for-profit entities be allowed to provide credit counseling and debt settlement services in Hawai‘i. As such, only the changes to sections -4, -5, or -9 of H.B. No. 184 in the revised version of the UDMSA are needed. However, if the Legislature decides that for-profits should be prohibited from providing debt-settlement and credit-counseling services, then sections -4, -5, and -9 of H.B. No. 184 should be amended. Language is provided in Appendix A.

AMENDMENTS TO

UNIFORM DEBT-MANAGEMENT SERVICES ACT

January 10, 2008

Section 2 is amended to read:

SECTION 2. DEFINITIONS. In this [act]:

* * *

(6) (a) "Certified counselor" means an individual certified by a training program or certifying organization, approved by the administrator, that authenticates the competence of individuals providing education and assistance to other individuals in connection with debt-management services in which an agreement contemplates that creditors will reduce finance charges or fees for late payment, default, or delinquency.

(b) "Certified debt specialist" means an individual certified by a training program or certifying organization, approved by the administrator, that authenticates the competence of individuals providing education and assistance to other individuals in connection with debt-management services in which an agreement contemplates that creditors will settle debts for less than the full principal amount of debt owed.

* * *

Comment

* * *

6. Paragraph (6) (certified counselor~~).~~ and certified debt specialist): "Debt specialist" includes a person who communicates with an individual about the features of a debt-settlement program or who, on behalf of a provider, forms an agreement with an individual.

Section 17 requires providers to perform certain functions, including education, through the services of a certified counselor or certified debt specialist; section 16 requires providers to make certified counselors and certified debt specialists available for consultation. The definition requires that the organization that trains or certifies counselors be approved by the administrator.

* * *

Section 4 is amended to read:

SECTION 4. REGISTRATION [AND NOT-FOR-PROFIT STATUS] REQUIRED.

(a) Except as otherwise provided in subsection (b), a provider may not provide debt-management services to an individual who it reasonably should know resides in this state at the time it agrees to provide the services, unless the provider is registered under this [act].

(b) If a provider is registered under this [act], subsection (a) does not apply to an employee or agent of the provider.

(c) The administrator shall maintain and publicize a list of the names of all registered providers.

[(d) A provider [whose ~~plans~~ agreements contemplate that creditors will reduce finance charges or fees for late payment, default, or delinquency] [whose ~~plans~~ agreements contemplate that creditors will settle debts for less than the full principal amount of debt owed] may be registered only if it is:

(1) organized and properly operating as a not-for-profit entity under the law of the state in which it was formed; and

(2) exempt from taxation under the Internal Revenue Code, 26 U.S.C. Section 501 [as amended]].

Legislative Note: *This section implements the state's decision concerning whether for-profit entities are permitted to provide debt-management services.*

If the state wishes to permit only not-for-profit entities to provide debt-management services, use subsection (d) without the either of the two bracketed phrases, so that the introduction to subsection (d) states:

(d) A provider may be registered only if it is:

If the state wishes to permit for-profit entities to provide all kinds of debt-management services, omit subsection (d) and delete the bracketed material in the section caption.

If the state wishes to permit for-profit entities to provide debt-settlement services but not credit-counseling services, use the language in the first set of brackets, so that so that the introduction to subsection (d) states:

(d) A provider whose ~~plans~~ agreements contemplate that creditors will reduce finance charges or fees for late payment, default, or delinquency may be registered only if it is:

If the state wishes to permit for-profit entities to provide credit-counseling services but *not debt-settlement services, use the language in the second set of brackets, so that so that the introduction to subsection (d) states:*

(d) A provider whose ~~plans~~ agreements contemplate that creditors will settle debts for less than the full principal amount of debt owed may be registered only if it is:

In states in which the constitution does not permit the phrase, "as amended," when federal statutes are incorporated into state law, the phrase should be deleted in subsection (d)(2).

* * *

Section 5 is amended to read:

SECTION 5. APPLICATION FOR REGISTRATION: FORM, FEE, AND ACCOMPANYING DOCUMENTS.

(a) An application for registration as a provider must be in a form prescribed by the administrator.

(b) Subject to adjustment of dollar amounts pursuant to Section 32(f), an application for registration as a provider must be accompanied by:

(1) the fee established by the administrator;

(2) the bond required by Section 13;

(3) identification of all trust accounts required by Section 22 and an irrevocable consent authorizing the administrator to review and examine the trust accounts;

(4) evidence of insurance in the amount of $250,000:

(A) against the risks of dishonesty, fraud, theft, and other misconduct on the part of the applicant or a director, employee, or agent of the applicant;

(B) issued by an insurance company authorized to do business in this state and rated at least A or equivalent by a nationally recognized rating organization approved by the administrator;

(C) with ~~no~~ a deductible not exceeding $5,000;

(D) payable ~~to~~ for the benefit of the applicant, ~~the~~ this state, and individuals who ~~have agreements with the applicant, and~~ are residents of this state, as their interests may appear; and

(E) not subject to cancellation by the applicant ~~without~~ or the ~~approval of~~ insurer until 60 days after written notice has been given to the administrator;

(5) proof of compliance with [insert the citation to the statute specifying the prerequisites for an entity to do business in this state][; and]

[(6) ~~[~~if the applicant ~~is organized as a not-for-profit entity or~~ is exempt from taxation~~,] evidence of not-for-profit and tax-exempt status applicable to the applicant~~ under the Internal Revenue ~~Code~~ code, 26 U.S.C. Section 501[, as amended], evidence of that status].

Legislative Note: *In states that do not empower administrative agencies to set fees, replace subsection (b)(1) with the desired fee.*

In subsection (b)(5) if the state has no statute specifying the prerequisites for an entity to do business in this state, substitute the following for subsection (b)(5):

(5) a record consenting to the jurisdiction of this state containing:

(A) the name, business address, and other contact information of its registered agent in this state for purposes of service of process; or

(B) the appointment of the [administrator or other state official] as agent of the provider for purposes of service of process.

If the state wishes to permit only ~~not-for-profit~~ tax-exempt entities to provide debt-management services, the first bracketed language in paragraph (6) should be deleted so that paragraph (6) states:

(6) evidence of ~~not-for-profit and~~ tax-exempt status applicable to the applicant under Internal Revenue Code, 26 U.S.C. Section 501 [, as amended].

If the state wishes to permit only not-for-profit entities to provide debt-management services, but does not wish to require that the entities also be exempt from taxation, substitute "organized as a not-for-profit entity" and omit the last part of paragraph (6), so that paragraph (6) would read, "if the applicant is organized as a not-for-profit entity, evidence of not-for-profit status."

If the state wishes to permit for-profit entities to provide all kinds of debt-management services, the brackets at the beginning of paragraph (6), should be deleted, so that paragraph (6) states:

(6) if the applicant is organized as a not-for-profit entity or is exempt from taxatio~~n, evidence of not-for-profit and tax-exempt status applicable to the applicant~~ under the Internal Revenue Code, 26 U.S.C. Section 501[, as amended], evidence of not-for-profit status, tax-exempt status, or both, as applicable.

If the state wishes to permit for-profit entities to provide debt-settlement services but not credit-counseling services:

(1) select the appropriate bracketed language and omit the other, so that paragraph (6) ~~should state~~ states: "(6) if the applicant's ~~plans~~ agreements contemplate that creditors will reduce finance charges or fees for late payment, default, or delinquency, evidence of [not-for-profit] [and] [tax-exempt status applicable to the applicant under Internal Revenue Code, 26 U.S.C. Section 501 [, as amended]]"; and

(2) add a new paragraph: "(7) if the applicant's ~~plans~~ agreements contemplate that creditors will settle debts for less than the full principal amount of debt owed and the applicant is

(A) organized as a not-for-profit entity ~~or is~~, evidence of not-for-profit status;

(B) exempt from taxation, evidence of not-for-profit and tax-exempt status applicable to the applicant under Internal Revenue Code, 26 U.S.C. Section 501 [, as amended]."

