



Consumer Protection and Unfair Competition Law

ALERT

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California's Proposed Debt Settlement Legislation Undergoes Extensive Amendments

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On April 5, 2010, the proposed legislation that would regulate California debt settlement providers was amended after nearly a year of negotiations between consumer advocates and industry representatives. The "Debt Settlement Services Act" (Assembly Bill 350) was approved last year by the state's Assembly and was forwarded to the Senate in May 2009. However, the bill was tabled less than a month later by the Senate Judiciary Committee in order to provide author Assemblyman Ted Lieu (D-Torrance) an opportunity to negotiate a compromise on various issues of contention between the interested factions.

The proposed new law would create extensive regulations, including a licensing system, to govern the debt settlement industry in California. As amended, the bill would take effect on January 11, 2012, if the bill is approved this year by the Legislature and the Governor.

Although the recent amendments generally strengthen the enforcement and licensing authority of the Department of Corporations (DOC), which would oversee debt settlement providers under the new law, the legislation maintains its essential characteristic as a workable regulatory structure that could be modeled by other states.

The various significant amendments to the previous version of the bill are discussed below.

Fee Structure Changes

The amendments reduce the previous proposed limits on maximum fees that may be charged to consumers, from 20% to 18% of the enrolled debt balance.

However, a significant change in the new version is that providers may not collect more than 1% of the consumer's enrolled debt each month, meaning that large upfront fees would no longer be viable under the proposed legislation.¹

The bill has added a new proposed fee structure (and fee cap) that is based on the amount of savings achieved on behalf of the consumer by the debt settlement provider. For the savings-based fee structure, the amended bill would allow providers to charge:

- an initial fee of no more than the lesser of \$400 or 4% of the enrolled debt;
- a monthly service fee up to \$50 a month; and
- a settlement fee of no more than 30% of the consumers savings at the time of the settlement.²

¹ If the period of the debt settlement plan is to be less than 18 months, the fees must be charged evenly on a monthly basis over the number of months of the program.

² The bill provides that "the settlement fee shall not exceed 30 percent of the excess of the outstanding amount of each debt over the amount actually paid to the creditor, as calculated at the time of settlement." See Section 60021(a)(2)(C).

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The settlement fee authorized under this “savings” fee structure may only be collected at the time the consumer’s debts are actually settled. The amended language makes clear that a provider cannot impose or receive fees based on both the flat fee and the savings fee structures.

Expanded Definition of Persons Covered By The New Law

The amended legislation makes clear that the new law would apply equally to those who “offer” debt settlement services (including “frontend” companies and lead generators) as well as those that actually “provide” the debt settlement services.

As such, in this discussion we will refer at times to all persons or entities covered by the new law as “providers.”

The amendments exempt non-profit organizations from compliance with the new law and increase the requirements for attorneys to be entitled to an exemption. For the attorney exemption to apply under the modified legislation, the services provided must be in the course of the attorney’s practice *in an attorney-client relationship*.

Finally, the amendments now make clear that licensed providers are exempted from the California’s Proraters Law (Financial Code, Section 12000 et. seq.).

The Annual Licensing Requirement Becomes An Annual Reporting Requirement

The amendments have changed the annual licensing requirement under the proposed statute to an annual reporting requirement. These new annual reporting requirements mandate the filing of an annual financial statement. The new provisions also increase the amount of information that must be submitted to the DOC and require providers to submit a sworn declaration certifying the provider’s compliance with the statute.

The amendments also add the following new requirements for licensees:

- Applicants and licensees must maintain a \$100,000 minimum net worth.
- The financial information and reporting of licensees must comply with generally accepted accounting principles and must be audited by a licensed third party accountant.

- Applicants must pay a minimum \$1,000 license application fee.
- Applicants and licensees must obtain and maintain a \$50,000 surety bond.

On the other hand, the amendments have eliminated the requirement in previous drafts that providers obtain debt settlement accreditation or certification.

The amendments have also added the requirement that the DOC approve or reject a license application within 60 days of receiving a completed application.

