

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1045 Debt Settlement Services

SPONSOR(S): Hudson

TIED BILLS: IDEN./SIM. BILLS:

Table with 4 columns: REFERENCE, ACTION, ANALYST, STAFF DIRECTOR. Row 1: Insurance, Business & Financial Affairs Policy Committee, Tanner, Cooper.

SUMMARY ANALYSIS

Debt settlement services reduce a consumer's outstanding balance, including principal. They negotiate with creditors to reduce the consumer's debt in exchange for an agreement of regular repayments, but debt settlement services do not handle consumer money.

Debt settlement services are distinguishable from credit counseling organizations (CCOs), which generally reduce only the interest and late fees of a debt. CCOs provide counseling to debtors on developing budgets, managing money, using credit, and building a savings plan.

Part IV of ch. 817, F.S. governs the regulation of credit counseling agencies, which includes fees, financial reporting, insurance requirements, and penalties for noncompliance. Essentially, this bill would make a distinction between credit counseling agencies and debt settlement services within ch. 817 and require debt settlement services to be licensed with the Office of Financial Regulation (OFR).

- Requires debt settlement providers to register and renew annually with the OFR in accordance with specified requirements. Currently, Florida does not require registration or licensure of debt settlement providers. Establishes grounds for denying registration; establishes prohibited acts for debt settlement providers, including limitations on fees and debt settlement amounts; and establishes standards for debt settlement agreements.

This bill appears to have a fiscal impact on state government revenues and expenditures. The OFR estimates that the bill will provide \$770,000 in revenue for each of the next three fiscal years and total expenditures of \$820,635 (FY 08-09), \$737,603 (FY 09-10) and \$737,603 (FY 10-11).

The bill takes effect July 1, 2009.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

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## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### **Background**

Debt settlement companies act on behalf of consumer debtors to help them resolve their debts.<sup>1</sup> They do this by entering into direct negotiations with creditors in order to facilitate the repayment of debts, reducing the consumer's outstanding balance, including principle.<sup>2</sup> In return for their services, debt settlement companies are generally paid a fee based upon a combination of the total amount of the debt handled and the amount saved by the consumer debtor.<sup>3</sup> Most debt settlement companies do not escrow, handle, manage, or otherwise control consumer money, usually requiring the consumer to set up a separate bank account or use an escrow company in making the new payments with the creditor.<sup>4</sup> This is a distinguishing factor between debt settlement companies and other debt management business models including the nonprofit consumer credit counseling companies.

Debt settlement services are distinguishable from credit counseling organizations (CCOs), which generally reduce only the interest and late fees of a debt.<sup>5</sup> CCOs provide counseling to debtors on developing budgets, managing money, using credit, and building a savings plan.<sup>6</sup> They also negotiate with creditors and debtors to set up 'debt management plans.' These organizations may attempt to help debtors avoid foreclosure and bankruptcy, reduce interest rates and late fees, and lower and consolidate monthly loan payments. By agreement, the consumer deposits funds with the CCO every month. The CCO in turn sends the money directly to the creditors. Under these agreements, creditors will close or suspend the consumer's lines of credit, except in limited circumstances. Upon completion of the repayment plan, some creditors will reestablish credit based on current ability to pay and payment history during the repayment period. CCOs are usually nonprofits, funded by creditors and banks which subsidize CCS operations.<sup>7</sup> Another major difference is that debt settlement services are unsubsidized, for-profit entities that operate mostly on fees charged to the consumers which are based on the total amount of debt handled and the amount saved by the debtor.<sup>8</sup> CCOs usually perform

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<sup>1</sup> The Association of Settlement Companies (TASC) White Paper dated March 9, 2006 on file with the Insurance, Business and Financial Affairs Policy Committee.

<sup>2</sup> Office of Financial Regulation (OFR) Bill Analysis dated March 16, 2009 on file with the Insurance, Business and Financial Affairs Policy Committee.

<sup>3</sup> TASC White Paper, *supra* note 1.

<sup>4</sup> OFR Bill Analysis, *supra* note 2.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

these services at little or no cost to consumers. Most creditors will not stop interest from accruing during repayment, but many will lower it.<sup>9</sup>

### **Current Law**

Part IV of ch. 817, F.S., titled "Consumer Counseling Services," governs the regulation of credit counseling agencies, which includes fees, financial reporting, insurance requirements, and penalties for noncompliance.

