



Consumer Protection and Unfair Competition Law

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Updated Summary of Proposed California Debt Settlement Act (AB 350)

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A proposed new law that would create extensive regulations governing the debt settlement industry in California was recently amended to respond to concerns raised by consumer advocates. On April 5, 2010, the "Debt Settlement Services Act" (Assembly Bill 350) was amended and will continue to be considered by the State Senate Judiciary Committee. In May 2009, an earlier version of the Act was approved by the State Assembly. If enacted, the bill would take effect on January 11, 2012.

The proposed Act would dramatically change the debt settlement landscape in California, providing for registration and oversight of debt settlement companies by the Department of Corporations (DOC). The law would create new requirements that would have to be met before companies could enter into agreements with consumers to provide debt settlement services, including the obligation to prepare a financial analysis tailored for each consumer, a good-faith estimate of the fees, charges and estimated length of the program and numerous other specific contractual and disclosure provisions.

The new law would require contractual provisions allowing consumers to cancel the agreement and receive a full refund within five days after signing the debt settlement agreement.

Among the disclosures that would be required by the new law are the potential impact of the program on the consumer's credit rating or score, that the program may

result in higher finance or other charges, the possibility of increased collection activity by creditors, that the program might not stop a creditor from filing or pursuing a lawsuit against a consumer, that the program could result in the creation of taxable income, that specific results cannot be predicted or guaranteed, that the program requires the individual to meet certain savings goals in order to maximize settlement results, that the provider does not provide accounting or legal services and that a provider cannot force creditors to engage in negotiations or reach settlements.

The proposed legislation would allow two alternative fee structures. Debt settlement providers would be able to charge a flat fee based on the amount of the consumer's debt at the start of the program. The law would set a fee cap of no more than eighteen percent of the total debt brought into the program, including a limitation that no more than one percent of the overall debt may be collected from the consumer each month of the program.

Alternatively, the proposed law would allow fees to be charged based on the savings obtained for consumers. The "savings" fee structure would allow an initial fee, compensating the provider for consultation, the cost of obtaining a credit report and setup costs, of the lesser of \$400 or 4% of the total debt brought into the program. In addition, the provider may charge a monthly fee of up to

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\$50 a month. Upon the settlement of the consumer's debts, the provider would be able to charge a fee of 30% of the difference between the amount of the debt and the amount paid to the creditor, calculated at the time of the settlement.

License Application Requirements

Applicants would be required to submit:

- A licensing fee in the amount of at least \$1,000.
- Evidence of a surety bond in the amount of at least \$50,000.
- Audited financial statements reflecting a net worth of at least \$100,000.
- Proof that appropriate business entity documents have been filed with the Secretary of State or the county where the applicant operates.
- Fingerprints and related information required by the California Department of Justice.

Applications may be denied if they are materially erroneous or incomplete; if an officer, director or owner of the applicant has been convicted of a crime, been subject to a civil judgment involving fraud, deceit, dishonesty or violations of state or federal securities laws; or if the required fees are not submitted.

The Department of Corporations must approve or reject a license application within 60 days of receiving a completed application.

After receiving a license, licensees must continue to maintain the required minimum \$100,000 net worth.

Once an initial license has been issued, licensees must submit an annual report that includes audited financial statements as well as the following information:

- The total amount of debt for all individuals for whom a licensee is providing debt settlement services, as of December 31.
- The total principal amount of debt of all individuals that entered into agreements.
- The total number of individuals that entered into agreements.

- The total number of individuals with outstanding debt settlement service agreements in California.
- The total number of debts settled by the provider.
- The total dollar amount of debts settled by the provider, as follows:
 - The dollar amount of the settled debt, as of the establishment of the program.
 - The dollar amount of the settled debt at the time of settlement, without debtor concessions.
 - The dollar amount of the settled debt with debtor concessions.
- The total amount of fees collected from California individuals.
- Any other information required by rule.

Fee Structure Requirements and Limitations

The Act would require providers to disclose their fee structures in the application process. The provider must list the goods and services it provides along with the cost of all fees for such goods and services.