If the state wishes to permit for-profit entities to provide credit-counseling services but not debt-settlement services:

(1) select the appropriate bracketed language and omit the other, so that paragraph (6) ~~should state~~ states: "(6) if the applicant's ~~plans~~ agreements contemplate that creditors will settle debts for less than the full principal amount of debt owed, evidence of [not-for-profit status] [and] [tax-exempt status applicable to the applicant under Internal Revenue Code, 26 U.S.C. Section 501[, as amended]]"; and

(2) add a new paragraph: "(7) if the applicant's ~~plans~~ agreements contemplate that creditors will reduce finance charges or fees for late payment, default, or delinquency and the applicant is

(A) organized as a not-for-profit entity ~~or is~~, evidence of not-for-profit status;

(B) exempt from taxation, evidence of not-for-profit and tax-exempt status applicable to the applicant under Internal Revenue Code, 26 U.S.C. Section 501[, as amended], as applicable."

In states in which the constitution does not permit the phrase, "as amended," when federal statutes are incorporated into state law, the phrase should be deleted in subsection (b)(6).

Comment

1. In subsection (a) "form" encompasses format, and the administrator by rule may permit all or part of the application to be submitted electronically.

2. Subsections (b)(2) and (3) refer to items "required by" other sections. If those other sections do not require the item as to a particular applicant, then the application may omit them.

The bond requirement in paragraph (2) may be satisfied also in the manner provided in section 14.

The consent required by paragraph (3) is for the purpose of satisfying the bank's requirements for disclosure of records to a person other than the account holder. The administrator may adopt a rule prescribing the form and content of that consent. Section 19(d)(2) requires a similar consent from the individuals whose money is in the trust account.

3. Subsection (b)(4) requires insurance in the amount of $250,000 against the risk of employee misconduct, including theft of funds from the trust account. Misconduct may consist of conduct that is prohibited by this Act or by other law, or it may consist of a failure to act when the provider has a duty to act. As used in this Act, "employee" encompasses officers of a provider.

4. The insurance required by this section must be provided by an insurer whose reliability is beyond question. Paragraph (B) speaks of an A rating, such as under the system of A.M. Best Co., but a comparable rating by any other administrator-approved, nationally recognized rating organization satisfies the requirement, even if the organization's system uses numbers or other symbols instead of letters. The purpose of the requirement is to ensure that the insurance will be issued by a very highly reliable insurer, and the requirements of paragraph (B) should be interpreted accordingly.

5. Ordinarily, the beneficiary of ~~such~~ insurance of the type required by this section would be the provider, but this paragraph expands the beneficiaries to include the state and the customers of the provider and requires that the insurance not be subject to cancellation without ~~the approval of~~ notice to the administrator. The insurance required by this paragraph overlaps the bond required by section 13.

~~4~~ 6. Subsection (b)(5) facilitates subjecting a non-resident business to the jurisdiction of this state. If the applicant is a domestic entity, so that the statute referenced in this subsection does not apply to it, the applicant complies with this subsection by indicating that fact. If existing statutes leave doubt about the mechanism for serving process on the provider and the state has chosen not to enact the language suggested in the Legislative Note, the administrator can promulgate a rule requiring the applicant to appoint a state official as the provider's agent for purposes of service of process.

Section 6 is amended to read:

SECTION 6. APPLICATION FOR REGISTRATION: REQUIRED INFORMATION. An application for registration must be signed under [oath] [penalty of false statement] and include:

(1) the applicant's name, principal business address and telephone number, and all other business addresses in this state, electronic-mail addresses, and Internet website

addresses;

(2) all names under which the applicant conducts business;

(3) the address of each location in this state at which the applicant will provide debt-management services or a statement that the applicant will have no such location;

(4) the name and home address of each officer and director of the applicant and each person that owns at least 10 percent of the applicant;

(5) identification of every jurisdiction in which, during the five years immediately preceding the application:

(A) the applicant or any of its officers or directors has been licensed or registered to provide debt-management services; or

(B) individuals have resided when they received debt-management services from the applicant;

(6) a statement describing, to the extent it is known or should be known by the applicant, any material civil or criminal judgment or litigation and any material administrative or enforcement action by a governmental agency in any jurisdiction against the applicant, any of its officers, directors, owners, or agents, or any person who is authorized to have access to the trust account required by Section 22;

(7) the applicant's financial statements, audited by an accountant licensed to conduct audits, for each of the two years immediately preceding the application or, if it has not been in operation for the two years preceding the application, for the period of its existence;

(8) evidence of accreditation by an independent accrediting organization approved by the administrator;

(9) evidence that, within 12 months after initial employment, each of the applicant's counselors becomes certified as a certified counselor or certified debt specialist;

(10) a description of the three most commonly used educational programs that the applicant provides or intends to provide to individuals who reside in this state and a copy of any materials used or to be used in those programs;

(11) a description of the applicant's financial analysis and initial budget plan, including any form or electronic model, used to evaluate the financial condition of individuals;

(12) a copy of each form of agreement that the applicant will use with individuals who reside in this state;

(13) the schedule of fees and charges that the applicant will use with individuals who reside in this state;

(14) at the applicant's expense, the results of a criminal-records check, including fingerprints, conducted within the immediately preceding 12 months, covering every officer of the applicant and every employee or agent of the applicant who is authorized to have access to the trust account required by Section 22;

(15) the names and addresses of all employers of each director during the 10 years immediately preceding the application;

(16) a description of any ownership interest of at least 10 percent by a director, owner, or employee of the applicant in:

(A) any affiliate of the applicant; or

(B) any entity that provides products or services to the applicant or any individual relating to the applicant's debt-management services;

(17) a statement of the amount of compensation of the applicant's five most highly compensated employees for each of the three years immediately preceding the application or, if it has not been in operation for the three years preceding the application, for the period of its existence; and

(18) the identity of each director who is an affiliate, as defined in Section 2(2)(A) or (B)(i), (ii), (iv), (v), (vi), or (vii), of the applicant; and

(19) any other information that the administrator reasonably requires to perform the administrator's duties under Section 9.

Legislative Note: *In the introductory language to this section, the state must determine whether to require the application to be made "under oath" or "under penalty of false statement." Similar choices are necessary in Sections 11 and 12.*

Comment

1. Paragraph (1) requires disclosure of the applicant's principal business address, in whatever jurisdiction it may be. It also requires disclosure of business addresses in this state, but not business addresses outside this state.

2. Paragraph (3) contemplates disclosure of the address of all facilities, like call centers and back-office operations, that are part of the provider's operations. It does not, however, require disclosure of the addresses of employees who work from home. If the applicant has no physical presence in this state, that must be disclosed.

3. Paragraph (4) requires identification of any person that owns more than 10 percent of an applicant. This applies to for-profit applicants, if the state permits them, and to nonprofit applicants that are owned by others. Most nonprofit entities are not owned by anyone, and, if that is true of an applicant, the applicant need only disclose that fact.

4. Paragraph (5) (identification of jurisdictions in which the applicant has done business or has been registered or licensed to provide debt-management services) requires information to enhance the administrator's ability to investigate the applicant and to coordinate enforcement efforts with administrators in other jurisdictions. Use of the word "jurisdiction" rather than "state" means that the applicant must disclose with respect to its activities in other countries, too. Unless required pursuant to paragraph (19), however, it does not mean that the applicant must break down its disclosures by county or other subdivision of a state or country.

5. Paragraph (6) requires disclosure of material judicial and administrative proceedings in any jurisdiction against the officers, directors, and owners (whether or not they are authorized to access the trust account containing customers' funds), as well as material judicial and administrative proceedings against any other persons who may be authorized to access the trust account. Proceedings dealing with matters of importance to the administrator in determining whether to approve an application for registration, such as alleged deception or financial irregularities, are material. See section 9(b)(4). The administrator by rule can elaborate on what proceedings are material. This paragraph does not impose any disclosure requirement with respect to proceedings of which the applicant reasonably is unaware, but the concept "should be known" encompasses facts that a reasonable investigation would have revealed. "Authorized to have access to the trust account" refers to persons who may initiate transactions in the account, not persons who merely are empowered to view the account.

6. Paragraph (7) requires financial statements by an accountant licensed to conduct audits. The accountant need not be licensed by this state.

7. Independent, nationally recognized accrediting organizations have been accrediting credit-counseling agencies for many years, though not all agencies have sought to be accredited. Paragraph (8) establishes accreditation as prerequisite to registration under this Act. The accreditation requirement, which applies to both credit-counseling entities and debt-settlement entities, reinforces regulation by the administrator and subjects providers to periodic review to ensure that they continue to meet the standards of the accrediting agency. The administrator must approve the organizations that accredit providers.

