

HOUSE BILL REPORT

ESSB 5321

As Reported by House Committee On:
Business & Financial Services

Title: An act relating to licensure of persons providing debt settlement services.

Brief Description: Concerning licensure of persons providing debt settlement services.

Sponsors: Senate Committee on Financial Institutions & Insurance (originally sponsored by Senators Benton, Mullet, Hobbs, Angel and Fain).

Brief History:

Committee Activity:

Business & Financial Services: 3/18/15, 3/24/15 [DPA].

**Brief Summary of Engrossed Substitute Bill
(As Amended by Committee)**

- Creates a licensing and enforcement framework for persons and entities who provide debt settlement services.
- Provides that persons and entities licensed as providers of debt settlement services are exempt from the provisions that govern debt adjusters.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: Do pass as amended. Signed by 9 members: Representatives Kirby, Chair; Vick, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Blake, G. Hunt, Hurst, Kochmar, McCabe and Santos.

Minority Report: Do not pass. Signed by 1 member: Representative Ryu, Vice Chair.

Minority Report: Without recommendation. Signed by 1 member: Representative Stanford.

Staff: David Rubenstein (786-7153).

Background:

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

"Debt adjusting" is defined as: (1) managing, counseling, settling, adjusting, pro-rating, or liquidating a debtor's indebtedness; or (2) receiving funds for distribution among creditors in payment of a debtor's obligations. A "debt adjuster" is a person who engages in debt adjusting for compensation. It includes debt poolers, debt managers, debt consolidators, debt pro-raters, and credit counselors.

The definition of a "debt adjuster" excludes: attorneys, escrow agents, accountants, and investment advisors while performing services solely incidental to the practice of their professions. It also excludes persons doing business that is permitted by law related to banks, credit unions, trust companies, and insurance companies; employees performing credit services for their employer; public officers and persons acting under court order; persons performing services incidental to the dissolution of a business entity; and certain nonprofit organizations.

After a Washington State Supreme Court ruling that held that an entity that received funds into a custodial account and then distributed such funds to creditors was a debt adjuster, the Legislature amended the definition of a debt adjuster to exclude such entities. Under the current definition of a debt adjuster, an independent entity that holds or administers a dedicated bank account for fees and payments to creditors, debt collectors, debt adjusters, or debt adjusting agencies in connection with the renegotiation, settlement, reduction or other alternation of the terms of payment or other terms of a debt is considered a "third party account administrator" and not a debt adjuster.

Debt Adjuster Contracts.

Every contract between the debt adjuster and the debtor must contain various disclosures, including the following:

- a list of every debt to be handled;
- precise terms of payments reasonably within the ability of the debtor to pay;
- precise terms of the rate and amount of all of the debt insurer's charges and fees;
- the approximate number and amount of installments required to pay the debts in full;
- the name and address of the debt adjuster and of the debtor;
- a provision that the debt adjuster must notify the debtor, in writing, within five days of receiving notice that a creditor will not accept payment pursuant to the debtor's contract with the debt adjuster;
- notice to the debtor regarding reading the contract before signing and not accepting blank spaces, that the debtor is entitled to a copy of the contract at the time of signing;
- notice to the debtor that the contract may be canceled within three days of signing by sending notice; and
- other provisions necessary for the protection of the debtor and the proper conduct of business by the debt adjuster.

Debt Adjuster Fees.

The total fee for debt adjusting services is capped at 15 percent of the debtor's total debt. Excess fees, except as a result of an accidental or bona fide error, void the contract.

Before retaining the fee, the debt adjuster must notify all creditors that the debtor has engaged the debt adjuster's services. The debt adjuster must distribute at least 85 percent of the debtor's payments to creditors at least once every 40 days. A debtor's payments to a debt adjuster must be held in a separate trust account.

Prohibited Acts.

A debt adjuster must not do any of the following:

- take a contract which has any blank spaces when signed by a debtor;
- receive or charge any fee in the form of a promissory note to receive or accept any mortgage or other security for a fee, whether regarding real or personal property;
- lend money or credit;
- take a confession of judgment against the debtor or appear as the debtor in any judicial proceedings;
- take a release of any obligation to be performed by the debt adjuster, concurrent with signing the contract with the debtor;
- make false, misleading, or deceptive statements or representations in advertisement;
- offer to pay cash, fees, gifts, premiums, bonuses, or rewards for referrals of customers;
- receive any cash, fee, gift bonus, premium or award, or other compensation in connection with activities as a debt adjuster; or
- disclose to anyone the debtors who have contracted with the debt adjuster, nor disclose the creditors to anyone other than the debtor or another creditor, and then only to the extent necessary to secure the cooperation of the creditor in a debt adjusting plan.

