

# SENATE BILL REPORT

## ESSB 5321

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As Passed Senate, March 10, 2015

**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:** Financial Institutions & Insurance: 2/05/15, 2/12/15 [DPS, DNP].  
Passed Senate: 3/10/15, 27-22.

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### SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

**Majority Report:** That Substitute Senate Bill No. 5321 be substituted therefor, and the substitute bill do pass.

Signed by Senators Benton, Chair; Angel, Vice Chair; Fain, Litzow and Roach.

**Minority Report:** Do not pass.

Signed by Senators Mullet, Ranking Minority Member; Darneille.

**Staff:** Shani Bauer (786-7468)

**Background:** 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.

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*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.*

After a Washington State Supreme Court ruling which 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 Engrossed Substitute Bill:** This chapter may be known and cited as the Debt Settlement Services Act (Act).

Terms are defined. Debt settlement services are defined to mean services as an intermediary between an individual and one or more unsecured creditors for the purpose of obtaining concessions in the reduction in principal of the individual's unsecured debt; and securing the discharge of such debt upon the individual's performance of the negotiated concessions. Debt settlement services do not include legal, accounting, or financial planning services if those services are provided by a licensed practitioner as part of a practitioner-client relationship. Further, the Act does not apply to a judicial officer, person acting under the authority of the court or administrative agency, financial institution, or escrow company.

After the effective date of the Act, a provider of debt settlement services be licensed with the Department of Financial Institutions (DFI) in order to provide those services. A license must be renewed annually and the licensee must pay an annual assessment.

DFI may deny a license if the applicant provides false or incomplete information, has been convicted of a felony involving fraud or financial misconduct in the past seven years, has had a prior license revoked or suspended, or has defaulted in the payment of money collected for others. Grounds are also specified under which DFI may revoke, suspend, or deny renewal of a license.

A person licensed to provide debt settlement services does not need to register as a debt adjuster. The Debt Adjusting Act is also amended to clarify that a provider of debt settlement services is exempt from that act.

Before an individual agrees to pay for debt settlement services, the provider must disclose the following:

- a good faith estimate of the amount of time necessary to achieve results;
- the amount of time it will take before the provider will make bona fide settlement offers to the individual's creditors,
- an estimate of the amount of money the individual must save before the provider will make a settlement offer;
- that the failure to make timely payments to creditors during the settlement process will likely adversely affect the individual's creditworthiness and may result in collection action; and
- to the extent the provider requests the individual place funds in an account, that the individual owns the funds and can withdraw from the debt settlement services at any time without penalty.

A provider may not misrepresent any material aspect of the debt settlement services including the amount of money the individual may save by using the services, the effect of the service on the individual's creditworthiness, the effect of the service on collection efforts of the individual's creditors or debt collectors, the number of individuals who attain the represented results, and whether debt settlement services are provided by a nonprofit entity.

A provider may not receive any fee unless the provider has settled or reduced at least one debt under the settlement program and the individual has made at least one payment in furtherance of settlement with that creditor. The fee for settling each individual debt must bear the same proportional relationship to the total fee for settling the entire debt amount or must be a percentage of the amount saved as a result of settlement. The total fee, including any fee charged by a financial institution or third-party account administrator, may not exceed 20 percent of the total debt listed by the debtor on the contract.

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

- the funds are held in a specifically designated account at a financial institution under the ownership and control of the individual;
- if the provider does not administer the account, the entity administering the account is not owned or controlled by the provider and is not an affiliate of the provider;
- the entity administering the account does not give or accept any money or other compensation in exchange for referrals of business by the provider;
- the individual may withdraw from debt settlement services at any time without penalty and receive all funds in the account less any funds earned by the provider in compliance with the Act;

A licensee must distribute a statement of accounting to the customer monthly or upon request. If the debt settlement services provider is not licensed when an individual enters into a debt settlement services agreement, the agreement is voidable by the individual.

DFI has the authority to ensure compliance with the Act and conduct investigations and examinations, enforce violations, and issue sanctions. If DFI determines continuation of business activities by the licensee is likely to cause insolvency or substantial injury to the public, DFI may issue a temporary cease and desist order. DFI may apply to the superior court for the appointment of a receiver in appropriate circumstances.

DFI may establish fees sufficient to cover the costs of administering the program. Information obtained by DFI that identifies individuals receiving debt settlement services is exempt from public disclosure.

A violation of the Act is a violation of the CPA.

**Appropriation:** None.

**Fiscal Note:** Available.

[OFM requested ten-year cost projection pursuant to I-960.]

**Committee/Commission/Task Force Created:** No.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony on Original Bill:** PRO: The existing debt-adjusting laws were created many years ago. Modern day business adjusting did not come about until after the Bankruptcy Act of 2005. That business model is not workable under current debt adjuster law, so debt settlement business is not active in Washington. One large company out of state has settled between \$65 and \$70 million in credit card debt in a month, at an average of \$0.42 on the dollar or \$0.63 on the dollar with fees. Debt settlement providers have been extremely successful in reducing debts. Debt settlement yields \$3.15 reduction for every \$1.00 paid in debt settlement fees. Under the bill, credit counseling would continue to operate under the debt adjuster law. While there is no cap on the amount of the fee, debt settlement is a contingent fee relationship based on the amount of the reduction; this is not the same scheme provided under the debt-adjusting law.

CON: There have been some studies that look at the outcomes and risks of for-profit debt-settlement companies. Research shows that most consumers do not benefit from these services and face significant risks and harms from the business model. Most people who engage the services of a for-profit debt settlement do not end up with an improved financial position. It is impossible for a person to evaluate ahead of time whether engaging the services of a debt settlement service will be successful and what type of risks are involved. Over half of consumers terminate the program within two years and experience substantial harm stemming from inherent flaws in the business model including tax liability, creditor lawsuits, and damaged credit scores. Debt settlement may seem attractive to someone who is trying to find a way out of debt, but most customers end up worse off. Some states ban for-profit debt settlement entirely. Other states institute strict regulations on the amount of the fee that may be charged. Debt adjustment law has important protections for people who are struggling with debts and this bill seeks to do away with those protections. These are people who are already struggling to put food on the table and pay for rent. This business is open for abuse. The Legislature should keep the current level of regulation for debt-adjusting businesses. This legislation should not be passed because the practice of debt settlement does not work; there is a high probability of consumers ending up worse off; and the history of the industry offers too much risk to consumers.

**Persons Testifying:** PRO: Bob Linderman, American Fair Credit Council.

CON: Marcy Bower, Statewide Poverty Action Network; Diane Standaert, Center for Responsible Lending; Joe Sky Tucker, Express Advantage Credit Union.