8. Paragraph (9) requires a provider to ensure that its counselors and debt specialists are

certified no later than 12 months after their initial employment. This requirement applies only with respect to employees who act as counselors, debt specialists, and educators. It does not apply to such other employees as customer service representatives. Section 17 prohibits ~~a plan~~ an agreement unless a certified counselor or certified debt specialist has done specified things. With respect to the obligations imposed by section 17(b), this [Act] draws no distinctions between credit-counseling entities and debt-settlement entities. Each must comply with the same obligations through the services of either certified counselors or certified debt specialists. Evidence that a provider has in place a system for certification of its counselors and debt specialists provides some assurance to the administrator that the provider will be able to comply with section 17.

9. As used in paragraph (10), "programs" encompasses both a course of instruction and computer software. Unless the administrator adopts a rule to the contrary, a course of instruction may be entirely oral.

10. An applicant, whether located in this state or elsewhere, need supply only those documents specified in paragraph (12) that it will use with residents of this state. If it will use more than one form, it must supply all of them. Section 32(b) empowers the administrator to investigate the activities in another jurisdiction of a provider that is doing business in this state. Under that section the administrator may obtain documents used in other jurisdictions.

11. As with the preceding paragraph, paragraph (13) only requires an applicant, regardless of its location, to supply the schedules of fees and charges for residents of this state, but if it uses more than one schedule, it must supply all of them. For purposes of this paragraph, "fees and charges" includes all costs, however denominated (e.g., "charitable subsidy"), to be paid by customers of the applicant. This information will enable the administrator to monitor the industry's practices in the state and may assist the administrator in determining whether an individual provider is gouging individuals or whether the legislature should be encouraged to raise the fee cap because the passage of time or changed circumstances make it too low. Section 23 imposes limitations on the amount of fees, and Section 24 prohibits the solicitation of voluntary contributions.

12. Paragraphs (12) and (13) require information that is current as of the time of the application. Unless the administrator adopts a rule to the contrary, an applicant is free to modify its forms or fees without prior approval, but section 7 requires the provider to notify the administrator promptly of any such modification.

13. Paragraph (14) requires the results of a criminal-records check on every officer of the applicant. In addition, it requires the results of a criminal-records check covering every employee or agent who is authorized to ~~access~~ initiate transactions in the applicant's trust account. If the applicant is a natural person, the criminal-records check must cover the applicant, too.

This paragraph requires "the results of a criminal-records check, including fingerprints."

In some jurisdictions the mechanics and procedures for obtaining fingerprints are quite burdensome. This paragraph attempts to reduce that burden. It does not require that an applicant obtain a criminal-records check specifically for the application for registration in this state. If an applicant has obtained a criminal-records check in connection with obtaining permission to do business in another state and that criminal-records check meets the standards of this paragraph, the applicant may submit the results of it in its application to this state. The 12-month limitation applies to the criminal-records check, not the time of submission to the other state. The criminal-records check must include a check of fingerprints, but the fingerprints need not have been obtained during the 12-month period.

14. Paragraphs (15)-(18) contain disclosures designed to enable the administrator to enforce the requirement of an independent board of directors and the restrictions on self-dealing. It requires these disclosures of all applicants, even for-profit entities, if they are permitted to provide debt-management services, because the restrictions on self-dealing (section 28(e)) apply to all providers. The disclosures also help the administrator monitor whether the fee limits are set at an appropriate level. Paragraph (16) requires the disclosure with respect to officers, since officers are included the category, "employees." In paragraph (17) "compensation" includes cash and all other items that ordinarily are considered part of compensation.

15. Paragraph (19) authorizes the administrator to require additional information either by rulemaking procedure applicable to all applicants or by specific request in response to a specific application. Section 9 specifies the grounds for denying registration (including a finding that the general fitness of the applicant is not such as to warrant belief that the applicant will comply with the Act). This paragraph authorizes the administrator to seek additional information relevant to the application of that standard.

Section 9 is amended to read:

SECTION 9. CERTIFICATE OF REGISTRATION: ISSUANCE OR DENIAL.

(a) Except as otherwise provided in subsections (b) and (c), the administrator shall issue a certificate of registration as a provider to a person that complies with Sections 5 and 6.

(b) If an applicant has otherwise complied with Sections 5 and 6, including a timely effort to obtain the information required by Section 6(14) but the information has not been received, the administrator may issue a temporary certificate of registration. The temporary certificate shall expire no later than 180 days after issuance.

~~(b)~~(c) The administrator may deny registration if:

(1) the application contains information that is materially erroneous or

incomplete;

(2) an officer, director, or owner of the applicant has been convicted of a crime, or suffered a civil judgment, involving dishonesty or the violation of state or federal securities laws;

(3) the applicant or any of its officers, directors, or owners has defaulted in the payment of money collected for others; or

(4) the administrator finds that the financial responsibility, experience, character, or general fitness of the applicant or its owners, directors, employees, or agents does not warrant belief that the business will be operated in compliance with this [act].

~~(c)~~(d) The administrator shall deny registration if~~:~~

~~(1) the application is not accompanied by the fee established by the administrator; or~~

~~(2)~~ [, with respect to an applicant that is organized as a not-for-profit entity or has obtained tax-exempt status under the Internal Revenue Code, 26 U.S.C. Section 501 [, as amended],] the applicant's board of directors is not independent of the applicant's employees and agents.

~~(d)~~(e) Subject to adjustment of the dollar amount pursuant to Section 32(f), a board of directors is not independent for purposes of subsection ~~(c)~~(d) if more than one-fourth of its members:

(1) are affiliates of the applicant, as defined in Section 2(2)(A) or (B)(i), (ii), (iv), (v), (vi), or (vii); or

(2) after the date 10 years before first becoming a director of the applicant, were employed by or directors of a person that received from the applicant more than $25,000 in either the current year or the preceding year.

Legislative Note: *If the state wishes to permit only not-for-profit entities to provide debt-management services, in subsection (c)(2) all the bracketed language should be deleted. If the state wishes to permit for-profit entities to provide credit-counseling services, debt-settlement services, or both, the first set of brackets should be deleted.*

In states in which the constitution does not permit the phrase, "as amended," when federal statutes are incorporated into state law, the phrase should be deleted in subsection (c)(2).

Comment

1. Section 6(14) requires an applicant to provide the results of a criminal-records check, including fingerprints. This information is provided by third parties, and the applicant has no control over the timeliness of any response. Subsection (b) therefore gives the administrator discretion to issue a temporary certificate of registration.

~~1~~ 2. Some conduct may justify a lifetime ban from the debt-management-services industry. Examples include some of the conduct described in subsection (b)(2) and (3). Other conduct can be readily corrected, e.g., subsection (b)(1). The introductory language of the subsection ("administrator *may* deny") gives the administrator discretion to consider the importance of various items of adverse information about an applicant, such as the precise nature and timing of past criminal conduct. The language of limitation at the end of subsection (b)(2) ("involving dishonesty or the violation of state or federal securities laws") applies to both criminal convictions and civil judgments. Subsection (b)(4) gives the administrator discretion to consider other relevant information, such as the fact of and reasons for any suspension or revocation of the applicant's right to provide debt-management services in another state.

~~2~~ 3. Paragraphs (2) and (3) do not express any temporal limts and therefore require disclosure of the specified information regardless of when the conviction, judgment, or default occurred.

~~3~~ 4. Because providers may have hundreds of employees, most of whom are not in control of the provider, subsection (b) does not include employees in the list of persons in paragraphs (2) and (3) whose conduct justifies the denial of registration. Conversely, paragraph (4) does include employees. It does not explicitly name officers, because officers are included in the category, "employee." The past misconduct of employees is a basis for action under paragraph (4), because the administrator has the discretion to deny registration if, e.g., a pattern of hiring raises doubts about the likelihood that the applicant will operate the business in compliance with the Act. Unless the administrator by rule requires otherwise, however, paragraph (4) does not require an applicant to disclose the convictions or adverse judgments of its employees. These disclosures are required by section 6(6), but only with respect to the applicant's officers, directors, owners, and those employees who are authorized to access the trust account.

~~4~~ 5. Subsection (c) states circumstances in which denial of registration is mandatory. Paragraph (2) requires that the board of directors of a nonprofit entity be independent of the management of the entity and independent of the creditors for whom the entity is, in a sense, acting as debt collector. If the board of directors is not independent, the administrator must deny registration. Similar to subsection (b)(4), this paragraph does not explicitly mention "officers" because officers are included in the term, "employee."