As discussed above, the Act would impose limits on the fees that may be charged by providers. Fees would be capped at no more than eighteen percent (18%) of the amount of debt at the time the agreement is entered with a consumer. However, no more than one percent (1%) of the consumer's debt may be collected each month.¹

Alternatively, the provider may collect fees based on the savings obtained for the consumer. The provider may charge a setup fee of no more than the lesser of \$400 or 4% of the enrolled debt, a monthly fee no greater than \$50, and a settlement fee up to 30% of the difference between the amount of the consumer's debt and the amount paid to the consumer's creditor, calculated at the time of the settlement.

Financial and Time Estimate Disclosure Requirements

The Act would prohibit a debt settlement provider from entering into an agreement with a consumer to engage in a debt settlement program until it has delivered a written financial analysis specific to the consumer, a good-faith

¹ If the debt settlement program is shorter than eighteen months, the provider may divide the 18% fee by the number of months of the program and collect that amount from the consumer each month.

estimate of the length of the time it will take to complete the program, and a statement of the total amount of debt owed to each creditor in the program.

In addition, based on the completed written financial analysis, the provider must make a determination that the consumer is qualified for a debt settlement program and that the consumer 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.

The providers must 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 written financial analyses, as well as the other good faith estimates and disclosures required by the proposed Act, must be provided in no less than 12-point type font.

Additional Required Disclosures to Consumers

Before engaging in the debt settlement program, the provider must make the following disclosures to consumers:

- The provider's name and business address.
- That some programs are not suitable for some consumers.
- That the program may affect credit rating and credit scores.
- That creditors may continue to charge interest, late fees, over the limit fees, and other fees.
- That nonpayment of debt may lead creditors to increase finance and other charges or undertake collection activity, including litigation and garnishment of wages.
- That a settlement may lead to taxable income.

- That there are no specific results or guarantees.
- That consumers are required to meet particular savings goals to increase settlement chances.
- That providers do not provide accounting or legal advice, unless otherwise authorized or professionally licensed.
- That providers do not receive compensation from any of the consumer's creditors, banks or third-party collection agencies.
- That providers advocate on the consumer's behalf, but cannot control how creditors will respond and cannot force settlement.
- That upon termination, no additional fees are due.
- That the use of debt settlement services may not stop a creditor from filing or pursuing a lawsuit against a consumer.
- That the consumer may owe fees upon signing an agreement whether or not any debts are reduced under the program.
- The statement in its consumer agreements that "Complaints related to this agreement may be directed to the Department of Corporations by telephone and to its Internet Web site address."

Written Agreement Requirements

In addition to the required disclosure requirements, the Act provides that a written agreement between the provider and the consumer must be obtained, including the following provisions that must appear on the front page:

- The total amount of the debt brought into the program.
- The amount of any setup fee.
- The amount of any monthly fee.
- The estimated number of months for which a monthly fee is required by the agreement.
- An estimate of the total amount of fees reasonably anticipated to be paid by the consumer over the term of the agreement, as applicable.
- The total amount of fees that may be charged under the contract.

The agreement must also include:

- The consumer's right to terminate the agreement at any time.

- The consumer's right to cancel the agreement and receive a full refund within the first five days after entering into the agreement.
- Confirmation that the provider's power of attorney is limited to communicating with creditors for the purpose of negotiating settlement offers and initiating fund transfers.

The Act would prohibit debt settlement agreements from:

- Modifying or limiting available forums and procedural rights that are otherwise available to the consumer by law, other than as permitted by the California Arbitration Act.
- Restricting a consumer's remedies under the Act or any other law.
- Limiting or releasing liability for failing to perform the agreement or under the Act.
- Indemnifying any person for liability arising under the agreement or that excuse any of the provider's duties under the Act.
- Including any clauses that result in an assignment of the consumer's wages, an order for the payment of wages or any other assignment of compensation.
- Requiring any acceleration provisions that are not authorized under the statute.
- Requiring the consumer to be responsible for payment of the provider's attorney's fees
- Including any other "unconscionable" provisions.

The proposed Act would allow the termination of a consumer agreement 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.

