To: Commission
From: Staff
Re: DMSANJ
Date: April 18, 2011

M E M O R A N D U M

At the January Commission meeting, the Commission asked that Staff present the Debt-Management Settlement Act – New Jersey project for the February meeting, highlighting matters on which the Commission had yet to make a final decision. Staff sought and received Commission input on a range of issues and modified the draft accordingly. In addition, Staff changed the draft to reflect NCCUSL's release of a revised Act in February 2011.

At the February meeting, the Commission approved the change from a registration scheme (as set forth in the UDMSA) to licensure, to comport with New Jersey's current statute. The Commission also approved the inclusion of additional consumer protection language in the prerequisites section of the Act as well as the effort to make the prerequisites for debt-management the same as those for debt-settlement. In addition, the Commission approved the modifications Staff made pursuant to the FTC Rule change.

The Commission did not object, at the February meeting, to the following changes to the draft: (a) the inclusion of certified counselors and certified debt specialists; (b) the modification of the definition of "plan"; (c) the removal of certain definitions; (d) the inclusion of language authorizing the definition of other terms by regulation; (e) the combining of UDMSA sections; (f) the use of a two year license cycle; (g) the incorporation of the fingerprint language from A1949; (h) including the bulk of the UDMSA provisions as default provisions in the statute; (i) permitting the use of a temporary license on renewal, but not on an initial application (although Commissioner Bell expressed concerns about permitting the use of a temporary license generally); (j) the change to the section pertaining to electronic communications; (k) language pertaining to a 10-day time period for disbursements; (*l*) the language pertaining to prohibited acts and practices; (m) the advertising and marketing information; (n) the powers of the administrator; or (o) the administrative remedies provisions.

Questions from the February meeting

At the February meeting, the Commission made no decision regarding the following issues: (a) the applicability of the Act to attorneys pending receipt of information from the State Bar, which Staff hopes to receive in late April or early May (in the current draft, attorneys are not subject to dual licensure but that attorneys engaging in a business that regularly provides debt-management services or with the principal purpose of providing debt-management services, the remainder of the provisions of the Act applies); (b) the requirement in the NCCUSL draft that a provider obtain surety bonds from an "A" rated company – instead, the Commission directed Staff to discuss with DOBI what is currently being done with the issue of an "A" rating; (c) the inclusion of a time period for a review and a determination by DOBI regarding licensing (Staff was directed to find out how quickly such matters proceed now); (d) fees; (e) private enforcement; or (f) the language pertaining to a violation of the consumer protection statutes.

With regard to the comments from the New Jersey Bar Association pertaining to the application of the Act to attorneys, those comments were not expected to be received by filing day and Staff is requesting that the Commission release this project as a Tentative Report and address any NJSBA comments during or after the close of the comment period.

In response to Staff's request for additional information concerning the requirement of an "A" rated bonding company, DOBI advised that it recommended the elimination of any reference to the insurer's rating. DOBI explained that none of New Jersey's current licensing laws prescribe a rating but instead establish only basic requirements, indicating, for example, that the bond must be obtained from "a surety company authorized by law to do business in this State." See, *N.J.S.* 17:11C-63 (residential mortgage lenders), *N.J.A.C.* 3:27-4.1(a) (money transmitters), *N.J.A.C.* 3:25-2.4(a) (debt adjusters). DOBI further explained that the precise rating of a fidelity or performance bond insurer is generally more of an issue with construction contracts to which the State is a party and that DOBI has not had a negative experience with the solvency or performance of bond insurers contracted in connection with licensing requirements that would suggest any real need for the additional complications of imposing a rating requirement in this new licensing program. The language of the Section was revised to include the language suggested by DOBI at b.(4)(B).

