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F I S C A L I M P A C T R E P O R T

ORIGINAL DATE 3/14/09
SPONSOR HCPAC **LAST UPDATED** **HB** 851/HCPACS

SHORT TITLE Uniform Debt Management Services Act **SB**

ANALYST Haug

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	**FY10**	**FY11**		
	$5.0	$6.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		$150.0	$150.0	$300.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Administrative Office of the Courts (AOC[1])
Attorney General's Office (AGO[2])
Regulation and Licensing Department (RLD)

No Response
Bernalillo County Metropolitan Court (BCMC)

SUMMARY

Synopsis of HCPACS

House Consumer and Public Affairs Committee Substitute for House Bill 851 proposes to enact the "Uniform Debt-Management Services Act" (UDMSA), promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 2005. The commissioners reveal that the purpose behind the act is to provide "guidance and regulation to the debt counseling industry. The Act applies to both consumer debt counseling services and debt

management services. The Act is a comprehensive statute that provides rules for, among other things, registration requirements, bond requirements, disclosure requirements, and penalties for non-compliance." According to the NCCUSL website, 4 states – Colorado, Delaware, Rhode Island and Utah – have adopted the UMSA to date

The House Consumer and Public Affairs Committee Substitute for HB851 makes the following changes to the original HB851:

Section 9: Certificate of Registration—Issuance or Denial

Adds a provision allowing the administrator to deny registration if the application is not accompanied by the fee established by the administrator.

Section 17: Prerequisites for Providing Debt-Management Services

Amends Section 17(B)(3) to clarify that the restrictions on provision of debt-management services where the individual makes regular, periodic payments "to a creditor or provider."

Amends Section 17(D) to require that the provider furnish a "separate record" to the consumer enrolling in one of the provider's programs, but removes the requirement from the earlier version of the bill that such a record "contain[s] nothing else."

Section 19: Form and Contents of Agreement

Amends Section 19(E) to limit provider's power to settle consumer's debt to no more than 50% of the "outstanding amount" of the debt, rather than 50% of the "principal" amount of the debt.

Section 23: Fees and Other Charges

Amends Section 23(D)(1)(b) to state that the monthly service fee a provider charges shall not exceed $10 multiplied by the number of "accounts" remaining in the consumer's plan rather than the number of "creditors" remaining in the plan at the time the fee is assessed.

Amends the fee structure for debt settlement services in Section 23(F). With respect to an agreement that provides for a flat fee based on the overall amount of included debt, the total aggregate amount of fees charged shall not exceed 17 percent of the principal amount of debt included in the agreement at the inception of the agreement. Those fees shall be assessed in equal monthly payments over at least half the length of the plan.

With respect to agreements where fees are calculated as a percentage of the amount saved by an individual, the settlement fee shall not exceed thirty percent of the excess of the outstanding amount of each debt over the amount actually paid to the creditor. The total aggregate amount of fees charged to an individual may not exceed 20 percent of the principal amount of debt included in the agreement at the inception of the agreement. The provider shall not impose or receive fees under both a flat-fee and percentage calculation structure.

Section 28: Prohibited Acts and Practices

Amends Section 28(A)(2) and (3) to prohibit settlement of debt for more than 50% of the "outstanding amount of the debt" rather than 50% of the "principal amount of the debt."

Amends Section 28(A)(11) to provide an additional alternative limitation to the provider's right to settle a debt or lead an individual to believe that a payment to a creditor is in settlement of a debt to the creditor. The individual may receive a certification that the payment "is part of a payment plan, the terms of which are included in the certification, which upon completion will result in full settlement of the debt."

Amends Section 28(B)(7) to include an exception to the rule that the provider shall not charge the individual for services not directly related to debt-management services or educational services concerning personal finance, except to the extent that "such services are expressly authorized by the administrator."

Summary of UDMSA Provisions

The UDMSA may be divided into three basic parts: registration of services, service debtor agreements and enforcement. Each part contributes to the comprehensive quality of the Uniform Act. A portion of the NCCUSL summary provides the following information.

Registration

No service may enter into an agreement with any debtor in a state without registering as a consumer debt-management service in that state. Registration requires submission of detailed information concerning the service, including its financial condition, the identity of principals, locations at which service will be offered, form for agreements with debtors and business history in other jurisdictions. To register, a service must have an effective insurance policy against fraud, dishonesty, theft and the like in an amount no less than $250 thousand. It must also provide a security bond of a minimum of $50 thousand which has the state administrator as a beneficiary. If a registration substantially duplicates one in another state, the service may offer proof of registration in that other state to satisfy the registration requirements in a state. A satisfactory application will result in a certificate to do business from the administrator. A yearly renewal is required.