In Florida, credit counseling agencies are organizations providing credit counseling services or debt management services.<sup>10</sup> The term, "credit counseling services," means confidential money management, debt reduction, and financial educational services.<sup>11</sup> Debt management services generally means services for a fee to adjust or discharge the indebtedness of the debtor.<sup>12</sup> Persons engaged in credit counseling or debt management services are prohibited from charging fees to any consumer or debtor residing in Florida in excess of amounts prescribed in s. 817.802, F.S. Each person providing credit counseling or debt management services must obtain an annual financial audit<sup>13</sup> and maintain insurance coverage for employee dishonesty, depositor's forgery, and computer fraud.<sup>14</sup>

Under Florida law, no state agency is charged with enforcing the laws regulating credit counseling agencies or debt settlement services.<sup>15</sup> Although, a violation of any provision of part IV of ch. 817, F.S., is an unfair or deceptive trade practice under the Florida Deceptive and Unfair Trade Practices Act<sup>16</sup> (Act) and the Office of the Attorney General could potentially enforce the Act against debt settlement companies engaging in unfair and deceptive trade practices.<sup>17</sup> A consumer harmed by a violation of this act may bring an action for recovery of damages, costs and attorney's fees.<sup>18</sup> A person who violates any provision of the act commits a third degree felony,<sup>19</sup> punishable by not more than 5 years in prison<sup>20</sup> and a fine of up to \$5,000.<sup>21</sup>

### **Effect of Bill**

This bill creates part V of ch. 817, F.S. entitled the "Debt Settlement Services Act," which makes a distinction between credit counseling agencies and debt settlement services within ch. 817, F.S. and requires the latter to be licensed with the Office of Financial Regulation.

The bill defines a "debt settlement provider" as a person required to be licensed under this part who provides, offers to provide, or agrees to provide debt settlement services. The term does not include a credit counseling agency as defined in s. 817.801, F.S. "Debt settlement services" is defined as services provided for a consumer by a debt settlement provider for a fee to obtain a concession from the consumer's creditor or otherwise effect the adjustment, compromise, or discharge of any unsecured account, note, or other indebtedness of the consumer without receiving from the consumer and disbursing to the creditor any money or other thing of value. The term does not include debt management services or credit counseling services as defined in s. 817.801.

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<sup>9</sup> *Id.*

<sup>10</sup> Section 817.801(1), F.S.

<sup>11</sup> Section 817.801(2), F.S.

<sup>12</sup> Section 817.801(4), F.S.

<sup>13</sup> Section 817.804(1)(a), F.S.

<sup>14</sup> Section 817.804(1)(b), F.S.

<sup>15</sup> OFR Bill Analysis, *supra* note 2.

<sup>16</sup> ch. 501 part II, F.S.

<sup>17</sup> Section 817.806(1), F.S.

<sup>18</sup> *Id.*

<sup>19</sup> Section 817.806(2), F.S.

<sup>20</sup> Section 775.082(3)(d), F.S.

<sup>21</sup> Section 775.083(1)(c), F.S.

The bill does not apply to:

- A person who provides debt settlement services for a consumer and who does not receive compensation for such services from the consumer or the consumer's creditors;
- licensed Florida attorneys, CPAs, and title agents;
- judicial officers, persons acting under court or administrative orders; and
- financial institutions or their holding companies, subsidiaries, agents, and affiliates.

This bill creates licensure requirements for debt settlement providers. A debt settlement provider is subject to annual registration with Office of Financial Regulation (OFR) of the Financial Services Commission. The registration fee may not exceed \$350 a year. The debt settlement provider must provide specified information in a format prescribed by OFR, including, but not limited to: material judgments and actions (civil, criminal, and administrative) relating to financial fraud or misuse from any jurisdiction; copies of all service agreements in use; evidence of insurance coverage or surety bond; schedule of fees; copies of financial analyses used to estimate consumer repayment.

The OFR would be authorized to deny or refuse to renew registration for materially erroneous or incomplete applications and for convictions and pleas to crimes involving fraud, moral turpitude, dishonest dealing, or any violation of this part. Applicants could also be denied for failure to satisfy any fine or penalty arising out of administrative or civil enforcement actions based on fraud, moral turpitude, dishonest dealing, or any violation of this part and for judgments entered against applicant or registrant in an unfair and deceptive trade practices suit under part II, chapter 501, F.S.

A debt settlement agreement is required before a debt settlement provider can engage in services. The bill also provides required components, such as an itemized schedule of fees, a notice of right to cancel, and prohibits choice of law clauses restricting the application of Florida law. It also requires providers to maintain records of debt settlement agreements for at least 4 years after the consumer's final payment.

