



Senate Fiscal Agency
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BILL ANALYSIS



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Senate Bill 664 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Mike Kowall
Committee: Banking and Financial Institutions

Date Completed: 9-2-14

RATIONALE

The Debt Management Act regulates debt management businesses, which enter into contracts with debtors to manage the payment of their financial obligations. The Act prescribes requirements for debt management contracts, permissible fees, and standards for the licensure of debt management businesses, and prohibits certain activities and practices. Since its passage in 1975, the Act has been amended once. Some believe that the Act does not reflect changes in the industry or advancements in technology that have occurred since the law was enacted. Also, because of economic conditions over the last few years, creditors evidently have become more stringent in their interaction with debt management services and their clients. To address these issues, it has been suggested that the Debt Management Act be amended.

CONTENT

The bill would amend the Debt Management Act to do the following:

- **Require a licensee to develop a plan outlining how a debtor would meet the payment obligations of his or her debt management plan if the debtor's monthly expense and debt payments exceeded his or her net income.**
- **Modify the requirements for information that must be included in a budget analysis.**
- **Allow a licensee to charge a nonrefundable fee for establishing a debt management plan for a debtor.**
- **Increase the initial fee a licensee may charge for establishing a debt management plan, and allow a fee for the purchase of credit reports and educational materials.**
- **Require a licensee to obtain consent to participate in a debt management plan from at least 51% of the debtor's creditors within 90 days after establishing the plan, and revise the requirements for obtaining consent.**
- **Allow a debtor to add or remove one or more debt obligations from the contract by submitting a written request to the licensee.**
- **Revise the standards for annual reviews of a licensee's procedures.**
- **Allow a licensee to cancel a contract under certain conditions.**
- **Require a licensee to state on a website available to the public that the licensee was licensed in this State.**
- **Remove a requirement that advertising be filed with the Department of Insurance and Financial Services, but prohibit a licensee from advertising, printing, or displaying a false, misleading, or deceptive statement.**

Budget Analysis

Before entering into a contract with a debtor, a licensee must compile a written budget analysis and determine if the debtor can meet the requirements of the debt management plan based on the budget analysis. Under the bill, if the licensee determined that a plan was suitable for a debtor whose current monthly expenses and debt payments exceeded his or her net income, the

licensee would have to develop a written plan that outlined how the debtor would meet payment obligations under the plan before entering into a contract with the debtor.

The bill would require a budget analysis to include the debtor's name and address, number of dependents, net monthly income, monthly home mortgage or rental payment amount and an estimate of the annual amount of real estate taxes on the property, the type and amount of all of the debtor's obligations included in the debt management plan (including a description of and amount owed for any outstanding garnishments and judgments) and known obligations that would not be included in the debt management plan, amount of household and living expenses, and a list of creditors to which payments would be made. The budget analysis would not need to include source of income, marital status, or gross income per pay period information, as currently required.

Consent of Creditors

The Act allows a licensee to charge an initial \$25 fee for establishing a debt management plan for a debtor. After establishing the plan, the licensee must obtain the consent of at least 51% of the debtor's creditors (in number and dollar amount) to the plan within 45 days. If the licensee fails to do this, the fee must be refunded and the debtor's account closed.

Under the bill, the fee would be increased to \$50. The licensee would have to attempt to obtain the consent of at least 51% of the debtor's creditors (in number or dollar amount), but would be allowed 90 days to accomplish this. If the licensee did not receive the required consent, the licensee would have to inform the debtor and he or she would have the option to close the account. If the account were closed, any unspent funds would have to be returned to the debtor or disbursed as he or she directed.

Currently, the consent of a creditor must be recorded on a separate form. The bill would eliminate that requirement.

The Act permits a licensee to seek the consent of a creditor by sending notice by telephone, fax, electronic mail, or first-class mail. As an alternative to those methods, the bill would allow a licensee to seek the consent of a creditor by sending a payment to the creditor under the terms of the debt management plan. Also, under the bill, a licensee would not be required to send notice of a debt management plan to all of the debtor's creditors.