Violation of the Debt Adjusting Act is a misdemeanor offense, and it is an unfair or deceptive act or practice under the Consumer Protection Act (CPA).

Summary of Amended Bill:

A new chapter, to be known as the "Debt Settlement Services Act" (Act) is created in Title 18 RCW.

"Debt settlement services" are services performed as an intermediary between an individual and one or more unsecured creditors of the individual for the purpose of: (1) obtaining negotiated concessions involving a reduction in principal of the individual's unsecured debt; and (2) securing discharge of the debt after the individual has performed the negotiated concessions. Licensed debt settlement service providers (providers) are exempt from the Debt Adjusting Act.

License Application and Renewal.

A person may not engage in or advertise for debt settlement services in Washington before obtaining a debt settlement services license from the Director of the Department of Financial

Institutions (Director). The applicant must apply through the nationwide licensing system and applicants must pay a fee set by rule.

The Director must evaluate the applicant's financial responsibility, character, reputation, integrity, and general fitness to determine whether the applicant will act lawfully, honestly, fairly, soundly, and efficiently in the public interest. The license is effective for a period of one year or less, depending upon the date issued. The license expires December 31 each calendar year in which it was issued, and it is not transferable or assignable.

The following persons or entities are exempt from the provisions governing debt settlement services:

- debt settlement services provider's employees;
- judicial officers;
- financial institutions;
- attorneys licensed to practice law in Washington;
- money transmitters licensed under RCW 19.230;
- creditors who negotiate debt settlement;
- officers or employees of state or federal government who perform debt services for individuals on behalf of a federal, state, county, or municipal government;
- Washington licensed or authorized certified public accountants;
- title insurers, escrow agents licensed under RCW 18.44 or other persons that provide bill-paying services, if debt settlement services are incidental; and
- third-party payment processors licensed under RCW 19.230 who do not directly provide debt settlement services.

Background Checks. In connection with an application for a license or periodically upon license renewal for debt settlement services, each applicant, including officers and directors, must furnish information regarding identity. Such information includes fingerprints for submission to the Washington State Patrol and the Federal Bureau of Investigation for state and national criminal history background checks. If an officer, director, member, or principal has been convicted of a felony involving fraud or financial misconduct in the preceding seven years, the application may be denied. Applicants must also provide personal history, experience, business records, and other pertinent facts as the Director may reasonably require.

Renewal. A provider must obtain a renewal of its license annually. If a provider files a complete application for a renewal of its license before the expiration of the license, the license remains effective until the Department of Financial Institutions (Department) notifies the applicant of a denial and states the reasons for the denial. Otherwise, the license expires. An applicant or a licensee must notify the Department no later than 10 days after a material change in the information provided in an application for licensure or renewal.

Evidence of Financial Responsibility. If the applicant for a debt settlement services license will receive or hold customer funds, the applicant must provide a fidelity bond providing coverage in the aggregate amount of \$150,000 with a deductible no greater than \$10,000. The applicant must execute a surety bond in the amount of \$10,000, unless the fidelity bond does not have a deductible.

If the applicant will not hold or receive consumer funds, a surety bond in the aggregate amount of \$50,000 is required. The surety bonds required under the provisions of the Act must be conditioned on the basis that the licensee will faithfully conform to and abide by the provisions of the chapter governing debt settlement services and the rules adopted. If the Director determines, and the Office of the Insurance Commissioner concurs, that the bonds are not reasonably available, the Director may waive the requirements for one or both of the bonds for a fixed period of time.

A "fidelity bond" is a primary commercial blanket bond which provides coverage for any fraudulent or dishonest acts committed by one or more officers, partners, sole practitioners, and employees of the applicant.

Annual Report. A licensee must pay an annual assessment, as established in rule by the Director and with it must submit an accurate annual report in a form and in a medium prescribed by the Director in rule. As part of the annual report, the Director may require a copy of the licensee's most recent audited annual financial statement or any other information that the Director deems necessary.

Disclosure Requirements.

Before a consumer consents to pay for goods or services offered, a provider must disclose truthfully, in a clear and conspicuous manner, the following:

- a good faith estimate of the amount of time necessary to achieve the represented results;
- a good faith estimate of the time by which the provider will start to make bona fide settlement offers to the consumer's creditors;
- a good faith estimate of the amount of money or the percentage of each outstanding debt that the consumer will need to accumulate before a bona fide settlement offer may be made;
- the cost to the consumer for providing debt settlement services;
- the potential adverse effects to the customer's creditworthiness and potential increase in the amount of money owed, where the services offered result in the consumer's failure to make timely payments to creditors or debt collections; and
- that the individual owns any funds placed in an account at a financial institution as a result of debt settlement services.

