SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Commerce and Consumer Services Committee

BILL: CS/SB 1954

INTRODUCER: Banking and Insurance Committee and Senator Aronberg

SUBJECT: Credit Counseling Services

DATE: April 19, 2006 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	**Fav/CS**
2.	Earlywine	Cooper	CM	**Favorable**
3.				
4.				
5.				
6.				

I. Summary:

Credit counseling agencies were initially established to assist persons in financial difficulty gain control of their finances, repay their credit card debts, and avoid bankruptcy. In 2004, Florida enacted legislation that established the framework for the regulation of the relationship between a consumer and a credit counseling agency that provides credit counseling or debt management services.[1] This committee substitute (CS) provides the following changes to the laws governing consumer counseling services and debt management services.

- Provides that the fee caps that currently apply to credit counseling services apply only to debtors residing in Florida. Therefore, the fee cap would not apply to a credit counseling agency located in Florida and providing services to a resident of another state. The CS may also clarify that a credit counseling agency located outside of Florida that provides services to a Florida resident is subject to the fee caps.
- Creates a definition of the term, “creditor contribution,” meaning a sum that a creditor (such as a financial institution) agrees to contribute to the credit counseling agency or otherwise setoff against the debt payable by the agency on behalf of debtors.
- Requires a debt management or credit counseling service to deduct and retain the voluntary, creditor’s contribution from the debtor’s payment. As a result, the debtor’s account would be credited for the amount remitted by the debtor, less any fees authorized by law. However, the CS prohibits these creditor contributions from reducing any amounts to be credited to the account of the debtor for further payment to the creditor. Currently, the law requires that all funds received from the debtor, less any fees allowed by s. 817.802 F.S., must be remitted to the creditors.

[1] Chapter 2004-351, L.O.F.

- Allows credit counseling agencies to establish a single trust account for funds received from "each debtor" rather than establishing a separate trust account for each debtor's payments.
- Allows certified public accountants licensed in other states to conduct annual audits of the accounts of a credit counseling or debt management service.

This CS substantially amends the following sections of the Florida Statutes: 817.801, 817.802, 817.804, and 817.805.

II. Present Situation:

Background
Credit counseling organizations generally attempt to assist people with managing their personal debt. These organizations may attempt to help debtors avoid foreclosure and bankruptcy, reduce interest rates on loans, and lower or consolidate monthly loan payments. Credit counseling organizations may also offer individual counseling for developing budgets, managing money, using credit, and building a savings plan. These services can be provided through local offices, the Internet, or the telephone.

Debt management plans are often provided by credit counseling organizations as a way of allowing a debtor to pay down debt through monthly deposits to the credit counseling service, which then distributes those funds to creditors. Credit counseling services often advertise that they work with clients to create a debt repayment plan that minimizes monthly payments, interest, and related fees. Consumers provide monthly payments to the credit counseling service and the agency uses the money to pay unsecured loans and other debts in accordance with a payment schedule that has been agreed upon with the debtor and creditor.

Nonprofit credit counseling organizations use various methods for producing income for the organization. Many creditors, particularly credit card issuers or financial institutions make voluntary contributions or "fair share" payments to nonprofit credit counseling organizations for providing an alternative means of debt collection. Since credit card issuers limit their fair-share payments to non-profit agencies for tax deduction purposes, the majority of these credit counseling agencies are organized as non-profits. Additionally, credit counseling organizations may request donations or fees from consumers for their services.

The new federal bankruptcy law, the Bankruptcy Abuse and Consumer Protection Act, mandates that a consumer participate in credit counseling services before and after filing for bankruptcy. The act requires that agencies that counsel bankrupt debtors be nonprofit and approved by the U.S. Trustees, a branch of the federal Department of Justice. Under the act, the consumer pays for this mandatory credit counseling.

Federal and State Regulation of Credit Counseling Services
In the last decade, new state and federal laws have been enacted to protect consumers from deceptive and fraudulent practices involving credit counseling and debt repair; however, these laws often provide specific exemptions for credit counseling agencies recognized under s. 501(c)(3) as tax-exempt entities. The Federal Trade Commission has jurisdiction to enforce certain federal consumer protection laws through the Federal Trade Commission Act (FTC Act),

which prohibits unfair or deceptive trade practices, the Telemarketing and Consumer Fraud Act, and the Credit Repair Organizations Act. However, the FTC Act and the Credit Repair Organizations Act do not apply to non-profit organizations.