Contract between Licensee & Debtor

The bill would allow a debtor to add or remove one or more debt obligations from the contract at any time by submitting a written request to the licensee.

If a debtor's contract with a licensee expired and one or more of the debt obligations included in the contract were not liquidated, the licensee could enter into one or more additional contracts with the debtor if the licensee determined that the debt management plan was suitable for the debtor.

Reconciliation & Annual Reviews

The Act requires payments received by a licensee from or on behalf of a debtor for the benefit of a creditor to be held in trust in a separate account at a financial institution whose deposits are insured by an agency of the Federal government. The bill would include a requirement that licensees maintain records of all debtor funds held in trust and all funds disbursed on behalf of debtors. Licensees also would have to provide the Department of Insurance and Financial Services (DIFS) with a full accounting of those funds and disbursements upon request.

The Act requires a licensee to reconcile a trust account at least once a month. At all times a trust account must have an actual account balance that is equal to or greater than the sum of the escrow balances of each debtor's account. Failure to maintain that amount is cause for summary suspension of a license. Under the bill, a licensee's failure to maintain that amount would be

cause for summary suspension, unless the failure was the result of an inadvertent clerical or human error.

If a trust account fails to contain sufficient funds to cover the debtor's escrow balances, a licensee is required to contact the DIFS Director and submit a written description of remedial actions that the licensee has taken. Under the bill, this notice requirement would not apply until there were insufficient funds on more than one occasion.

At least annually, a licensee is required to a) review each debtor's account file, b) review checks paid by the licensee, c) review procedures used by the licensee for processing checks and handling cash, d) review complaint files, e) verify payments to selected creditor accounts, and f) review selected counselor records and work papers. The bill would retain the requirements to review check processing procedures and verify that consumer complaints are properly handled, and would add requirements to verify that payments to selected creditor accounts were properly disbursed and that selected client files contained the proper documentation. The bill also provides that a licensee that had proper controls in place to ensure that those actions were taken would meet the annual review requirements.

Fees & Cancellation of a Contract

The Act allows a licensee to charge reasonable fees under a debt management contract, but the fees may not exceed 15% of the amount of debt to be liquidated during the contract. Under the bill, a licensee could offer a debtor the option of purchasing credit reports and educational materials and products, and could charge a fee to the debtor if the debtor elected to purchase any of those items from the licensee. Currently, in the event of the debtor's default or cancellation, the licensee may charge a \$25 fee, which is not subject to the 15% limitation on fees. The bill would retain this provision and exclude the fee for educational materials and other products from the 15% limitation, as well.

A contract is in effect when it is signed by the licensee and the debtor and the debtor has made a payment to the licensee. The bill specifies that a contract would be in effect upon the payment of any amount of money. The debtor has the right to cancel the contract until midnight of the third business day after the first day the contract is in effect by written notice to the licensee. In this case, under the bill, the licensee would be prohibited from collecting a cancellation fee.

Currently, if a debtor fails to make a payment to a licensee with 60 days after it is due to the licensee, the contract is considered cancelled by debtor, unless he or she files a letter of continuation of a contract meeting certain requirements. Under the bill, instead, if a debtor failed to make a payment to a licensee within 60 days after it was due, the licensee could, in its discretion, cancel the contract if: a) it determined that the plan was no longer suitable for the debtor, b) the debtor failed to affirmatively communicate to the licensee a desire to continue the plan, or c) the debtor's creditors refused to continue accepting payments under the plan.