5 6. Since the definition of "affiliate" includes directors (section 2(2)(B)(iii)), subsection (d)(1) omits this subparagraph of the definition of affiliates for purposes of determining the independence of the board.

6 7. Subsection (d)(2) specifies a period beginning 10 years before a person first becomes a director. It specifies a starting point for the period but no ending point. This means that if a person meets the employee/director test of paragraph (2) while the person is on the applicant's board of directors, the person is not independent, even if more than 10 years have elapsed since the person first became a member of the applicant's board.

Section 11 is amended to read:

SECTION 11. RENEWAL OF REGISTRATION.

(a) A provider must obtain a renewal of its registration annually.

(b) An application for renewal of registration as a provider must be in a form prescribed by the administrator, signed under [oath] [penalty of false statement], and:

(1) be filed no fewer than 30 and no more than 60 days before the registration expires;

(2) be accompanied by the fee established by the administrator and the bond required by Section 13;

(3) contain the matter required for initial registration as a provider by Section 6(8) and (9) and a financial statement, audited by an accountant licensed to conduct audits, for the applicant's fiscal year immediately preceding the application;

(4) disclose any changes in the information contained in the applicant's application for registration or its immediately previous application for renewal, as applicable. If an application is otherwise complete and the applicant has made a timely effort to obtain the information required by Section 6(14) but the information has not been received, the administrator may issue a temporary renewal of registration. The temporary renewal shall expire no later than 180 days after issuance;

(5) supply evidence of insurance in an amount equal to the larger of $250,000 or the highest daily balance in the trust account required by Section 22 during the six-month period immediately preceding the application:

(A) against risks of dishonesty, fraud, theft, and other misconduct on the part of the applicant or a director, employee, or agent of the applicant;

(B) issued by an insurance company authorized to do business in this state and rated at least A or equivalent by a nationally recognized rating organization approved by the administrator;

(C) with ~~no~~ a deductible not exceeding $5,000;

(D) payable ~~to~~ for the benefit of the applicant, ~~the~~ this state, and individuals who ~~have agreements with the applicant, and~~ are residents of this state, as their interests may appear; and

(E) not subject to cancellation by the applicant ~~without~~ or the ~~approval of~~ insurer until 60 days after written notice has been given to the administrator;

* * *

Comment

1. A registration must be renewed every year. The administrator may adopt a rule specifying the timing of renewals, so that renewals of registration of all providers occur on the same date, occur on a rolling basis, or otherwise.

2. Subsection (b) states the prerequisites for renewal of registration. The bond requirement in paragraph (2) may be satisfied also in the manner provided in section 14.

3. Paragraph (4) requires a provider to update any required information that has changed. This includes background checks on anyone who, since the last renewal, has become an officer of the applicant or has been given power to initiate transactions in the trust account required by Section 22. Since acquisition of this information is not entirely within the control of the provider, this paragraph grants the administrator the discretion to issue a temporary renewal of registration.

~~3~~ 4. Paragraph (5) contains the same requirements that section 5(b)(4) does for initial registration, except that upon renewal the provider must obtain insurance in an amount equal to the highest balance in the trust account during the six months preceding the application for renewal.

~~4~~ 5. Paragraph (6) requires disclosure of two items. The first is the total amount received from its customers by a provider (or its designee). This requirement does not apply to a provider that directs its customers to accumulate money on their own. The second item is the total amount distributed to creditors, and this requirement applies to all providers, whether or not they (or their designees) take possession of their customers' funds.

~~5~~ 6. Paragraph (7) supplements paragraph (6) by requiring a provider that does not take possession of its customers' funds to disclose the gross amount its customers have accumulated. "Gross amount" means the total amount accumulated without adjustment for any debits, withdrawals, or payments for fees or for satisfaction of creditors' claims. A provider that does not take possession of its customers' money may monitor the customers' accounts, either by direct access to the accounts or by requiring the customers to provide periodic copies of bank statements. If the provider does not do either of these, and therefore has no knowledge of the amounts accumulated, it need make no disclosure under paragraph (7).

~~6~~ 7. Paragraph (8) authorizes the administrator to require additional information from an applicant. This refers both to information required by rule and information requested in response to the information in an application. For example, the administrator may exercise the rulemaking authority to require applicants to disclose indicia of success, such as the percentage of individuals who complete plans or the amounts a provider has received from creditors (or others).

~~7~~ 8. The home addresses, financial statements, salaries of the highest-paid employees, and results of the criminal-records check, as disclosed in an application for renewal, remain exempt from public disclosure.

~~8~~ 9. The grounds for denial of an application to renew registration appear in section 34. If a provider files a timely and complete application, subsection (d) provides that the registration remains effective until the administrator denies it. The denial of an application for renewal triggers a right of appeal under subsection (e). Pending completion of the appeals process, a provider is required to continue providing debt-management services, even though the administrator has determined that it should not be permitted to continue its business in this state. For this reason, subsection (e) limits to 30 days the time for initiating the appeals process. If the appeals process concludes with a determination upholding the administrator's decision, section 4(a) prohibits the provider from providing debt-management services. An abrupt end to the provider's activity, however, may adversely affect its customers who are in the middle of a plan. Consequently, this subsection qualifies section 4(a) and compels the provider to continue providing services to existing customers until the administrator authorizes it to cease.

Section 14 is amended to read:

SECTION 14. BOND REQUIRED: SUBSTITUTE.

(a) Instead of the surety bond required by Section 13, a provider may deliver to the administrator, in the amount required by Section 13(b), and, except as otherwise provided in paragraph (2)(A), payable or available to this state and to individuals who reside in this state when they agree to receive debt-management services from the provider, as their interests may appear, if the provider or its agent does not comply with this [act]:

(1) a certificate of insurance

(A) issued by an insurance company authorized to do business in this state and rated at least A or equivalent by a nationally recognized rating organization~~;~~ approved by the administrator; and

(B) with no deductible, or if the provider supplies a bond in the amount of $5,000, a deductible not exceeding $5,000; or

(2) with the approval of the administrator:

(A) an irrevocable letter of credit, issued or confirmed by a bank approved by the administrator, payable upon presentation of a certificate by the administrator stating that the provider or its agent has not complied with this [act]; or

(B) bonds or other obligations of the United States or guaranteed by the United States or bonds or other obligations of this state or a political subdivision of this state, to be deposited and maintained with a bank approved by the administrator for this purpose.

(b) If a provider furnishes a substitute pursuant to subsection (a), the provisions of Section 13(a), (c), (d), and (e) apply to the substitute.

* * *

Section 16 is amended to read:

SECTION 16. CUSTOMER SERVICE. A provider that is required to be registered under this [act] shall maintain a toll-free communication system, staffed at a level that reasonably permits an individual to speak to a certified counselor, certified debt specialist, or customer-service representative, as appropriate, during ordinary business hours.

* * *

Section 17 is amended to read:

SECTION 17. PREREQUISITES FOR PROVIDING DEBT-MANAGEMENT SERVICES.

(a) Before providing debt-management services, a registered provider shall give the individual an itemized list of goods and services and the charges for each. The list must be clear and conspicuous, be in a record the individual may keep whether or not the individual assents to an agreement, and describe the goods and services the provider offers:

(1) free of additional charge if the individual enters into an agreement;

(2) for a charge if the individual does not enter into an agreement; and

(3) for a charge if the individual enters into an agreement, using the following terminology, as applicable, and format:

Set-up fee ____________________
dollar amount of fee

Monthly service fee ____________________
dollar amount of fee or method of determining amount

Settlement fee ____________________
dollar amount of fee or method of determining amount

Goods and services in addition to those provided in connection with a plan:

__________ ____________________
(item) *dollar amount or method of determining amount*

__________ ____________________
(item) *dollar amount or method of determining amount.*

(b) A provider may not furnish debt-management services unless the provider, through the services of a certified counselor or certified debt specialist:

(1) provides the individual with reasonable education about the management of personal finance;

(2) has prepared a financial analysis; and

(3) if the individual is to make regular, periodic payments:

(A) has prepared a plan for the individual;

(B) has made a determination, based on the provider's analysis of the information provided by the individual and otherwise available to it, that the plan is suitable for the individual and the individual will be able to meet the payment obligations under the plan; and

(C) believes that each creditor of the individual listed as a participating creditor in the plan will accept payment of the individual's debts as provided in the plan.