When asked, for purposes of Section 7, how quickly the Department generally acts with regard to the issuance or denial of a license, and about the possibility of including a time period for review within the statute, DOBI explained that, as a general matter, the Department does not favor the statutory establishment of a time period within which a completed application for a license must be acted upon by the Department. DOBI explained that such provisions do exist in the statute with respect to lesser filings, submitted in the course of dealings after initial licensing or chartering, e.g., the bylaws amendment provision for credit unions, at *N.J.S.* 17:13-94. DOBI indicated that, as the credit union provision illustrates, an alternative to a statutory deadline is the possibility of a "deemer clause" that operates to grant automatic approval of the application. DOBI suggested that while a deemer clause makes business and policy sense with certain applications affecting issues after the initial formation or licensing of an entity, the Department does not believe that it makes sense as applied to fundamental qualification issues included in a license application. The Department's website does provide public information on the licensing process. This information includes a Frequently Asked Questions section for debt adjusters. In the FAQ, DOBI advises applicants that the process time for a fully completed application is normally 90 days and has no problem with advising about such timing in an informative but non-binding manner. DOBI expressed concerns regarding a change to the law and the attendant complications of starting up an entirely new, comprehensive licensing program under DMSA. DOBI requested that no specific deadline for Department action (approval or denial) on a license application be inserted in this statute, noting the absence of such timeframes imposed for other types of license applications.

The fee issue has generated substantial controversy. With more than 30 years of experience in the regulation and enforcement of New Jersey's current Debt Adjustment and Credit Counseling Act, DOBI may be the most appropriate entity to establish the fees for debt-management services in this state, guided by any applicable federal law (including the FTC Rule pertaining to fees that may be imposed by debt settlement entities). Default fee provisions have, however, been included in this section of the draft for review and consideration. The fees that may be charged under the current act are set forth in the regulations (*N.J.A.C.* 3:25-1.2) and in the statute (*N.J.S.* 17:16G-6) but the regulations have been more frequently, and more recently, updated. The current regulations, the NCCUSL draft, and the Maine statute pertaining to debt management have guided the fees set here for debt-management services, including education and counseling but the current draft language leaves open the possibility of DOBI altering the fee amounts by regulation. The general fee limitations for debt-settlement services were incorporated from the Illinois law, much lauded for its level of consumer protection. If the amount proves to be prohibitive to debt-settlement providers doing business in New Jersey, the Department of Banking and Insurance may choose to promulgate new fees[1]. After the UDMSA was initially drafted, the Federal Trade Commission amended the Telemarketing Sales Rules to limits fees for certain for-profit entities who engage in "debt settlement" (reduction in the principal amount of the debt). Pursuant to those Rules (specifically 16 *C.F.R.* Sec. 310.4(a)(5)), a provider subject to the rules may not request or receive payment of any fee or consideration for any debt relief service until and unless certain conditions are met. The relevant language of the rules has been incorporated here (modified slightly to use UDMSA terminology) and applied to *all* entities engaging in debt settlement (although the federal Rule is limited to for-profit entities whose activities involve at least one interstate telephone call). It is noted that the FTC Rule limits only the timing, not the amount of the payments. In addition, the FTC Rule allowed either a flat fee or a percentage figure to be charged as a fee. The option has not been preserved in this draft, which permits only a percentage of savings to be charged. More information pertaining to fees is found below.

With regard to private enforcement, the revised language in Section 24b.(2) attempts to provide additional protection for New Jersey consumers by authorizing an award of treble damages in an expanded category of cases, not only those in which an improper fee is charged, or cases in which the Consumer Fraud Act would apply to permit treble damages. Also included are cases in which the provider: fails to comply with the prerequisites for providing debt-management services (Section 10); fails to comply with the requirements for the form and contents of the agreement (Section 12); or engages in certain significant prohibited acts and

[1] The original language of the draft called for the following fees for "debt-management" services (the reduction in finance charges, interest and/or fees for late payment, default or delinquency): (A) a fee not exceeding $50 for consultation, obtaining a credit report, setting up an account, and the like; and (B) a monthly service fee, not to exceed $10 times the number of creditors remaining in a plan at the time the fee is assessed, but not more than $50 in any month. The original subsection c. also called for the following fees for "debt settlement" (a reduction in the principal amount of the debt): (A) subject to Section 19(d), a fee for consultation, obtaining a credit report, setting up an account, and the like, in an amount not exceeding the lesser of $400 and four percent of the debt in the plan at the inception of the plan; and (B) a monthly service fee, not to exceed $10 times the number of creditors remaining in a plan at the time the fee is assessed, but not more than $50 in any month. A provider was precluded from imposing or receiving fees under both fee schedules. The UDMSA also provided that except as otherwise provided in subsections (c) and (d), if an agreement contemplates that creditors will settle an individual's debts for less than the principal amount of the debt, compensation for services in connection with settling a debt may not exceed, with respect to each debt: (1) 30% of the excess of the principal amount of the debt over the amount paid the creditor pursuant to the agreement, less (2) to the extent it has not been credited against an earlier settlement fee: (A) the fee charged pursuant to subsection (d)(2)(A); and (B) the aggregate of fees charged pursuant to subsection (d)(2)(B).

practices (Section 18a., b. and d.). This draft also provides additional guidance regarding class actions and requires the assistance of the administrator in enforcing judgments against the bond or other security.