Agreements

In order to enter into agreements with debtors, there is a disclosure requirement respecting fees and services to be offered, and the risks and benefits of entering into such a contract. The service must offer counseling services from a certified counselor and a plan must be created in consultation by the counselor for debt-management service to commence. The contents of the agreements and fees that may be charged are set by the statute. There is a penalty-free three-day right of rescission on the part of the debtor. The debtor may cancel the agreement also after 30 days, but may be subject to fees if that occurs. The service may terminate the agreement if required payments are delinquent for at least 60 days. Any payments for creditors received from a debtor must be kept in a trust account that may not be used to hold any other funds of the service. There are strict accounting requirements and periodic reporting requirements respecting funds held.

Enforcement

The Act prohibits specific acts on the part of a service including: misappropriation of funds in trust; settlement for more than 50% 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. Enforcement of the Uniform Act occurs at two levels, the administrator and the individual level. The administrator has investigative powers, power to order an individual to cease and desist; power to assess a civil penalty up to $10 thousand, and the power to bring a civil action. An individual may bring a civil action for compensatory damages, including triple damages if a service obtains payments not authorized in the Uniform Act, and may seek punitive damages and attorney's fees. A service has a good faith mistake defense against liability. The statute of limitations pertaining to an action by the administrator is four years, and two years for a private right of action.

FISCAL IMPLICATIONS

According to the RLD, fiscal implications are indeterminate because there is no data available on the number of Debt-Management Service providers located in New Mexico. The bill requires a $500 registration fee for original registrations and $100 fee for renewals. However, since it is not known how many Debt-Management Service providers are doing business in New Mexico, it is not possible to estimate the amount of revenue that would be generated.

The revenue table above assumes 10 initial registrations in the first year and in the second year 10 new registrations and renewal of the 10 registrations in the first year.

The RLD further notes that the registration, investigation, examination, supervision and administration of the Act will require additional staff and related facilities/equipment and administrative costs. No estimate is provided, but the RLD states that without an appropriation, the Financial Institutions Division would not be able to carry out the new additional duties required by the Act.

The additional operating costs table above assumes two to three additional FTE based on RLD's comments above.

SIGNIFICANT ISSUES

The AGO provides the following considerations regarding House Bill 851.

The UDMSA drafted by the NCCUSL allows states to decide whether to require that debt management and debt settlement companies be non-profit entities in order to establish domestic operations. As currently written, House Bill 851 has adopted the most permissive version of the UDMSA, by allowing for-profit entities to provide both credit-counseling and debt-settlement services, subject, of course, to the administrative safeguards set forth therein. If New Mexico is to pass this piece of legislation, there are strong pro-consumer arguments that it should do so only after incorporating the not-for-profit limitations set forth in the "Amendments" section below.

Debt settlement can be a legitimate debt management tool for consumers who have funds to put toward settling debts. For-profit debt-settlement businesses, however, do not target these

consumers. Instead, there is a consumer protection argument that they target vulnerable consumers who lack the necessary funds to settle debts, requiring them to pay hefty fees while supposedly saving money to eventually pay off debts through agreements with intermediaries to negotiate settlements with creditor companies (credit card issuers and the like). While this process is ongoing (fees and other charges captured by intermediaries are routinely frontloaded), the consumers are not paying their debts and are generally facing collection efforts and, ultimately, lawsuits—all while interest and fees on the underlying debt accrue on their accounts. As a consequence of this predatory behavior, the IRS and FTC have spearheaded nationwide enforcement actions against debt-settlement firms for unfair and deceptive trade practices in recent years. The New Mexico Attorney General has participated in multi-state actions against various debt-settlement companies in recent years as well.

New Mexico law already prohibits for-profit entities from providing these sorts of services in the Debt Adjusters Act (NMSA 56-2-1 to 56-2-4 (1978)), which generally prohibits parties from providing debt adjustment services in New Mexico, but which exempts certain parties, such as nonprofits. HB851 could be amended (as set forth in the "Amendments" section below) to bring it into conformity with the Debt Adjusters Act; namely, by including a provision that permits only nonprofit entities to provide credit-counseling and/or debt-settlement services to individuals in New Mexico.

Limiting the industry to nonprofit providers is not about restricting competition, as many profit-oriented members of the industry argue. Instead, the consumer protection argument is that it is intended to ensure that credit counseling and debt-relief services are truly educational and to prevent obtrusive corporate profiteering and poor-quality counseling at the expense of New Mexico consumers. Only a true non-profit can be counted on to provide quality counseling and educational services and to act in the best interests of consumers.

Passage of the UDMSA with these amendments would, with respect to traditional debt management practices, significantly improve consumer protection in this state. However, policymakers should understand that the law contemplates an extensive registration process that will be effective only as long as adequate resources are devoted to oversight and enforcement.