(c) Before an individual assents to an agreement to engage in a plan, a provider shall:

(1) provide the individual with a copy of the analysis and plan required by subsection (b) in a record that identifies the provider and that the individual may keep whether or not the individual assents to the agreement;

(2) inform the individual of the availability, at the individual's option, of assistance by a toll-free communication system or in person to discuss the financial analysis and plan required by subsection (b); and

(3) with respect to all creditors identified by the individual or otherwise known by the provider to be creditors of the individual, provide the individual with a list of:

(A) creditors that the provider expects to participate in the plan and grant concessions;

(B) creditors that the provider expects to participate in the plan but not grant concessions;

(C) creditors that the provider expects not to participate in the plan; and

(D) all other creditors.

(d) Before an individual assents to an agreement~~ to engage in a plan~~, the provider shall inform the individual, in a record that contains nothing else, that is given separately, and that the individual may keep whether or not the individual assents to the agreement:

(1) of the name and business address of the provider;

(2) that plans are not suitable for all individuals and the individual may ask the provider about other ways, including bankruptcy, to deal with indebtedness;

(3) that establishment of a plan may adversely affect the individual's credit rating or credit scores;

(4) that nonpayment of debt may lead creditors to increase finance and other charges or undertake collection activity, including litigation;

(5) unless it is not true, that the provider may receive compensation from the creditors of the individual; and

(6) that, unless the individual is insolvent, if a creditor settles for less than the full amount of the debt, the plan may result in the creation of taxable income to the individual, even though the individual does not receive any money.

(e) If a provider may receive payments from an individual's creditors and the plan contemplates that the individual's creditors will reduce finance charges or fees for late payment, default, or delinquency, the provider may comply with subsection (d) by providing the following disclosure, surrounded by black lines:

IMPORTANT INFORMATION FOR YOU TO CONSIDER

(1) Debt-management plans are not right for all individuals, and you may ask us to provide information about other ways, including bankruptcy, to deal with your debts.

(2) Using a debt-management plan may ~~hurt your~~ make it harder for you to obtain credit ~~rating or credit scores~~.

(3) We may receive compensation for our services from your creditors.

____

Name and business address of provider

(f) If a provider will not receive payments from an individual's creditors and the plan contemplates that the individual's creditors will reduce finance charges or fees for late payment, default, or delinquency, a provider may comply with subsection (d) by providing the following disclosure, surrounded by black lines:

IMPORTANT INFORMATION FOR YOU TO CONSIDER

(1) Debt-management plans are not right for all individuals, and you may ask us to provide information about other ways, including bankruptcy, to deal with your debts.

(2) Using a debt-management plan may ~~hurt your~~ make it harder for you to obtain credit ~~rating or credit scores~~.

____

Name and business address of provider

(g) If ~~a plan~~ an agreement contemplates that creditors will settle debts for less than the full principal amount of debt owed, a provider may comply with subsection (d) by providing the following disclosure, surrounded by black lines:

IMPORTANT INFORMATION FOR YOU TO CONSIDER

(1) Our program is not right for all individuals, and you may ask us to provide information about bankruptcy and other ways to deal with your debts.

(2) Nonpayment of your debts under our program may

- hurt your credit rating or credit scores;
- lead your creditors to increase finance and other charges; and
- lead your creditors to undertake activity, including lawsuits, to collect the debts.

(3) Reduction of debt under our program may result in taxable income to you, even though you will not actually receive any money.

____

Name and business address of provider

Comment

* * *

8. Subsection (d) requires providers to give a warning to individuals before they commit to ~~a plan~~ an agreement, and it requires the warning to be given separately. This prohibits a provider from handing the warning over along with other documents or materials. The intention of the subsection is to require delivery in a form and context in which the individual will actually notice and read the warning.

9. Subsections (e) through (g) provide safe-harbor language for the provider to use. Subsection (e) is designed for credit-counseling entities that receive payments from the creditors of its customers. Subsection (f) is designed for credit-counseling entities that do not receive payments from their customers' creditors. Subsection (g) is designed for debt-settlement entities. Use of the exact language in these subsections, contained in a box consisting of black lines, constitutes compliance with subsection (d). This is true even though the language in subsections (e)(2) and (f)(2) differs significantly from the language in subsection (d)(3). If the provider uses ~~other~~ language other than that prescribed in subsections (e)-(g), the disclosure is subject to review to determine if it adequately discloses the ~~required~~ information required by subsection (d). If the provider furnishes both credit-counseling and debt-settlement services, it may combine the disclosures into one form, but this section does not provide any safe harbor.

Section 18 is amended to read:

SECTION 18. COMMUNICATION BY ELECTRONIC OR OTHER MEANS.

(a) In this section:

(1) "Federal act" means the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq.[, as amended].

(2) "Consumer" means an individual who seeks or obtains goods or services that are used primarily for personal, family, or household purposes.

(b) A provider may satisfy the requirements of Section 17, 19, or 27 by means of the Internet or other electronic means if the provider obtains a consumer's consent in the manner provided by Section 101(c)(1) of the federal act.

(c) The disclosures and materials required by Sections 17, 19, and 27 shall be presented in a form that is capable of being accurately reproduced for later reference.

(d) With respect to disclosure by means of an Internet website, the disclosure of the information required by Section 17(d) must appear on one or more screens that:

(1) contain no other information; and

(2) the individual must see before proceeding to assent to formation of ~~a plan~~ an agreement.

(e) At the time of providing the materials and agreement required by Sections 17(c) and (d), 19, and 27, a provider shall inform the individual that upon electronic, telephonic, or written request, it will send the individual a written copy of the materials, and shall comply with a request as provided in subsection (f).

(f) If a provider is requested, before the expiration of 90 days after ~~a plan~~ an agreement is completed or terminated, to send a written copy of the materials required by Section 17(c) and (d), 19, or 27, the provider shall send them at no charge within three business days after the request, but the provider need not comply with a request more than once per calendar month or if it reasonably believes the request is made for purposes of harassment. If a request is made more than 90 days after ~~a plan~~ an agreement is completed or terminated, the provider shall send within a reasonable time a written copy of the materials requested.

(g) A provider that maintains an Internet website shall disclose on the home page of its website or on a page that is clearly and conspicuously connected to the home page by a link that clearly reveals its contents:

(1) its name and all names under which it does business;

(2) its principal business address, telephone number, and electronic-mail address, if any; and

(3) the names of its principal officers.

(h) Subject to subsection (i), if a consumer who has consented to electronic communication in the manner provided by Section 101 of the federal act withdraws consent as provided in the federal act, a provider may terminate its agreement with the consumer.

(i) If a provider wishes to terminate an agreement with a consumer pursuant to subsection (h), it shall notify the consumer that it will terminate the agreement unless the consumer, within 30 days after receiving the notification, consents to electronic communication in the manner provided in Section 101(c) of the federal act. If the consumer consents, the provider may terminate the agreement only as permitted by Section 19(a)(6)(G).

Legislative Note: *In states in which the constitution does not permit the phrase "as amended," the phrase should be deleted in subsection (a).*

Comment

* * *

3. To meet the objectives of the separate delivery contemplated by section 17, electronic delivery must satisfy certain requirements of form, such as appearing on a screen that contains no other information. ~~Although~~ The subsection uses the term "screen," which is synonymous with "window," "web page," "tab within a browser display," and perhaps other terms. The critical factor is that the record may not contain other information~~,~~; but it does not violate subsection (d) if the record is an electronic page on a website and the record reveals how the individual may exit the page.

* * *

Section 19 is amended to read:

SECTION 19. FORM AND CONTENTS OF AGREEMENT.

* * *

(d) An agreement must provide that:

(1) the individual has a right to terminate the agreement at any time, without penalty or obligation, by giving the provider written or electronic notice, in which event:

(A) the provider will refund all unexpended money that the provider or its agent has received from or on behalf of the individual for the reduction or satisfaction of the individual's debt;

(B) with respect to an agreement that contemplates that creditors will settle debts for less than the principal amount of debt, the provider will refund 65 percent of any portion of the set-up fee that has not been credited against the settlement fee; and

(C) all powers of attorney granted by the individual to the provider are revoked and ineffective;

(2) the individual authorizes any bank in which the provider or its agent has established a trust account to disclose to the administrator any financial records relating to the trust account; and

(3) the provider will notify the individual within five days after learning of a creditor's <u>final</u> decision to reject or withdraw from a plan and that this notice will include:

(A) the identity of the creditor; and

(B) the right of the individual to modify or terminate the agreement.