The bill requires debt settlement providers to act in good faith. Additionally, it requires registrants to maintain insurance coverage identical to that required for credit counseling agencies; in lieu of the insurance, registrants may obtain a minimum \$10,000 surety bond (max \$50K) for the use and benefit of any consumer who suffers any loss due to any violation of this part. Providers will be required to maintain a toll-free number that customers can call during regular business hours. The bill sets forth required procedures for providers to follow before executing debt settlement agreements, including preparing a financial analysis for the consumer and informing the consumer that not all debt settlement services are suitable for all consumers and no specific results can be guaranteed.

A debt settlement provider may not impose a fee or other charge on a consumer unless authorized by this bill. The bill prohibits debt settlement providers from assessing fees in excess of 20% of the consumer's presettlement debt and requires that providers execute agreements before charging fees.

The bill prohibits debt settlement providers from engaging in specified acts, such as:

- engaging in debt settlement services before the consumer signs a service agreement;
- settling a debt on behalf of a consumer for more than 50% of the amount of the presettlement debt unless the consumers agrees in writing to the settlement;
- structuring a settlement that results in a negative amortization schedule for repayment of any of a consumer's debts; or
- advising a consumer to stop payment on any debts.

This bill requires debt settlement providers to establish internal complaint processes. The bill allows a consumer injured by a debt settlement provider's violation of this part to seek the greater of compensatory damages or \$1,000 from providers in circuit court, in addition to attorney's fees and costs. The bill also provides for additional recoveries if the debt settlement provider violates a consumer's rights under the debt settlement agreement. There is a limitation of liability for providers acting in good faith and can demonstrate that the violation was not intentional.

This bill authorizes OFR to enforce this part and rules adopted under this part, including:

- ordering a cease and desist from any violation;
- ordering a debt settlement provider to correct a violation, including making restitution of money or property to the person aggrieved by the violation;
- imposing a civil penalty not to exceed \$1,000 for each violation; and
- prosecuting a civil action to enforce an order.

If a person violates or knowingly authorizes another person to violated a final order issued, OFR may impose an additional civil penalty no greater than \$1000 for each violation. Additionally, OFR may recover the reasonable costs of enforcing this part, including attorney's fees.

The bill sets a two-year statute of limitations for consumer civil actions under §817.917(2). Administrative remedies<sup>22</sup> must be commenced within 4 years after the conduct that is the basis of OFR's complaint.

This bill authorizes OFR to suspend, revoke, or deny the renewal of debt settlement provider's license for various acts, including but not limited to:

- insolvency;
- material misrepresentation or omission; and
- failure to respond to the office within a reasonable time.

The bill also authorizes OFR to enforce this part, through investigative, examination, and rulemaking authority, including the authority to charge reasonable expenses necessary for examinations and to require statements under oath. OFR is also authorized to enter into cooperative arrangements with other state or federal agencies having authority over debt settlement providers.

In conclusion, the bill states that this part shall be legislatively reviewed before June 30, 2015, but does not expire or self-repeal if Legislature fails to do so.

#### B. SECTION DIRECTORY:

Section 1 amends subsections (1), (2), and (4) of 817.801, F.S, relating to definitions.

Section 2 creates Part V of chapter 817, F.S., consisting of §§ 817.901, 817.903, 817.905, 817.907, 817.909, 817.911, 817.913, 817.915, 817.917, 817.919, 817.921, 817.923, 817.925, and 817.927.

Section 3 provides an effective date of July 1, 2009.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

##### 1. Revenues:

The OFR estimates recurring revenues from application and renewal fees (2,200 applications x \$350 maximum) to be \$770,000 for each of the next three fiscal years.

##### 2. Expenditures:

OFR estimates total expenditures to be:

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<sup>22</sup> Under s. 817.919, F.S.

	(FY 08-09) Amount / FTE	(FY 09-10) Amount / FTE	(FY 10-11) Amount / FTE
1) Recurring – 11 FTE			
Salary and Benefits	\$ 629,660	\$ 629,660	\$ 629,660
Expense	\$ 103,400	\$ 103,400	\$ 103,400
Transfer to DMS	\$ 4,543	\$ 4,543	\$ 4,543
Total Recurring	\$ 737,603	\$ 737,603	\$ 737,603
2) Non-Recurring			
Expense	\$ 37,532		
OCO	\$ 15,500		
OPS	\$ 30,000		
Total Non-Recurring	\$ 83,032		
Total Expenditures	\$ 820,635	\$ 737,603	\$ 737,603

Positions included:

Licensing	1 Financial Examiner/Analyst II
Examinations/Complaints	2 Financial Specialists
	4 Financial Examiner/Analyst II
	3 Financial Examiner/Analyst II
Legal	1 Senior Attorney

The OFR fiscal projections include the following:

“It is estimated there are approximately 2,200 debt settlement service providers who would be required to register under the bill. It is estimated that 1 FTE would be required to process applications and renewals on a normal basis, along with OPS assistance to process the initial wave of applications expected after passage of the bill.