Federal and state regulators are concerned that some credit counseling agencies using questionable practices may seek tax-exempt status in order to circumvent state and federal consumer protection laws. The federal regulation of nonprofit credit counseling agencies is provided through the scrutiny of their tax-exempt status under s. 501 of the Internal Revenue Code. To be exempt from income taxes, a credit counseling agency must limit its services to low-income customers or must primarily provide education and counseling to the public, according to the Internal Revenue Service (IRS). [2] The IRS has increased its enforcement efforts to ensure that existing s. 501(c) organizations are complying with the applicable regulations. According to the IRS, approximately 50 percent of the industry is under audit and the IRS has issued proposed revocations, or actually revoked the tax-exempt status of 20 percent of the industry.

According to the National Consumer Law Center, 26 states have enacted laws to require registration or licensing of companies offering credit counseling services. Florida does not require licensure or registration of credit counseling services.[3] As mentioned, many states exempt non-profits from regulation. Some states, including Florida (below) limit the fees that debt management or credit counseling services may charge. For example, Arizona sets a ceiling of $39 for retainers and a monthly limit of 0.75 of 1 percent of the consumer's total indebtedness or $50, whichever is greater. The law also authorizes an agency to charge for certain out-of-pocket expenses with the debtor approval. California caps fees for enrollment at no more than $50 for education and counseling combined in connection with debt management or debt settlement services and a monthly sum not to exceed 6.5 percent of the money disbursed each month, or $20, whichever is greater. Georgia limits fees to 7.5 percent of the amount paid monthly by a debtor.

Illinois limits initial fees to a maximum of $50. North Dakota limits the amount of origination fee a credit counseling organization may charge to $50, which may be subtracted from the initial amount paid by the debtor to the counseling service.[4] In some states, a maximum dollar cap is used. For example, New Jersey sets a fee limit of no more than 1 percent of a consumer's gross income but, in any case, no more than $15. Tennessee's limit is $20. Rhode Island law provides that costs of the non-profit must not exceed amounts necessary to defray bona fide expenses.

Florida Regulation of Credit Counseling Services

In 2004, the Florida Legislature enacted laws governing credit counseling agencies, which are organizations providing "credit counseling services" or "debt management services."[5] The term, "credit counseling services," means confidential money management, debt reduction, and financial educational services. "Debt management services" generally means services for a fee to

[2] *New York Times,* volume 123, number 48, October 14, 2003.
[3] *Credit Counseling in Crisis Update: Poor Compliance and Weak Enforcement Undermine Laws Governing Credit Counseling Agencies*, National Consumer Law Center. November 2004.
[4] ND ST 13-07-06.
[5] Part IV, ch. 817, F.S.

adjust or discharge the indebtedness of the debtor.[6] Persons engaged in credit counseling or debt management services are prohibited from charging fees to any debtor in excess of prescribed amounts for the following services:

- A fee greater than $50 for an initial consultation;
- Fees amounting to greater than $120 per year for additional consultations; and
- For debt management services, a fee may not exceed the greater of 7.5 percent of the amount paid monthly by a debtor, or $35 per month.

Each person providing credit counseling or debt management services is required to be audited annually, and to maintain insurance coverage for employee dishonesty, depositor's forgery, and computer fraud. A person engaged in credit counseling or debt management is required to disburse a debtor's payment, less any applicable fees, within 30 days after receiving such funds, and must maintain a separate trust account for the receipt of funds from "each debtor" and their subsequent disbursement for each debtor.

No state agency is charged with enforcing the laws regulating credit counseling agencies. 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. A consumer harmed by a violation of this CS may bring an action for recovery of damages, costs and attorney's fees. A person who violates any provision of the CS commits a third degree felony, punishable by not more than 5 years in prison and a fine of up to $5,000.

Certain entities are exempted from the Florida law. These laws do not apply if these services are provided in the practice of law in Florida. The law also exempts persons who engage in debt adjustment to adjust the debt owed to that person. Also, exemptions exist in law for all regulated financial entities; specifically, the following entities and their subsidiaries: the Federal National Mortgage Association; the Federal Home Loan Mortgage Corporation; the Florida Housing Finance Corporation, a public corporation created in s. 420.504, F.S.; or a bank, bank holding company, trust company, savings and loan association, credit union, credit card bank, or savings bank that is regulated by the federal Office of the Comptroller of Currency, the Office of Thrift Supervision, the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, or the Florida Department of Financial Services.

III. Effect of Proposed Changes:

Section 1 amends s. 817.801, F.S., to define the term, "creditor contribution" to mean any sum that a creditor agrees to contribute to a credit counseling agency, whether directly or by setoff against amounts otherwise payable to the creditor on behalf of the debtors.