Client Qualification Requirements

Besides the qualification requirements that were included in previous versions of the bill, the current draft requires that providers “have reasonable grounds to believe that the consumer is qualified for the debt settlement program and can reasonably meet the requirements of the program on the basis of information furnished by the consumer after reasonable inquiry concerning the consumer’s financial situation and needs.”

These requirements mandate that providers consult with the consumer and consider 1) whether the consumer’s monthly income exceeds their basic living expenses by an amount that permits the consumer to meet the savings goals of the program, 2) whether the consumer’s creditors are likely to agree to the settlement of the consumer’s debts, and 3) whether the consumer is current or delinquent on their debts.

This determination of the consumer’s qualifications for the program must be supported by a mandatory financial analysis that is based on information provided by the consumer. These financial analyses must be in “plain language” and must be delivered before the consumer agrees to enter the program.

The amendments require that all of the written financial analyses, as well as the other good faith estimates and disclosures required in the bill, be provided in no less than 12-point type font.

Additional Requirements Regarding Disclosures, Websites and Agreements

Besides the numerous disclosure requirements that were included in previous versions of the bill, the amendments require providers to make the additional disclosure that “creditors may continue to charge interest, late fees, over the limit fees, and other fees and nonpayment of debt may lead creditors to increase finance and other charges or undertake collection activity, including litigation and garnishment of wages.”

The existing bill requires that all debt settlement providers maintain a website that includes certain mandatory disclosures. The amendments add the requirement that such websites ensure that consumers are required to access these mandatory disclosures before any personal information, including any information regarding their debts, is obtained from them.

The modified bill prohibits written agreements that include any hold harmless clauses that excuse any of the provider’s duties under the statute. It also prohibits clauses that result in an assignment of the consumer’s wages, an order for the payment of wages or any other assignment of compensation. Similarly, any acceleration provisions that are not authorized under the statute are prohibited as are any other “unconscionable” provisions.

The amended bill provides that a consumer agreement may be terminated if the consumer fails to pay fees required by the agreement for 60 days, so long as the provider has given the consumer 30 days notice and an opportunity to cure. However, the provider may not earn any additional fees or charge a termination fee on or after the termination of the agreement.

Additional Requirements And Prohibitions

The amended bill states that if a provider receives the consumer’s monthly billing statements from the consumer’s creditors, the provider must deliver to the consumer monthly statements that reflect the consumer’s outstanding debt. This is obviously intended to ensure that consumers continue to be aware of their debt balances during the debt settlement process.

As amended, the bill prohibits providers from engaging in the business of debt collection on behalf of an consumer’s creditor, and would prohibit them from engaging in the

business of debt buying for an consumer represented by the provider.

The modified provisions require that providers identify a risk manager within their organization whose responsibilities include responding to consumer complaints.

The new bill would also require that all printed text advertising in California disclose that the provider is licensed under the statute.

Additional DOC Investigation and Enforcement Powers

The amendments provide substantial new enforcement obligations and powers to the DOC. The bill authorizes the DOC Commissioner to investigate licensees at any time, but no less than once every four years, and the costs of any such investigations may be charged to the provider. The bill grants substantial investigative powers to the DOC, including the power to compel the production of witnesses and documents, to require declarations and witness testimony, and to impose cease and desist orders on providers or other persons or entities.

Finally, the new bill expands the requirement that providers retain all records for five years from the date of the last entry on a debt settlement transaction, and it imposes a \$10,000 fine for each year that such records are not kept.

Conclusion

In this update we have attempted to summarize the most significant changes that have been made to AB 350 in the recent amendments completed on April 9, 2010. However, the changes reflected in this update are not comprehensive since the amendments are extremely numerous and affect many aspects of the proposed law. We recommend that interested persons and entities carefully review the current draft of the proposed legislation and consult with legal counsel regarding any specific questions relating to their situation.

The current amended legislation can be viewed at www.ioeb.com/files/Uploads/Amended_Legislation.04.05.10.pdf.

An updated summary of the proposed California Debt Settlement Act (AB 350) can be viewed at <http://www.ioeb.com/updatedsummaryproposedcaliforniadebtsettlementact>.

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