* * *

Section 20 is amended to read:

SECTION 20. CANCELLATION OF AGREEMENT; WAIVER.

(a) An individual may cancel an agreement before midnight of the third business day after the individual assents to it, unless the agreement does not comply with subsection (b) or Section 19 or 28, in which event the individual may cancel the agreement within 30 days after the individual assents to it. To exercise the right to cancel, the individual must give notice in a record to the provider. Notice by mail is given when mailed.

(b) An agreement must be accompanied by a form that contains in bold-face type, surrounded by bold black lines:

Notice of Right to Cancel

You may cancel this agreement, without any penalty or obligation, at any time before midnight of the third business day that begins the day after you agree to it by electronic communication or by signing it.

To cancel this agreement during this period, send an e-mail to

____________________________ or mail or deliver a signed, dated copy of this
E-mail address of provider

notice, or any other written notice to ___________________________________
Name of provider

at _______________________________ before midnight on ____________________.
Address of provider *Date*

If you cancel this agreement within the 3-day period, we will refund all money you already have paid us.

You also may terminate this agreement at any later time, but we ~~are~~ may not be required to refund fees you have paid us.

I cancel this agreement,

____
Print your name

____
Signature

____
Date

* * *

Section 22 is amended to read:

SECTION 22. TRUST ACCOUNT.

(a) All money paid to a provider by or on behalf of an individual ~~pursuant to a plan~~ for distribution to creditors pursuant to a plan is held in trust. Within two business days after receipt, the provider shall deposit the money in a trust account established for the benefit of individuals to whom the provider is furnishing debt-management services.

* * *

Section 23 is amended to read:

SECTION 23. FEES AND OTHER CHARGES.

(a) A provider may not impose directly or indirectly a fee or other charge on an individual or receive money from or on behalf of an individual for debt-management services except as permitted by this section.

(b) A provider may not impose charges or receive payment for debt-management services until the provider and the individual have signed an agreement that complies with Sections 19 and 28.

(c) If an individual assents to an agreement, a provider may not impose a fee or other charge for educational or counseling services, or the like, except as otherwise provided in this subsection and Section 28(d). The administrator may authorize a provider to charge a fee based on the nature and extent of the educational or counseling services furnished by the provider.

(d) Subject to adjustment of dollar amounts pursuant to Section 32(f), the following rules apply:

(1) If an individual assents to a plan that contemplates that creditors will reduce finance charges or fees for late payment, default, or delinquency, the provider may charge:

(A) a fee not exceeding $50 for consultation, obtaining a credit report, setting up an account, and the like; and

(B) a monthly service fee, not to exceed $10 times the number of creditors remaining in a plan at the time the fee is assessed, but not more than $50 in any month.

(2) If an individual assents to ~~a plan~~ an agreement that contemplates that creditors will settle debts for less than the principal amount of the debt, a provider may charge:

(A) subject to Section 19(d), a fee for consultation, obtaining a credit report, setting up an account, and the like, in an amount not exceeding the lesser of $400 and four percent of the debt in the plan at the inception of the plan; and

(B) a monthly service fee, not to exceed $10 times the number of creditors remaining in a plan at the time the fee is assessed, but not more than $50 in any month.

(3) A provider may not impose or receive fees under both paragraphs (1) and (2).

(4) Except as otherwise provided in Section 28(d), if an individual does not assent to an agreement, a provider may receive for educational and counseling services it provides to the individual a fee not exceeding $100 or, with the approval of the administrator, a larger fee. The administrator may approve a fee larger than $100 if the nature and extent of the educational and counseling services warrant the larger fee.

(e) If, before the expiration of 90 days after the completion or termination of educational or counseling services, an individual assents to an agreement, the provider shall refund to the individual any fee paid pursuant to subsection (d)(4).

(f) Except as otherwise provided in subsections (c) and (d), if ~~a plan~~ an agreement contemplates that creditors will settle an individual's debts for less than the principal amount of the debt, compensation for services in connection with settling a debt may not exceed, with respect to each debt~~,~~:

(1) 30 percent of the excess of the principal amount of the debt over the amount paid the creditor pursuant to the ~~plan,~~ agreement less~~;~~

(2) to the extent it has not been credited against an earlier settlement fee:

~~(1)~~(A) the fee charged pursuant to subsection (d)(2)(A); and

~~(2)~~(B) the aggregate of fees charged pursuant to subsection (d)(2)(B).

(g) Subject to adjustment of the dollar amount pursuant to Section 32(f), if a payment to a provider by an individual under this [act] is dishonored, a provider may impose a reasonable charge on the individual, not to exceed the lesser of $25 and the amount permitted by law other than this [act].

Comment

* * *

9. Paragraph (4) permits a provider to impose a charge for education or counseling if an individual does not enter ~~a plan~~ an agreement. The maximum fee for this education or counseling is specified in the statute, but this paragraph permits the administrator to authorize a larger fee. The approval may, but need not, refer to a specific provider or a specified program of study, such as a course of instruction developed by a third party for use by others. The nature and extent of the educational services may warrant approval of a larger fee if they exceed the minimum standard contemplated by section 17(b)(1).

* * *

12. Subsection (c) prohibits a provider from charging for education or counseling if an individual enters ~~a plan~~ an agreement. To evade this limitation, a provider might attempt to divide the enrollment process into two stages: a period of education or counseling, for which it imposes a fee, as permitted by subsection (d)(4), followed by a plan or an agreement, in connection with which it would obey the prohibition in subsection (c) against a fee for education or counseling. Subsection (e) addresses subterfuges like this by requiring a refund of the fee for education or counseling if the individual assents to ~~a plan~~ an agreement before the expiration of 90 days after the completion or termination of the education or counseling. This bright-line test is the minimum restriction on evasion of the limit on charges. Courts and the administrator can and should deal with attempts to evade the prohibition of subsection (c). Moreover, the obligation to act in good faith and the prohibition against unfair, unconscionable, or deceptive acts or practices also constrain attempts to evade the restrictions of this section.

* * *

Section 26 is amended to read:

SECTION 26. TERMINATION OF AGREEMENTS.

(a) If an individual who has entered into an agreement fails for 60 days to make payments required by the agreement, a provider may terminate the agreement.

(b) If a provider or an individual terminates an agreement, the provider shall immediately return to the individual:

(1) any money of the individual held in trust for the benefit of the individual; and

(2) 65 percent of any portion of the set-up fee received pursuant to Section 23(d)(2) which has not been credited against settlement fees.

Comment

1. Section 19(a)(6)(G) requires a provider to include in an agreement a provision disclosing that the provider may terminate the agreement for good cause. Subsection (a) gives an example of what constitutes good cause. There may be others.

2. Upon termination, whether by the provider or the individual, the provider must immediately return the individual's money. In the context of credit-counseling entities, if the provider is acting in conformity with the Act, there will be no money in the trust account. Subsection (b)(1) addresses the provider that has not yet distributed the money to creditors as required by section 22(c)(2). It also requires a debt-settlement entity in possession of an individual's money to return it to the individual. Paragraph (1) does not require refund of money properly held as payment of fees. Paragraph (2), on the other hand, requires a debt settlement entity to refund 65 percent of any portion of the set-up fee that has not already, in effect, been refunded as a credit against settlement fees for debts already settled. To determine the amount of the refund, the provider must calculate how much of the set-up fee has been credited against the settlement fee. The provider must pay the individual 65% of the remainder. For commentary on how to make this calculation, see ~~Official~~ Comment 11 to section 19.

Section 28 is amended to read:

SECTION 28. PROHIBITED ACTS AND PRACTICES.