Separate Account.

A provider may request or require that a customer place funds in an account to be used for payment of the provider's fees and for payments to creditors if:

- the funds are held in a specifically designated account at a financial institution;
- the customer, not the provider, owns and controls the account and any accrued interest;
- if the provider does not administer the account, the entity administering the account is not owned or controlled by or an affiliate of the provider and does not give or accept referral fees; and
- the individual may withdraw from the debt settlement agreement at any time without penalty.

If the provider receives money from a customer, it must hold the funds in a separate trust account at a state-chartered, federally insured financial institution in Washington. The provider may not commingle its own money with customer funds.

Prohibitions.

The provider is prohibited from misrepresenting, directly or by implication, any material aspect of any debt settlement services, including:

- the amount of money or the percentage of the debt amount that a consumer may save by using the service;
- the effect of the service on the consumer's creditworthiness;
- the effect of the service on collection efforts of the consumer's creditors or debt collectors;
- the percentage of the number of consumers who attain the represented results; and
- whether debt settlement services are offered or provided by a nonprofit entity.

A provider is prohibited from directly or indirectly employing any scheme, device, or artifice to defraud or mislead consumers or to defraud any person, and from engaging in any unfair or deceptive practice toward any person.

Fees and Payment.

A provider may not receive payment of any fee or consideration for services until and unless:

- the provider has renegotiated, settled, reduced, or otherwise altered the terms of at least one debt under a debt settlement program;
- the consumer has made at least one payment to a creditor in furtherance of a settlement with that creditor; and
- the fee or consideration for settling each individual debt in a debt settlement plan either bears the same proportional relationship to the total fee for settling the entire debt balance as the individual debt amount bears to the entire debt amount, or is a percent of the amount saved as a result of the settlement.

The fee must not exceed 30 percent of the customer's total debt at the time the customer enrolled in debt adjusting services.

Statement of Accounting.

A statement of accounting (statement) must be distributed at least once per month on or before the fifth business day after a consumer demands a statement. Where a provider permits electronic access to a consumer's account information 24 hours per day and seven days per week, the provider satisfies the requirements regarding the distribution of the statement.

A statement must contain:

- the amount of money that the consumer has paid to the provider since the last statement;

- the amounts, dates, and creditors paid on the consumer's behalf since the last statement;
- the amounts of money collected by the provider as compensation from the consumer's payments;
- the amount of money that the provider holds in trust for the consumer and amount of money paid; and
- the amount of the debt satisfied where a creditor has accepted payment from a provider in full or partial satisfaction of a consumer's debt with that creditor.

Secured Debt.

Unless authorized under another chapter of the Revised Code of Washington, a provider may not provide services for compensation as an intermediary between a customer and one or more secured creditors to obtain a reduction in the principal or interest of a customer's secured debt.

Agreements and Provider Duties.

If a provider is not licensed as required when a customer enters into an agreement for debt settlement services, the agreement may be voided by the customer. If the provider is licensed, the customer may withdraw from the agreement at any time without penalty.

A provider must act in good faith in all matters regarding the provision of debt settlement services and the statutory and administrative requirements. If a licensee delegates a duty or obligation under the Act, the licensee is liable for any conduct of the delegate if he or she violates an agreement or legal or administrative requirement.

Examination and Investigation by Director.

The Director may at any time examine and investigate the business and examine the books, accounts, records, and files of any licensee or person who the Director has reason to believe is engaging in the business of providing debt settlement services. The Director may require testimony under oath regarding the business or subject matter of the investigation.

The Director may apply for and obtain a superior court order approving and authorizing a subpoena in advance of its issuance. The application may be made in the county where the subject of the subpoena resides or in Thurston County, and must adequately specify the documents, records, evidence, or testimony sought. The Director or his or her designee must include a declaration under oath that an investigation is being conducted for a lawfully authorized purpose within the Department's authority.

The Director may issue a statement of charges upon a licensee if, in the opinion of the Director, the licensee or a director or officer of the licensee is engaging in, has engaged in, or is about to engage in an unsafe or unsound financial practice in conducting a business governed under the Act if the licensee omits material information during a response to an examination, violates any written agreement with the Director, fails to pay a fee required by the Director, or commits fraud or a crime involving moral turpitude, financial misconduct, or dishonest dealings.

Sanctions.