As concerns the consumer protection statutes and the issue of remedies, the suggestion of LSNJ to expressly preserve consumer remedies available under other laws was incorporated into this section as subsection a., but subsection b. is intended to preclude a duplicative recovery for the same act or practice. The language of subsection b. was revised to read as follows in response to a LSNJ suggestion: "Notwithstanding subsection a. of this section, if an act or practice of a provider violates both this act and New Jersey's Consumer Fraud Act, or any New Jersey or federal law dealing with consumer protection or unfair or deceptive trade practices in consumer transactions, <u>an individual may plead and pursue claims based on this act as well as other law</u> but may not recover under both for the same act or practice." The underlined language was added to address the concern that stating that an individual could not recover under both claims for the same act or practice left some claims vulnerable to dismissal in advance of trial. The language may require additional revision.

Questions raised by NCCUSL's 2011 revision

In addition to the foregoing, the following changes were made to the draft in response to NCCUSL's 2011 revision (and are shown in the draft with underlining and strikethrough) and Commission input is sought regarding these items:

(a) Section 2 – the term "lead generator" is defined ("a person who supplies a provider with the names of potential customers, directs communications of an individual to a provider, or otherwise channels customers to a provider"), a change which LSNJ has suggested is an important consumer protection, and the definition of "trust account" has been streamlined.

(b) Section 5 – an irrevocable consent authorizing the administrator to review and examine any trust accounts of the provider was included with the items required to be submitted as a part of the application for licensure. With regard to license renewal, the language as modified to require the provider to supply information pertaining not only to the amount of money it accumulated during the preceding 24 months, but also the amount of money deposited to a trust account during that time.

(c) Section 12 – Before the 2011 revisions, the NCCUSL language pertaining to powers of attorney and settlement read: "An agreement may confer on a provider a power of attorney to settle the individual's debt for no more than 50 percent of the principal amount of the debt. An agreement may not confer a power of attorney to settle a debt for more than 50 percent of that amount, but may confer a power of attorney to negotiate with creditors of the individual on behalf of the individual. An agreement must provide that the provider will obtain the assent of the individual after a creditor has assented to a settlement for more than 50 percent of the principal amount of the debt." In the 2001 revision, that language was changed to read: "<u>An agreement may not confer a power of attorney to settle a debt for more than 50 percent of that amount, but may confer a power of attorney to negotiate with creditors of the individual on behalf of the individual. An agreement must provide that the provider will obtain the assent of</u>

the individual after a creditor has assented to a settlement for more than 50 percent of the principal amount of the debt." Additionally, subsection g, was modified by the NCCUSL 2011 revisions, but those revisions have not been incorporated in the current draft. Subsection g. currently reads: "All rights and obligations specified in subsection d. of this section and Section 13 exist even if not provided in the agreement. A provision in an agreement which violates subsection d., e., or f. of this section is void." The NCCUSL 2011 revision eliminated the first sentence of subsection g. and eliminated the reference to subsection d. in the second sentence.

(d) Section 13 – Previously, this section contained provisions pertaining to a three-day right of cancellation, a notice of right to cancel, provisions for cancellation within 30 days of entering the agreement, and language pertaining to a waiver of the right to cancel. The 2011 revisions contain much more streamlined provisions, which have been incorporated into the draft, simply stating that an individual may terminate an agreement at any time and receive a return of all funds not paid to a creditor or earned as fees. It also contains provisions for termination of the agreement by the provider for failure of the individual to make payments for 60 days or other good cause (substantially identical to the provisions in the current draft) and language which indicates that upon termination, all powers of attorney granted by the individual to the provider are revoked and ineffective.