(a) A provider may not, directly or indirectly:

(1) misappropriate or misapply money held in trust;

(2) settle a debt on behalf of an individual for more than 50 percent of the principal amount of the debt owed a creditor, unless the individual assents to the settlement after the creditor has assented;

(3) take a power of attorney that authorizes it to settle a debt, unless the power of attorney expressly limits the provider's authority to settle debts for not more than 50

percent of the principal amount of the debt owed a creditor;

(4) exercise or attempt to exercise a power of attorney after an individual has terminated an agreement;

(5) initiate a transfer from an individual's account at a bank or with another person unless the transfer is:

(A) a return of money to the individual; or

(B) before termination of an agreement, properly authorized by the agreement and this [act], and for:

(i) payment to one or more creditors pursuant to ~~a plan~~ an agreement; or

(ii) payment of a fee;

(6) offer a gift or bonus, premium, reward, or other compensation to an individual for executing an agreement;

(7) offer, pay, or give a gift or bonus, premium, reward, or other compensation to a person for referring a prospective customer, if the person making the referral has a financial interest in the outcome of debt-management services provided to the customer, unless neither the provider nor the person making the referral communicates to the prospective customer the identity of the source of the referral;

(8) receive a bonus, commission, or other benefit for referring an individual to a person;

(9) structure a plan in a manner that would result in a negative amortization of any of an individual's debts, unless a creditor that is owed a negatively amortizing debt agrees to refund or waive the finance charge upon payment of the principal amount of the debt;

(10) compensate its employees on the basis of a formula that incorporates the number of individuals the employee induces to enter into agreements;

(11) settle a debt or lead an individual to believe that a payment to a creditor is in settlement of a debt to the creditor unless, at the time of settlement, the individual

receives a certification by the creditor that the payment is in full settlement of the debt;

(12) make a representation that:

(A) the provider will furnish money to pay bills or prevent attachments;

(B) payment of a certain amount will permit satisfaction of a certain amount or range of indebtedness; or

(C) participation in a plan will or may prevent litigation, garnishment, attachment, repossession, foreclosure, eviction, or loss of employment;

(13) misrepresent that it is authorized or competent to furnish legal advice or perform legal services;

(14) represent in its agreements, disclosures required by this [Act], advertisements, or Internet web site that it is

(A) a not-for-profit entity unless it is organized and properly operating as a not-for-profit entity under the law of the state in which it was formed; or ~~that it is~~

(B) a tax-exempt entity unless it has received certification of tax-exempt status from the Internal Revenue Service and is properly operating as a not-for-profit entity under the law of the state in which it was formed;

(15) take a confession of judgment or power of attorney to confess judgment against an individual; or

(16) employ an unfair, unconscionable, or deceptive act or practice, including the knowing omission of any material information.

* * *

Comment

* * *

7. The practice of many providers has been to compensate their employees on the basis of how many individuals they can enroll in plans. This provides an incentive to the employees to engage in deceptive and coercive sales pitches. Paragraph (10) seeks to curb the deception and coercion by barring this method of compensating employees. The Bankruptcy Code, 11 U.S.C. § 111(c)(2)(F), contains a similar prohibition for the credit-counseling entities within its purview. Courts and the administrator should be vigilant to attempts to evade the prohibition of this

paragraph. Nevertheless, it is permissible for providers to create incentives for their employees to identify individuals who will be able to perform an agreement completely. Thus it is not a violation of this subsection for a provider to use the number of successfully completed agreements as a criterion for compensation of its employees.

8. If ~~a plan contemplates~~ an agreementcontemplates settlement of a debt for less than the full principal amount of the debt, paragraph (11) prohibits a provider from paying, or directing an individual to pay, a creditor unless the individual receives formal acknowledgment from the creditor that the debt is satisfied. This ~~acknowledgement~~ acknowledgment may come in at least two forms. The creditor may assent to a settlement in a communication offering to settle the debt in exchange for specified performance by the individual, typically payment of a specified amount by a specified date. This communication often is called a settlement offer and may be sent to the individual or the provider. After the individual renders the specified performance, the creditor may send a communication stating that the debt is satisfied. This communication often is called a satisfaction letter. This paragraph requires transmission of the settlement offer to the individual in all cases. If the creditor sends a satisfaction letter to the provider, the obligation of good faith requires the provider to forward that to the individual as well. In the case of either a settlement offer or a satisfaction letter, the creditor's certification may be passed on by the provider or come directly from the creditor.

9. Paragraph (11) also prohibits a provider from misleading an individual into believing that a payment will settle a debt. To violate the paragraph, a misrepresentation does not have to be express. If a settlement contemplates that a creditor will be accepting installment payments, the provider must make it clear to the individual that the initial installment does not settle the debt.

10. Paragraph (12) applies not only to statements made specifically to an individual; it also applies to advertising. Subparagraphs (B) and (C) prohibit certain representations that sometimes are used to entice individuals to sign up for plans. They are prohibited here even when they are true because they too often are untrue.

11. Paragraph (14) applies to advertisements and other communications that a provider intends to reach potential customers. Not-for-profit status is a status under state law. An entity may qualify for that status without also being tax-exempt under federal law. For a provider to represent that it is a nonprofit or not-for-profit entity, it is not enough that the provider was organized under a statute authorizing not-for-profits. Paragraph (14) requires that the provider also must be properly operating as a not-for-profit. Nor does it suffice that the provider has been granted tax-exempt status under the Internal Revenue Code. If it is not operating in a manner consistent with the law under which it was formed, a representation that it is a nonprofit or tax-exempt entity violates this section. A provider that is unsure whether it is properly operating as a not-for-profit entity may avoid liability under this paragraph by not representing that it has tax-exempt or not-for-profit status in any of its communications that are designed to reach the individuals it seeks to serve.

* * *

Section 30 is amended to read:

SECTION 30. ADVERTISING. ~~A provider that~~

(a) If a provider whose agreements contemplate that creditors will reduce finance charges or fees for late payment, default, or delinquency advertises debt-management services, it shall disclose, in an easily comprehensible manner, that using a debt-management plan may make it harder for the individual to obtain credit.

(b) If a provider whose agreements contemplate that creditors will settle for less than the full principal amount of debt advertises debt-management services, it shall disclose, in an easily comprehensible manner, the information specified in Section 17(d)(3) and (4).

* * *

Section 32 is amended to read:

SECTION 32. POWERS OF ADMINISTRATOR.

(a) The administrator may act on its own initiative or in response to complaints and may receive complaints, take action to obtain voluntary compliance with this [act], [refer cases to the [attorney general]], and seek or provide remedies as provided in this [act].

(b) The administrator may investigate and examine, in this state or elsewhere, by subpoena or otherwise, the activities, books, accounts, and records of a person that provides or offers to provide debt-management services, or a person to which a provider has delegated its obligations under an agreement or this [act], to determine compliance with this [act]. Information that identifies individuals who have agreements with the provider shall not be disclosed to the public. In connection with the investigation, the administrator may:

(1) charge the person the reasonable expenses necessarily incurred to conduct the examination;

(2) require or permit a person to file a statement under oath as to all the facts and circumstances of a matter to be investigated; and

(3) seek a court order authorizing seizure from a bank at which the person

maintains a trust account required by Section 22, any or all money, books, records, accounts, and other property of the provider that is in the control of the bank and relates to individuals who reside in this state.

(c) The administrator may adopt rules to implement the provisions of this [act] in accordance with [insert the appropriate section of the Administrative Procedure Act or other statute governing administrative procedure].

(d) The administrator may enter into cooperative arrangements with any other federal or state agency having authority over providers and may exchange with any of those agencies information about a provider, including information obtained during an examination of the provider.

(e) The administrator, by rule, shall establish reasonable fees to be paid by providers for the expense of administering this [act].

(f) The administrator, by rule, shall adopt dollar amounts instead of those specified in Sections 2, 5, 9, 13, 23, 33, and 35 to reflect inflation, as measured by the United States Bureau of Labor Statistics Consumer Price Index for All Urban Consumers or, if that index is not available, another index adopted by rule by the administrator. The administrator shall adopt a base year and adjust the dollar amounts, effective on July 1 of each year, if the change in the index from the base year, as of December 31 of the preceding year, is at least 10 percent. The dollar amount must be rounded to the nearest $100, except that the amounts in Section 23 must be rounded to the nearest dollar.

(g) The administrator shall notify registered providers of any change in dollar amounts made pursuant to subsection (f) and make that information available to the public.

Legislative Note: *If the administrator is the attorney general, the bracketed language in subsection (a) ("refer cases to the [attorney general]") should be deleted. If the administrator is not the attorney general, those brackets and the brackets around "attorney general" should be deleted. If the state wishes the prosecution to be handled by some other official, the name of that official should be substituted for "attorney general."*

In states that do not empower administrative agencies to set fees, replace subsection (e) with the desired fees or fee structure.

The dollar amounts that appear in this Act were selected in August 2005. The state may wish to adjust those amounts to reflect changes in the index specified in subsection (f) between that date and the date of enactment. Subsection (f) specifies the sections in which dollar amounts appear.