Prohibited Acts & Exceptions

A licensee is prohibited from taking certain actions, including purchasing an obligation of a debtor from a creditor, lending money or credit except as approved by the Department, and taking a confession of judgment or power of attorney to confess judgment against the debtor. A licensee also is prohibited from offering, paying, or giving any cash, gift, premium, reward, or other compensation to a person for referring a prospective customer to the licensee. The Act exempts from this prohibition payments by the licensee for the lawful sale, transfer, or assignment of a contract to the licensee from another licensee. The bill also would exempt payments by the licensee to credit counseling associations (such as the National Foundation for Credit Counseling or the Association of Independent Consumer Credit Counseling Agencies) to participate in a locator service. In addition, a payment received by a licensee from a creditor, financial institution, or other third party as part of a fair share program, grant program, or a similar program would not be subject to a prohibition against receiving any cash, fee, gift, or other compensation from a person other than a debtor in connection with the business of debt management.

("Locator service" would mean "a telephone service that automatically connect to a network of member service providers, based on geographic location or another parameter". "Fair share program" would mean "a program in which voluntary contributions are made by some creditors to a licensee based on a percentage of the amount disbursed by the licensee on behalf of a debtor".)

Currently, a person is prohibited from publishing or circulating a pamphlet, circular, form letter, advertisement, or other sales literature addressed to or intended for distribution to prospective debtors unless a copy has been filed with DIFS at least 10 business days before the first publication, and the Department has approved its use. The bill would remove this prohibition, but would prohibit a licensee from advertising, printing, displaying, publishing, distributing, or broadcasting any false, misleading, or deceptive statement or representation with regard to providing debt management services. The bill also would prohibit a licensee from permitting another person to violate this restriction.

Display of License

While a license is in force, the licensee is required to display it conspicuously in the outer office, or branch office of the licensee. Under the bill, this requirement would apply to those offices that offer in-person services to consumers. The licensee also would have to state on a publicly available website that the licensee was licensed in this State.

Definition

The bill would define "debtor's obligation" as "any current or past-due monetary obligation of the debtor, including, but not limited to, amounts owed for payment of credit cards, utilities, mortgages, student loans, home equity loans, personal loans, judgments, garnishments, property taxes, rent, or vehicle loans or leases or any other obligation whether secured or unsecured or whether or not the obligation has a principal and interest component".

MCL 451.412 et al.

BACKGROUND

Debt management is the "planning and management of the financial affairs of a debtor and the receipt of money from the debtor for distribution to a creditor in payment or partial payment of the debtor's obligation".¹ Firms that offer debt management (also referred to as credit counseling) services typically provide low-cost or free educational programs on financial education and managing debt. Sometimes this is in the form of one-on-one counseling.

Some clients may continue counseling or may enter into a debt management contract. A debt management contract allows a debtor to enter into payment arrangements with his or her creditors. Usually, debt management companies can negotiate lower interest rates or the removal of late fees and penalties for their clients, and are able to stop collection efforts.² The nature of the debt that a service will assist with varies. Some services prefer to work only with unsecured debt or credit card debt. Other services will work with many or all different types of debt.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The proposed changes are necessary to help debt management firms better serve their clients. Compared with past practices, creditors are stricter about the concessions they make to debtors,

¹ MCL 451.412(d).

² Rick Bialozbreski-GreenPath Debt Solutions, Oral Testimony, Senate Banking and Financial Institutions Committee, 3-6-2014.

and will often cancel those concessions if the debt management plan fails. The bill would prevent debt management plans from being cancelled if there were a short-term financial hardship; for example, a debtor might be able to make only partial payments over a 60-day period. The bill also would allow consumers to include any current or past-due obligation in their debt management program. By allowing a debtor to begin a contract with any deposit, the bill would prevent delays and permit creditor concessions to be obtained quickly. By modifying the requirement that 51% of the creditors consent to the debt management plan, the bill would create more flexibility and bring Michigan in line with other states. Clients could retain the benefit of concessions that would be lost if a debt management plan were cancelled.

The bill also would reduce the burdens on debt management firms by eliminating the mandate to submit advertising materials to the Department for approval and establishing specific requirements for what advertising may and may not do. In addition, the bill would allow a firm to charge an initial fee of \$50, rather than \$25, which would bring Michigan in line with at least 39 other states.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Glenn Steffens

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.