(e) Section 14 – This section dealing with trust accounts contains the following new language:

b. A provider may request or require an individual to place money in a trust account.

c. A trust account must be at an insured bank and, unless the individual owns the account, must:

(1) be designated as a trust account or other account designated to indicate the that money in the account is not the money of the provider or its designee;

(2) be administered by an entity that is not:

(A) the provider or

(B) an affiliate of the provider; and

(3) provide that any interest accruing on the individual's funds in the account is credited to the individual.

d. A person administering a trust account may not give or accept any compensation from the provider in exchange for referrals of business involving debt-management services.

e. Upon termination of an agreement, a person administering a trust account shall, within seven business days of the termination, pay the individual all money received by or on behalf of the individual, other than amounts it has properly disbursed to creditors or the provider.

f. Money in a trust account is not property of the provider or the person administering the account. The money belongs to the individual from whom or on whose behalf it was deposited and is not available to creditors of the person administering the account or creditors of the provider.

* * *

h. A provider or person administering a trust account may not include in the trust account money of individuals other than those to whom the provider is furnishing debt management services.

(f) Section 15 – This section, pertaining to fees and other charges, was revised in the 2011 draft to state that not-for-profit entities cannot charge or collect a fee unless and until the provider has secured the assent of the individual and at least one creditor to a change in the terms of a debt and the individual has made at least one payment toward satisfying the modified terms. This provision follows the new FTC rules pertaining to for-profit entities. Also, instead of the $25 per month currently payable to not-for-profit providers, the NCCUSL document provides for a fee of $10 per creditor per month not to exceed $50, and that higher fee has been incorporated. In addition, a one-time set-up fee of $75 is allowed for all providers, based on the Maine statute (which allows $75, rather than the $50 found in the prior draft). The following language has also been included, based on language in the Maine statute: "A debt management service provider may not charge more than one fee authorized under this section on the basis that the consumer has entered into a debt management services agreement for joint obligations of a consumer and a consumer's spouse or other member of the consumer's household." No other substantive changes were made to the fee provisions based on the NCCUSL revision since Staff had already incorporated language broader than the FTC Rule change language in an effort to increase consumer protection.

The comments regarding fees *since the distribution of the last revised draft of this report* in February are summarized as follows – if additional information is required to be added to this summary, Staff relies on the commenters to advise accordingly:

- For-profit commenters have indicated that: the debt-settlement process is more labor-intensive than debt-management (as described, in part, in a work-flow chart distributed previously) since a debt-management plan, once established, is described as a turn-key operation; the most expensive part of the settlement process is negotiation, a component entirely absent from debt-management work; debt-settlement entities require unique systems, well-trained negotiators, and ongoing support to the consumer; debt-settlement providers use their history of experience with creditors (each of which deals with delinquent debtors in different ways and has different business cycles) and pit one against the other; some for-profit entities have indicated that they support a fee model in which the provider receives a percentage of the consumer's savings, because then the interests of the parties are aligned; no two consumers are exactly alike; although not-for-profit entities claim that they are not paid adequately for the work they perform, management at some of those entities is paid salaries in the mid-six-figures according to a news article found at NorthJersey.com March 27, 2011 (of the 44 non-profits authorized by the federal government to provide bankruptcy counseling to NJ residents, 12 pay their top executives more than $300,000.

- Not-for-profit commenters have indicated that debt-settlement is not more labor intensive than the debt-management services provided by non-profits, suggesting that many for-profit entities do not provide anything in the way of counseling; debt-settlement entities claim that their costs for providing services are very high, when in reality it is their advertising costs that are very high; debt-settlement entities do not disburse monies monthly for each consumer, as debt-management entities do.

- Having received information regarding the work involved in debt-management and debt-settlement, it appears that (assuming that the information received can be characterized as representative of the industry) similar work is done by both entities with regard to: client assessment and enrollment; client education; regulatory and compliance efforts; program activation; client support; client communications and cash management. It appears that some additional work is done for debt-settlement plans in the area of client communications and that more additional work is done for debt-settlement plans in the area of creditor negotiations, but it is not clear how labor and time intensive these services are, on average.