The AOC states that the following provisions of the UMSA will have an impact upon the courts:

- Section 25, Subsection B, provides that if a provider is not registered as required by the UDMSA when an individual assents to an agreement, the agreement is voidable by the individual. The bill further provides that if an individual voids an agreement pursuant to Subsection B, the provider does not have a claim against the individual for breach of contract or for restitution
- Section 28 lists prohibited acts and practices under the UDMSA
- Section 29 provides that no later than 30 days after a provider has been served with a notice of a civil action for violation of the UDMSA by or on behalf of an individual who resides in NM at either the time of an agreement or the time the notice is served, the provider shall notify the administrator – the director of the Financial Institutions Division of the Regulation and Licensing Department or the director's designee – in a record that it has been sued.
- Section 32 provides that the administrator may refer cases to the AG. The UDMSA provides that in connection with an investigation to determine compliance with the UDMSA, the administrator may seek a court order authorizing seizure from a bank at

which the person maintains a trust account required by Section 22 of the Act any materials in the control of the bank and related to individual residing in NM

- Section 33 provides that the administrator may enforce the UDMSA by prosecuting a civil action to enforce an order or obtain restitution or an injunction or other equitable relief, or both, or intervene in an action brought pursuant to section 35 of the UDMSA. The administrator may recover the reasonable expenses of enforcing the UDMSA, including attorney and expert witness fees
- Section 34 provides that if the administrator suspends, revokes or denies renewal of the registration of a provider, the administrator may seek a court order authorizing seizure of any or all of the money in a trust account required by Section 22 of the Act, materials and other property of the provider located in NM
- Section 35 provides for a civil action to recover all money paid or deposited by or on behalf of the individual pursuant to the agreement, except amounts paid to creditors, by an individual who voids an agreement pursuant to Subsection B of Section 25 of the UDMSA. Section 35 also provides that subject to Subsection D of this section, an individual with respect to whom a provider violates the UDMSA may recover damages in a civil action from the provider and any person that caused the violation. HB 851 provides that a provider is not liable pursuant to this section for a violation of the UDMSA if the provider proves that the violation was not intentional and resulted from a good-faith error notwithstanding the maintenance of procedures reasonably adapted to avoid the error. If, in connection with a violation, the provider has received more money than authorized by an agreement of the UDMSA, the defense provided by this subsection is not available unless the provider refunds the excess within 2 business days of learning of the violation
- Section 36 provides that if an act or practice of a provider violates both the UDMSA and the Unfair Practices Act, an individual shall not recover under both for the same act or practice

TECHNICAL ISSUES

The AGO submitted the following recommendations.

In order to bring the bill into conformity with the Debt Adjusters Act (§ 56-2-1, et seq. NMSA 1978), there are consumer protection argument in favor of several provisions of the UDMSA be amended to limit the parties who can provide debt-management services (as therein defined) to not-for-profit entities. Those amendments include:

<u>Section 4: REGISTRATION AND NOT-FOR-PROFIT STATUS REQUIRED</u>

<u>D. A provider may be registered only if it is:</u>

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

(2) <u>exempt from taxation under the Internal Revenue Code, 26 U.SC. Section 501, as amended</u>

The new Subsection (d) requires providers to be organized and operating as a not-for-profit entity and also be tax-exempt under federal law. The former is a prerequisite for the

latter. The purpose of stating it here as a separate requirement is to authorize a review of the ongoing, actual operation of the entity, even though at its formation it may truly have been a not-for-profit. *See Zimmerman v. Cambridge Credit Counseling*, 409 F.3d 473 (1st Cir. 2005). If an entity is not properly operating as a not-for-profit entity under the law of its organization, it is not properly registered under this Act.

Section 5

As a result of the proposed amendment to Section 4, Subsection (6) of Subsection B. of Section 5 should be amended to read: "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."

Section 9

Subsection 2 of Subsection C. should be amended to read: "the applicant's board of directors is not independent of the applicant's employees and agents." There should no longer be language limiting the application of this provision to entities that are otherwise organized as not-for-profits, as the proposed amendments will allow *only* not-for-profit entities to register as providers under the Act.

The Regulation and Licensing Department contributed the following technical concerns.

Page 12 lines 8 and 9 refer to an application requirement of "evidence of accreditation by an independent accrediting organization approved by the administrator". It is not clear if this is different than the certification or authentication required of "certified counselors" and "certified debt specialists" on page 4 lines 1 - 14.

It is unclear who will do the criminal records check including fingerprints, of every officer of the applicant and every employee or agent of the applicant who is authorized access to the trust account, page 13 lines 1 - 7. The applicant will pay for the criminal record check, but is it the responsibility of the applicant or of the Administrator to initiate and obtain such criminal record check?

The Bill does not identify who the hearing officer would be relevant to hearings regarding denial, renewal, suspension or revocation of a registration. Page 16 line 23 - page 17 line 1, page 20 lines 3-6, page 63 lines 4 - 6.

CH/svb:mc

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[1] The analysis from the Administrative Office of the Courts carries the following disclaimer.
THIS BILL ANALYSIS IS SUBMITTED BY THE AOC AND SHALL NOT BE CONSTRUED AS A SUBMISSION BY THE SUPREME COURT OR ANY OTHER COURT.

[2] The analysis from the Attorney General's Office carries the following disclaimer.
This analysis is neither a formal Attorney General's Opinion nor an Attorney General's Advisory Opinion letter. This is a staff analysis in response to the agency's, committee's or legislator's request.