Consumers' Right to Periodic Accountings

The proposed law would require providers to prepare and deliver an accounting to consumers in any of the following situations:

- upon settlement of a debt
- within five business days after a request is received from the consumer, but not more than once a month and

- upon cancellation or termination of the agreement.

The accounting requirement generally requires the provider to disclose the total amount and terms of any settlement as well as all fees and how they were calculated.

Document Retention Requirements

The Act would require debt settlement providers to maintain records for all consumers for five years from the date of the last entry on the debt settlement transaction. Violation of this requirement would result in a fine of \$10,000 for each year of non-compliance.

Prohibited Conduct

A debt settlement provider would be prohibited from doing, directly or indirectly, any of the following:

- Exercise or attempt to exercise a power of attorney after termination of the agreement by the consumer.
- Initiate a transfer of funds to or from the consumer's financial institution, unless under specified conditions.
- Settle a debt or cause a consumer to believe that a payment to a creditor is in settlement of a debt, unless under specified conditions.
- Represent that it will do any of the following: furnish money to pay bills; that payment of a certain amount will guarantee satisfaction of a certain amount or range of indebtedness; prevent litigation, garnishment, attachment, repossession, foreclosure, eviction or loss of employment.
- Represent that it is a non-profit entity unless it is properly organized as such.
- Employ any unfair, unconscionable or deceptive acts or practices.
- Fail to respond or research any complaint filed by a consumer within 20 days.
- Require a consumer to participate in additional ancillary services.
- Receive financial compensation based in excess of the fee caps.
- Pay referral fees to creditors.
- Purchase a debt or obligation of the consumer.
- Unless through a separately licensed affiliate, receive a promissory note, postdated check, or lend money or provide credit to the consumer.

- Obtain a mortgage or other security interest in connection with the services provided.
- Require a consumer to deposit funds into a specific financial institution.
- Disclose the identity or identifying information of the consumer, except as permitted by law, or upon demand by the commissioner, to the extent necessary to effectuate the program, or to the extent necessary to obtain cooperation of the creditor.
- Charge the consumer for or provide other compensation not directly related to the debt settlement services.
- Provide legal advice or services.
- Advise consumers to stop making payments on accounts administered by the provider.
- Hold consumers' funds in trust.
- Include secured debt in any debt settlement services agreement.
- Engage in the business of debt collection on behalf of an consumer's creditor.
- Engage in the business of debt buying for an consumer represented by the provider.
- Alter, destroy, mutilate, conceal, cover up, falsify or make a false entry in any record with the intent to impede, obstruct or influence administration or enforcement of the Act.
- Make a false statement or omission to the Commissioner with the intent to impede, obstruct or influence administration or enforcement of the Act.
- Engage in any false, misleading, or deceptive advertising.

Web Site Requirements

The Act would require a provider to maintain an Internet Web site, and specifies a number of disclosures that must be placed on the home page or on a page clearly and conspicuously connected to the home page. To highlight a few mandates for the Web site, the provider must set forth: its business address, telephone number, email address and license number; all of the disclosures stated above; the fee structure and the method of determining the amount of all fees; and the provider's termination policy, as specified in the Act. The provider must ensure that consumers are required to access these mandatory disclosures before any

personal information, including any information regarding their debts, is obtained from them.

A provider must also maintain a toll-free communication system that allows customers to speak to a debt specialist or customer service representative during ordinary business hours.

Additional Requirements

The proposed Act requires 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 mandate is obviously intended to ensure that consumers continue to be aware of their debt balances during the debt settlement process.

The Act would also require that providers identify a risk manager within their organization whose responsibilities include responding to consumer complaints.

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

Investigation and Enforcement of Act Violations

The proposed Act provides substantial new enforcement obligations and powers to the DOC. The Act 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. It 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.

Any debt settlement provider that knowingly misrepresents or submits any false information, or otherwise violates the Act, would be guilty of a misdemeanor. The Commissioner would be authorized to act on his or her own initiative or in response to a complaint.

The limitations period for any action brought under the Act would be three years after the latest of the consumer's last payment to the provider, or the date when the consumer discovered, or reasonably should have discovered, the facts leading to the claim. The limitations period is also

tollled if the provider materially and willfully misrepresents information.

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

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