- Legal Services of New Jersey and other consumer-protection groups (the comments are not uniform and are summarized below without attribution) have indicated that: their strong preference is that no action be taken on this project at this time; consumers are better off negotiating directly with creditors than hiring a debt-settlement provider; when consumers withhold payments to accumulate funds with which to make lump-sum offers under a debt-settlement plan, they incur default penalty rates and are subject to more vigorous collection efforts; at debt-settlement fee rates of 25-50%, the debtors incurred considerably more in total costs then debtors negotiating on their own; even with a 15% back-end fee, the consumer does not come out ahead; applying the FTC Rule provisions to all debt-settlement providers, rather than as limited by the FTC Rule itself, and including fee caps in the statute are strong consumer-protective components.

- Maine: It was suggested to Staff that no for-profit debt-settlement providers will operate in Maine (fee: 15% of the difference between the debt enrolled in a plan and the debt at the time of settlement) or Illinois (fee: 15% of savings to debtor as described in NJ draft). In an effort to obtain additional information for the Commission, Staff contacted the Bureau of Consumer Credit Protection in Maine. The representative with whom Staff spoke indicated that several years ago, Maine decided to regulate the act, not the actor, and opened the state to the participation of for-profit entities. Maine imposes a fee cap of 15% but it is based on the amount of the debt at the time the debt is settled. If $7,000 of debt is enrolled in a plan in Maine, and it grows to $10,000 during the course of the plan, but is settled for $5,000, the debt-settlement provider is permitted to take 15% of the $5,000 "saved" rather than 15% of the $2,000 difference between the amount initially enrolled and the amount paid. By the end of this year, Maine expects to have about six registered debt-settlement companies (they have a population of approximately 1.2 million people). As it was explained to Staff, Maine already had (as New Jersey does) bad actor debt-settlement companies engaging in predatory business practices. By allowing for-profit entities to operate there legally, Maine offers consumers an option with the protection of the bond required to be posted. Last year, Maine discussed raising its fee to 20% for debt-settlement work. Debt-settlement companies said even that was not enough and it was decided that the fee level would remain at 15%. Maine's perspective is that allowing for-profit entities to participate in the state legally affords some measure of accountability to the consumer since a surety bond and other protections are provided. In addition, the State is able to review contracts, accounts, etc. Even if, as it has been said, Maine is now "licensing the best of the worst", at least the State has a relationship with responsible providers who generally have legal counsel and are somewhat responsive to consumer complaints and issues.

- Based on the information received and reviewed to this time, it appears that a fee cap based on a percentage of the actual savings to the debtor is the most consumer protective option for a debt-settlement fee. This fee structure appears to have the support of the majority of the commenters. It is not, however, clear what that percent fee should be. Based on the experience of the state of Maine, it is seems that a fee cap in the neighborhood of 15%-20% may be a logical place to start. The debt-settlement companies have been relatively uniform in their objections to a 15% fee cap and have suggested that 30% is the lowest workable number. Maine has found, however, that debt-settlement companies will work there at a 15% cap. That does not necessarily translate into New Jersey, but it is useful information. Maine's 15% cap is different from the one that was proposed for NJ though, since (as explained above) it could allow an unscrupulous debt-settlement provider to benefit from a deliberate delay in the settlement of a debtor's accounts. To keep the interests of the provider and the debtor aligned, the Commission may wish to maintain the structure contained in the existing draft. Since Maine does allow a higher payment to the providers, a cap higher than 15% may be warranted.

(g) Section 18 – This section deals with prohibited acts and practices and, in the NCCUSL 2011 revisions, was changed to clarify that a provider settle a debt unless the individual assents to the new terms after the creditor has assented, or accept a power of attorney that authorizes it to settle a debt. The language is also modified to clarify that the prohibitions apply to lead generators as well as other participants. The revised language also prohibits a provider from compensating someone for referring a prospective customer if the person making the referral pays its employees on the basis of a formula that incorporates the number of individuals the employee refers to the provider.

(h) Section 22 (administrative remedies) and Section 23 (suspension, revocation and nonrenewal of license) – These sections now include language pertaining to lead generators and persons who administer trust accounts based on the NCCUSL 2011 revision.

(i) Section 24 – This section pertains to private enforcement and does not include a change found in the NCCUSL 2011 revision striking the following language: "In addition to the remedy available under subsection c., if a provider violates an individual's rights under Section 13a. – c., the individual may recover in a civil action all money paid or deposited by or on behalf of the individual pursuant to the agreement, except for amounts paid to creditors."

Commission input is sought on the issues identified above. In addition, Staff would like the opportunity to release the project as a Tentative Report after the April meeting.