As a sanction, the Director may deny, revoke, suspend, or condition a license. The Director may also order a licensee or person to cease and desist from practices that violate the debt settlement services provisions; impose a fine not to exceed \$100 per day per violation; order restitution; and remove from office or ban from participation any director, officer, sole proprietor, partner, or employee in the affairs of the licensee.

Upon application by the Director or any other interested party and upon a showing that the interest of creditors or consumers requires it, the superior court may appoint a receiver to take over, operate, or liquidate any licensee.

Unless prohibited by other statutes, the Director may informally settle complaints or enforcement actions.

Privacy and Confidentiality of Records.

The requirements under any federal law or laws of another state regarding the privacy, confidentiality, or privilege regarding any information or material provided to the Department continues to apply to the information or material after the information or material has been disclosed to the Department.

Adoption of Rules.

The Director must adopt rules for the implementation, administration, and enforcement of the Act and must establish reasonable fees by rule sufficient to cover the costs of administering the Act.

Consumer Protection Act.

Any violation of this Act is a violation of the CPA.

Public Disclosure Act.

Information obtained by the Department that identifies individuals who have agreements with a provider of debt settlement services is exempt from public inspection.

Amended Bill Compared to Engrossed Substitute Bill:

The striking amendment modifies the exemption from regulation available to attorneys such that the exemption only applies when the attorney's debt settlement services are solely incidental to the attorney's practice rather than when the attorney does not solicit debt settlement business.

It also restores existing language to the definition of "debt adjusting" such that the definition applies to persons either managing or settling a debt or receiving money for distribution to

creditors. Debt settlement services by a licensed provider are expressly excluded from the definition of "debt adjusting."

Finally, the striking amendment caps the fees a debt settlement services provider may collect at 30 percent of the debt at the time the client entered the debt settlement program. The language capping certain fees at 20 percent is removed.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended Bill: The bill takes effect on January 1, 2016.

Staff Summary of Public Testimony:

(In support) Debt settlement will help reduce bankruptcy, compete with bad actors in the marketplace, and aid consumers. Debt settlement service providers also take working with seniors very seriously and have collaborated with the American Association of Retired Persons.

Opponents argue that this bill would allow providers to evade regulation by merely getting a license, but licensing is no small level of regulation. This bill will impose a rigorous licensing system with background checks and financial audits even before the applicant provides services. There is also shared oversight by the Department and the Office of the Attorney General (OAG) after licensure. Litigation with Freedom Financial several years ago resulted in cooperation by Freedom Financial and full restitution to all consumers who were harmed. Now, debt settlement service providers work closely with regulators because losing a license could be catastrophic.

It is true that there are bad actors in the marketplace, some of whom act as attorneys who loan out their licenses to avoid regulation. However, they only find success and cause harm to consumers because there is no legitimate alternative in Washington. A licensed, free-market option would provide such an alternative to unaccountable, out-of-state businesses, and could undercut the prices of attorneys who must stack their fees on top of the providers' fees.

There are flaws in the Senate version that may be unlawful under federal law and which must be addressed.

(Opposed) The debt settlement and debt adjusting industries have many bad actors, many of whom evade regulation by casting their services as legal services offered by attorneys. These and similar tactics are deceiving to vulnerable consumers, seniors, and communities of color. The industry has a bad track record in Washington, as indicated by Freedom Financial's litigation with the OAG several years ago. Nationwide, debt settlement and adjusting have resulted in some 11,000 complaints to the Consumer Financial Protection Bureau.

The Debt Adjusting Act is very strong, containing a prohibition on paid-in-advance fees and imposing a 15 percent fee cap. This bill would allow providers to evade the strong protections in the Debt Adjusting Act by simply getting a license from the Department. Additionally, the wording of the bill would allow disproportionate fee structures in which the provider could charge its entire fee for all debts after having settled only one debt.

It is true that there are good actors in the marketplace, but this bill would provide safe harbor to the bad actors along with the good. Many debt settlers operate from out-of-state call centers, make deceptive and predatory claims, and advise the customer to stop paying debts entirely, resulting in default and damaged credit. Instead of seeking these options, consumers should be encouraged to find a reputable credit counselor who can help them enter a debt management plan.

Persons Testifying: (In support) Robert Linderman, American Fair Credit Council.

(Opposed) Mike Tucker, American Association of Retired Persons; Majken Ryherd, Statewide Poverty Action Network; Joy Scott, Solid Ground; Eric Gonzalez, One America; and Toby Marshall, Terrell Marshall Daudt & Willie PLLC.

Persons Signed In To Testify But Not Testifying: None.