* * *

Section 33 is amended to read:

SECTION 33. ADMINISTRATIVE REMEDIES.

(a) The administrator may enforce this [act] and rules adopted under this [act] by taking one or more of the following actions:

(1) ordering a provider or a director, employee, or other agent of a provider to cease and desist from any violations;

(2) ordering a provider or a person that has caused a violation to correct the violation, including making restitution of money or property to a person aggrieved by a violation;

(3) subject to adjustment of the dollar amount pursuant to Section 32(f), imposing on a provider or a person that has caused a violation a civil penalty not exceeding $10,000 for each violation;

(4) prosecuting a civil action to:

(A) enforce an order; or

(B) obtain restitution or an injunction or other equitable relief, or both; ~~or~~

(5) intervening in an action brought under Section 35.

* * *

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Notes

Chapter 1

1. Benjamin Shimberg and Doug Roederer, *Questions a Legislator Should Ask*, Second Edition, The Council on Licensure, Enforcement and Regulation, Lexington, Kentucky, 1994, p. 24.

Chapter 2

1. According to the OCP, this case was initiated by OCP when someone alerted it to a solicitation. Since no specific victim was involved, the case was opened as a project. The investigation centered on a North Carolina company that called itself a "Debt Forgiveness Club" and advertised on the web. Claiming that "…all unsecured debts can be effectively eliminated" during the loan process, and that lenders fail to disclose that "there is really no loan, just an equal exchange" of promissory note for the monies received. "The promissory note is converted into a cash asset and then deposited. This instrument of value is then used to fund the loan. Nondisclosure of these details is your ticket to getting your bank loans quietly discharged forever." OCP never identified any victims in Hawai'i and the case was essentially closed.

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Responses of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Commerce and Consumer Affairs on February 6, 2008. A copy of the transmittal letter to the department is included as Attachment 1. The response of the department is included as Attachment 2.

The department commented on the two recommendations in our report. The department strongly feels that House Bill No. 184, although well intentioned, should not be enacted. Instead, the department recommends that Chapter 446, Hawai‘i Revised Statutes (HRS) be kept in place to prohibit debt settlers from operating a business for a profit in Hawai‘i. The department also feels that the antitrust provisions of Chapter 480, HRS, and the unfair and deceptive trade practices under Section 481B-12, HRS, be used to continue to respond to the occasional complaints by consumers against credit counselors operating as non-profits. The department feels that consumer complaints against credit counselors operating as non-profit tax exempt organizations are too few to justify a need for a regulatory program that is estimated to cost more than $350,000 annually to administer and allows for-profit debt settlers to do business in Hawai‘i.

Based on the evidence of abuse, data on complaints, harm on a national level and the prevalence of debt-management services available via the internet, the potential risk to Hawai‘i's consumers posed by unscrupulous providers whether operating under the guise of a non-profit tax exempt organization or for-profit entity, is serious. Given the increase in demand expected as a result of changes in the bankruptcy law, consumers need more choices in the types of debt-management services available and protection from providers in the industry, who have been engaging in misleading and deceptive practices, charging excessive fees, abusing their non-profit status, and failing to abide by telemarketing laws.

Our finding that House Bill No. 184 meets the criteria for regulation applies equally to the credit counselors operating under the guise of a non-profit, tax exempt organization. We found that the federal laws provide minimal consumer protection from debt-management service providers operating for a profit under the Credit Repair Organization Act that addresses abuses in the credit repair industry, and the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices in commerce. Credit counseling agencies operating as an IRC 501(c)(3) organization would not be subject to the deceptive practice prohibitions under either of these federal laws. The Internal Revenue Service is responsible for investigating whether an organization's non-profit, tax-exempt status is bonafide and has been revoking the tax-exempt status of over 50 percent in the industry based on the number of debt management plans. While we understand the department's reluctance to change the policy prohibiting debt adjusters from operating for a profit in Hawai'i, we are not confident that state and federal laws adequately protect consumers from the abuses prevalent in the industry.

STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

February 6, 2008

COPY

The Honorable Lawrence M. Reifurth, Director
Department of Commerce and Consumer Protection
King Kalākaua Building
335 Merchant Street
Honolulu, Hawai'i 96813

Dear Mr. Reifurth:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Sunrise Analysis: Debt-Management Service Providers*. We ask that you telephone us by Friday, February 8, 2008, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Friday, February 15, 2008.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

ATTACHMENT 2

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
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LAWRENCE M. REIFURTH
DIRECTOR

RONALD BOYER
DEPUTY DIRECTOR

February 14, 2008

RECEIVED

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OFC. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State Auditor
Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813-2917

Re **Confidential Draft Report –**
<u>Sunrise Analysis: Debt-Management Service Providers</u>

Dear Ms. Higa:

Reference is made to your letter of February 6, 2008 enclosing copies of your confidential draft report, *Sunrise Analysis: Debt-Management Service Providers* ("Report").

The Department of Commerce and Consumer Affairs ("Department") has reviewed the Report and has the following comments regarding the debt management service provider regulation recommendations on page 28 of that Report.

1. The conclusions point out that the nature of the debt-management services provided by credit counselors and debt settlers pose potentially serious risks to the welfare of consumers already in financial trouble. The Report, however, applies this conclusion to both for-profit entities and non-profit entities. As the Report points out, for-profit entities – compared in the Report to "…a fox guarding a henhouse…" – are already banned from operating in Hawaii under the provisions of Chapter 446, Hawaii Revised Statutes. The Department feels that this ban was appropriate when enacted and remains even more so today as additional information is learned about the predatory operating methods employed by similar operations in other jurisdictions. Enacting legislation to permit their

operation under the mantle of providing consumers with more choices in this area appears to be opening the door to significant abuses in this sector.

2. HRS Chapter 446 does allow, as the Report points out, non-profit or charitable corporations or associations to act as an adjuster of a debtor's debts. While these non-profit or charitable entities are permitted under statute to collect nominal sums for expenses in connection with their services, empirical evidence confirms that consumer complaints are few. There have been only 14 complaints received by the State Office of Consumer Protection since 2000. The Report also concedes that official complaints against debt-management service providers in Hawaii are relatively low. There is, therefore, a real question as to the need for a regulatory program – "the cost of which will be steep – more than $350,000 annually"[1] – to establish a regulatory and supervisory framework for a potentially predatory consumer service (for-profit debt management) which is currently prohibited under Hawaii law.

3. While the Report recommends adoption of the Uniform Debt-Management Services Act ("UDMSA"), it later observes that the UDMSA "...is problematic" and "...has its flaws". Only four states have enacted UDMSA to date and the Report notes that at "...least two of these states have encountered major difficulties in administering this very comprehensive piece of legislation". That is, half of the states adopting it find it difficult to implement. For several years the Department has submitted legislation calling for the regulation and supervision of mortgage brokers – arguably a segment of the business community having a far greater impact on consumers than debt-management service providers. In addition, the Department, again for some years, has been trying to implement the provisions of an industry-sponsored bill to regulate and supervise money transmitter services. Neither of these initiatives is excessively complex or inherently difficult to administer, yet the difficulty in devising a regulatory scheme that includes a sufficiently funded regulatory program has resulted in an absence of appropriate regulation for both these critical businesses. As noted, the current State statutes have a clear and robust prohibition against the most egregious segment of the debt-management service providers – the "for profit" operators. Currently, violators are prosecuted pursuant to Chapters 446 and 480 and Section 481B-12 of the Hawaii

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[1] Sunrise Analysis: Debt-Management Service Providers (Draft). A Report to the Governor and the Legislature of the State of Hawaii. The Auditor, State of Hawaii. February 2008. page 11

Revised Statutes. The Department is concerned that in a rush to "improve" the regulation of debt-management service providers with the passage of a UDMSA-based statute, the opposite result would be achieved: a weak, possibly unfunded and under-staffed effort which would only throw wide open the door of the henhouse to the consumer predators in the for-profit debt-management service provider industry.

Accordingly, the Department strongly feels that the statutory initiative recommended by the Report, although well intentioned, will not meet the desired objective of providing enhanced protection of Hawaii consumers. The Department recommends that the existing statute be kept in place and that the provisions of HRS Chapters 446 and 480 and Section 481B-12 be used to continue to respond to consumers in pursuing the occasional incidence of non-profit debt-management service provider related complaints that come to our attention.

Very truly yours,

Lawrence M Reifurth

LAWRENCE M. REIFURTH