The industry-wide practice is for various creditors (i.e., financial institutions) to make contributions to credit counseling agencies for the work that credit counseling agencies do with consumers to recover payments for debts. An organization engaged in debt management services may withhold amounts due to the creditor by the debtor, which the creditor treats as a

[6] Section 817.801, F.S.

contribution to an exempt organization. As an alternative, the financial institution may provide grants to the agency or arrange other creditor's contribution allocations.

Section 2 amends s. 817.802, F.S., to provide that the fee caps that currently apply to credit counseling services (as described in Present Situation, above) apply only to debtors residing in Florida. Therefore, the fee cap would not apply to a credit counseling agency located in Florida and providing services to a resident of another state. The laws of such other state would apply, which may or may not restrict the fees that may be charged. The CS may also clarify that a credit counseling agency located outside of Florida that provides services to a Florida resident is subject to the fee caps.

Section 3 amends s. 817.804, F.S., to clarify that the scope of the required annual audit must include all accounts in which the funds of debtors are deposited and from which payments are made to creditors on behalf of the debtors and to allow a certified public accountant that is licensed in any state to conduct the audit, as long as the audit was conducted in accordance with generally accepted auditing standards. Currently, only certified public accountants licensed in Florida may conduct these audits and the statutes are silent regarding the standards for such audits.

Section 4 amends s. 817.805, F.S., to require a debt management or credit counseling service to deduct any creditor contributions from all funds it is required to disburse to the creditor from those it receives from the debtor. However, a "creditor contribution" may not reduce the amounts credited to the account of a debtor making payment to the credit counseling agency towards his or her debt. According to the proponents of this CS, the intent of this provision is to ensure that debtors receive credit for their payments, less any applicable fees, regardless of any contributions made by the creditor and to allow the companies to deduct the creditor's contribution prior to disbursing funds to the creditor. As an example of the application of the disbursement allocation provided in this section, a debtor pays a credit counseling service a $125 payment. The credit counseling service may receive a $25 fee, and a 4 percent fee or $4 for the creditor contribution would be deducted from the debtor's payment. However, $100 would be allocated by the creditor for the debtor's benefit.

Currently, creditors may contribute anywhere from 3 percent or more of their monthly payment or provide periodic grants to the counseling agency. Under current law, creditors make their creditor's contribution to the company once the payment from the debtor is received. This section may require creditors to revise their method for paying creditor's contributions.

The CS also specifies that the requirement for credit counseling agencies to establish a separate trust account for funds received from "each debtor" applies, instead, to funds received from "debtors." Therefore, a single trust fund for all amounts received from all of the debtor clients of the agency would be clearly permitted. This may allow credit counselors to alter the ways in which they handle debtor funds, and the way in which their trust accounts for such funds are set-up, audited, and disbursed.

Section 5 provides that the act will take effect July 1, 2006.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Credit counseling services provided by Florida companies to persons residing outside of Florida would not be subject to the current fee caps. These persons would be subject to any fee cap law enacted in their state, if applicable. The fee caps would continue to apply to debtors residing in Florida.

Financial institutions and other creditors will now be required to make their voluntary donation or creditor's contribution prior to the receipt of the debtor's payment via the consumer credit counseling or debt management service. The creditor's contribution would be deducted from the debtor's payment to the credit counseling or debt management service; however, the creditor's contribution cannot reduce any amount of payments that will be credited to the account of the debtor.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

Generally, nationally chartered banks and their operating subsidiaries are regulated by the Office of the Comptroller of the Currency (OCC). The OCC has broad authority to regulate the conduct of national banks except where the authority to issue such regulations has been expressly and

exclusively given to another federal regulatory agency.[7] State laws could be applicable to national banks, however, in limited circumstances when it does not conflict or interfere with the national bank's exercise of its powers. Section 817.803, F.S., recognizes these federal preemptions by exempting a bank, bank holding company, trust company, savings and loan association, credit union, credit card bank, or savings bank that is regulated by the federal Office of the Comptroller of Currency, the Office of Thrift Supervision, the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, or the Florida Department of Financial Services. Therefore, it is unclear whether the creditor contributions requirements in section 4 of this analysis, as it relates to credit card activities of a nationally chartered financial institution or its subsidiary would be preempted by the federal law.[8] Currently, creditor's contributions are voluntary donations made by creditors to these tax-exempt entities and formalized through voluntary agreements with the individual credit counseling or debt management services.

This Senate staff analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

[7] 12 U.S.C. s. 93a.
[8] 12 U.S.C. s. 484.

VIII. Summary of Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.