In reviewing the complaints on collection agencies, OFR receives 500 complaints a year on average. This includes the handling and processing of the complaints and the telephone calls from consumers and industry. The percentage of complaints based on total number of licensees is 40%. Using the estimated 2,200 licensees, this would mean 880 complaints (2200 X 40%) per year regarding debt management providers. This would require 4 FTE to handle the complaint process (1 FTE per 220 complaints per year).

To conduct examinations over a 5 year period of 2,200 licensees would require 440 examinations per year to be conducted. Based on an estimated average of 2 exams per week including travel time, on-site review, and drafting the exam report, 1 FTE could conduct 89 exams per year (1854 hrs in a year / 40 = 46.3 weeks X 2 = 92.4 exams). 440 exams / 92.4 exams = 4.78 FTEs (round to 5). A Senior Attorney would be required to handle legal work related to the licensing and examination processes.

Under the proposed language, fees would be deposited into the General Inspection Trust Fund which is not currently used by the Office. Licensing fees for other Finance license types are deposited into the Regulatory Trust Fund and the budget for the Division of Finance is appropriated from the Regulatory Trust Fund.

It should be noted that all licenses currently administered by the Office renew on a date certain rather than renewing one year after issuance. Requiring renewal of all licenses one year after issue would require substantial changes to the existing Regulatory Enforcement and Licensing (REAL) System and would cause substantial additional cost to implement the bill.”

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Currently, debt settlement service providers are not required to register or pay a fee. Each provider will be required to pay an initial application fee not to exceed \$350 and an annual renewal fee not to exceed \$350. Additionally, each provider would be required to obtain an insurance policy or surety bond. The cost of the insurance policy or surety bond is indeterminate.<sup>23</sup>

D. FISCAL COMMENTS:

None.

**III. COMMENTS**

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

None.

2. Other:

OFR notes that the Pennsylvania Legislature enacted its Debt Management Services Act (2008-117) last year, with an effective date of February 6, 2009.<sup>24</sup> However, in late January of this year, the Association of Settlement Companies and two Pennsylvania debt settlement company members filed suit against the Pennsylvania Department of Banking, seeking declaratory judgment on the Act's constitutionality. The lawsuit brings several claims including allegations that the new law violates the due process rights of the businesses, violates Equal Protection rights in the unequal application of law to varying debt relief businesses and interferes with existing contractual relationships between consumers and debt settlement companies. It also claims that the statute as written is defective and grants the Department unconstitutional authority.<sup>25</sup> The Commonwealth Court of Pennsylvania granted a preliminary injunction.<sup>26</sup> In accordance with the injunction, the Pennsylvania Department of Banking is not accepting applications for debt settlement services at this time.<sup>27</sup>

B. RULE-MAKING AUTHORITY:

The bill authorizes OFR to adopt rules under ss. 120.536(1) and 120.54, F.S. to administer this part.

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<sup>23</sup> OFR Bill Analysis, *supra* note 2.

<sup>24</sup> *Id.* at 5; *see also* Pennsylvania Debt Management Services Act *available at* <http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=PDF&sessYr=2007&sessInd=0&billBody=H&billTyp=B&billNbr=2294&pn=4525>.

<sup>25</sup> OFR Bill Analysis, *supra* note 2; which references *Debt Settlement Industry Sues Pennsylvania – Department of Banking creates unconstitutional law; hurts consumers, suit claims*, TASC website, *available at* <http://www.tascsite.org/article.php?id=30> (Feb. 3, 2009).

<sup>26</sup> OFR Bill Analysis, *supra* note 2; which references *Debt Settlement Industry Earns Injunction on New Pennsylvania Law*, TASC website, *available at* <http://www.tascsite.org/article.php?id=31> (Feb. 3, 2009).

<sup>27</sup> Pennsylvania Department of Banking website, *available at* <http://www.banking.state.pa.us/banking/cwp/view.asp?a=1351&q=548320> (website states: "The Department of Banking has been enjoined by the PA Commonwealth Court from enforcing the debt settlement provisions of the Debt Management Services Act. Therefore, the Department will not be accepting applications for debt settlement services at this time.") (Last visited March 22, 2009).

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES**