



For questions and comments,
please contact:

JONATHAN L. POMPAN
202.344.4383
JLPOMPAN@VENABLE.COM

JEFFREY S. TENENBAUM
202.344.8138
JSTENENBAUM@VENABLE.COM

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As lawmakers continue to address the nation's financial crisis, federal and state law enforcement agencies continue to crack down on debt relief companies that allegedly fail to comply with legal requirements and regulations. Although the legal landscape is shifting, opportunities for debt relief options and new opportunities for credit counseling and debt settlement companies to assist consumers continue to rise. For instance, one legislative initiative in the U.S. Congress would create a new Office of Housing Counseling within the Department of Housing and Urban Development. Also, many states continue to introduce and enact laws that allow, but regulate, debt settlement activities.

This alert provides a broad survey of some recent notable legislative initiatives, federal and state regulatory actions, and other developments affecting providers of debt relief services—including financial counseling and education, debt management plans, and debt settlement.

From the U.S. Congress

In addition to pending bills to reform credit card lending practices, there are several other proposals of importance to the counseling and debt settlement industries. Below we highlight just a sampling of the many proposals that are under consideration by Congress:

Bill Introduced to Direct the FTC to Regulate the Debt Settlement Industry; Hearing Scheduled

On May 7, 2009, the Consumer Credit and Debt Protection Act (H.R. 2309) was introduced in the U.S. House of Representatives to provide authority to the Federal Trade Commission ("FTC" or the "Commission") to conduct rulemakings on an expedited basis concerning consumer credit or debt, specifically directing the Commission to promulgate rules with regard to debt settlement (broadly defined). The bill also would expand the FTC's enforcement powers by allowing it to seek civil penalties in connection with unfair and deceptive acts or practices relating to consumer credit or debt.

A hearing on the bill by the House Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection was held on May 12, 2009. The bill is authored by Subcommittee Chairman Rep. Bobby Rush (D-IL) who previously held a hearing on this topic in March 2009.¹

Over the last several months, the FTC and others have requested that Congress provide the Commission with expanded rulemaking authority and enforcement powers related to consumer credit and debt, as provided for in this bill. The bill does not, however, specifically direct the Commission to consider regulations for any specific consumer credit and debt-related products or services—other than debt settlement services and automobile sales.

In its present form, the bill would have a significant impact on the debt settlement industry and providers of other forms of consumer financial services, including credit counseling agencies that offer less-than-full balance repayment plans.

Moreover, the bill would enable the Commission to play a greater role in the oversight of consumer financial services related to consumer credit or debt. The Commission would be permitted to use this expedited rulemaking authority to issue rules covering the entire range of consumer financial

products and services within its jurisdiction, either directed at consumer financial products/services in general or specific industry subsets (e.g., payday lending, mortgage servicing, credit counseling agencies, credit card marketers and advertisers, and credit repair companies). In addition, the bill would enhance the Commission's ability to prosecute cases against such companies.

The Consumer Credit and Debt Protection Act contains several specific provisions of interest to providers of consumer financial products and services, including:

- Permitting the FTC to employ notice and comment procedures to establish rules pursuant to the Federal Trade Commission Act that set forth unfair or deceptive acts and practices relating to consumer credit or debt, rather than rulemaking processes that are more burdensome on the Commission.
- Directing the FTC to examine the practices of “debt settlement service” providers and to establish such rules as the Commission determines necessary to prevent unfair and deceptive acts or practices of such providers. The bill also requires the Commission to consider adopting rules that specifically:
 - “prohibit the charging of fees to consumers prior to any debt settlement service being fully rendered and limiting fees that may be charged after a settlement with a creditor is reached”; and
 - “require disclosures before a contract is signed regarding the fee structure, expected time frames for a successful settlement, success rate of debtors in settling their debts, information about creditor participation in settlement plans, and the potential impact on a consumer’s credit score.”
- Defining the term “debt settlement service” (broadly) as “a commercial service provided to assist consumers in managing and repaying consumer debt, including the offering of advice or acting as an intermediary between a debtor and one or more of the debtor’s creditors, where the primary purpose of the advice or action is to obtain a settlement for less than the full amount of debt owed.”
- Requiring that the specified required rulemakings be commenced within six months of the date of enactment of this bill.
- Authorizing the FTC to obtain civil penalties for unfair or deceptive acts or practices relating to consumer credit and debt, and providing authority for the FTC to bring suit in its own right in federal court to obtain civil penalties.
- Authorizing States to initiate civil action on behalf of their residents to enforce the provisions of the FTC Act (or any other Act enforced by the FTC) to obtain penalties and relief provided under such laws, whenever the attorney general of the State has reason to believe that the interests of the residents of the State have been or are being threatened or adversely affected by a violation of a FTC rule relating to consumer credit or debt.

Considers Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud

In the wake of the announcement of a coordinated state and federal crackdown on fraudulent foreclosure rescue schemes (see From the Federal Agencies, below), the House Subcommittee on Housing and Community Opportunity, a subcommittee of the House Committee on Financial Services, held a hearing on the Foreclosure Rescue Fraud Act of 2009 (H.R. 1231).² This measure is aimed at curbing loan modification and foreclosure relief scams. The Committee heard testimony from the Federal Trade Commission, the U.S. Department of the Treasury, the Massachusetts Attorney General, the National Consumer Law Center, the Mortgage Bankers Association, the National Association of Realtors, and the State Bar of California.³

Sponsored by Congresswoman Gwen Moore (D-WI), H.R. 1231 would prohibit foreclosure consulting companies from collecting certain fees before completing delivery of services. At present, the legislation carves out exemptions for licensed lawyers (with some restrictions), licensed real-estate brokers, HUD-approved counseling agencies, and certain others.

Several witnesses at the hearing told the Subcommittee that lawyers should not be widely exempted from the fee restrictions, citing a number of examples of abuses by lawyers and former mortgage brokers charging high upfront fees. The proposal places enforcement power for violations with the FTC and state attorneys general.

If enacted into law, the Act would not preempt any state or local law respecting any foreclosure consultant, residential mortgage loan, or residential real property that provides equal or greater protection to homeowners than what is provided under the Act.

Senator Herb Kohl (D-WI) is sponsoring the companion proposal in the U.S. Senate, S. 117, also titled the Foreclosure Rescue Fraud Act of 2009.⁴ H.R. 1231 and S. 117 are modeled after various state foreclosure consultant statutes that exist in about twenty-five jurisdictions. These state laws contain similar conduct prohibitions, stiff money penalties, private rights of action, and criminal provisions.⁵

Mortgage Reform and Anti-Predatory Lending Act

The Mortgage Reform and Anti-Predatory Act (H.R. 1728)⁶ was reported out of the House Financial Services Committee on April 29, 2009, and was approved by the full House of Representatives on May 7, 2009. Title IV of the bill, entitled the “Expand and Improve Home Ownership Through Counseling Act,” would create an Office of Housing Counseling within the Department of Housing and Urban Development. This new HUD office will be given oversight over the following:

- Counseling procedures;
- Grants for housing counseling assistance;
- Requirements to use HUD-certified counselors under HUD programs;
- Studies of defaults and foreclosures;
- Definitions for counseling-related programs;
- Updating and simplifying mortgage information publications; and
- Home inspection counseling.

From the Federal Agencies

Federal Trade Commission

Federal and State Law Enforcement Focus on Foreclosure Rescue and Loan Modification Companies

In April, the FTC, Department of Treasury, Department of Justice, Department Housing and Urban Development, several state attorneys general, and others announced a coordinated law enforcement and consumer education initiative as part of a federal and state crackdown on fraudulent foreclosure rescue and loan modification schemes.⁷ The announcement coincided with the FTC's release of warning letters to seventy-one companies for marketing potentially deceptive mortgage loan modification and foreclosure assistance programs. The FTC also released a list of more than twenty states that have already taken action on loan modification or foreclosure rescue scams.

FTC Testifies on Efforts to Combat Foreclosure Rescue and Loan Modification Scams; FTC to Use New Rulemaking Authority to Address Issue

On May 6, 2009, FTC representatives told the House Subcommittee on Housing and Community Opportunity that, with the rapid increase in mortgage delinquencies and foreclosures, the FTC has intensified its efforts to protect consumers from foreclosure rescue and loan modification scams.⁸ According to an FTC press release announcing the testimony, the FTC has initiated eleven cases targeting mortgage foreclosure rescue and loan modification scams in the past year, and is actively engaged in several ongoing, non-public investigations. The FTC has described these defendants as often falsely appearing to be affiliated with nonprofit or government entities or otherwise endorsed by government officials.

Echoing statements made earlier this year in other hearings, the FTC noted its new rulemaking authority to prohibit unfair and deceptive practices with respect to mortgage loans under the Omnibus Appropriations Act of 2009. The Act, which directed the Commission to commence a rulemaking with respect to mortgage loans within ninety days of taking effect, allows the FTC to use relatively streamlined notice and comment rulemaking procedures. As part of this rulemaking, the Commission clearly intends to address unfair and deceptive acts and practices regarding mortgage loan modification and foreclosure rescue scams.

In its testimony, FTC representatives also recommended that Congress take certain steps to enhance the Commission's consumer protection efforts, including:

- Authorizing the agency to employ notice and comment rulemaking procedures to establish rules pursuant to the FTC Act that prohibit unfair or deceptive acts and practices relating to all financial services;
- Authorizing the agency to obtain civil penalties for unfair or deceptive acts and practices relating to all financial services, and to bring suit in its own right in federal court to such penalties;
- Ensuring that the FTC is considered as Congress moves forward in determining how to modify federal oversight of consumer financial services; and

- Providing additional resources to the FTC to increase the scope of its law enforcement activities relating to financial services and to expand critical research on the efficacy of mortgage disclosures and other topics.

As a response to these recommendations, Congress is now considering H.R. 2309, a bill that would grant the FTC expedited rulemaking authority with respect to both credit counseling and debt settlement (see From the U.S. Congress, above).

FTC Delays Enforcement of the Red Flags Rule

On April 30, 2009, the Federal Trade Commission (FTC) announced a three-month delay in FTC enforcement of the “Red Flags Rule,” which was set to take effect on May 1.⁹ The Red Flags Rule requires covered entities—creditors, financial institutions, and other institutions under the jurisdiction of the federal bank regulatory agencies and the National Credit Union Administration—to develop and implement identity theft programs designed to identify, detect, and respond to possible risks of identity theft.¹⁰ Creditors and financial institutions under the jurisdiction of the FTC now have until August 1, 2009 to comply with the Rule.

Because application of the Red Flags Rule is risk-based—i.e., covered entities are only required to develop identity theft programs commensurate with the risk of identity theft entailed in their operations—compliance with the rule need not be burdensome.

Credit counseling and debt settlement organizations should evaluate whether they fall under the scope of the Rule and, if so, tailor an identity theft program to fit their particular business model. These organizations should also make regular assessments of their coverage under the Red Flags Rule and the evolving standards of consumer privacy protection.

Failure to establish a program by August 1 could open you up to administrative penalties of \$3,500 per violation. There is no express private right of action and no criminal penalty under the Rule; however, the Rule’s underlying concepts may eventually become the expected standard from which state tort actions are measured.

FTC Offers Payoff Information to Consumers with Non-Bank Credit Cards

The FTC is providing a telephone number (1-888-600-4804) for consumers with non-bank cards to call for their estimated payoff information.¹¹ Information is available in both English and Spanish. The Commission also has posted a calculator on its website at <http://www.ftc.gov/creditcardcalculator> that provides the same information.

FTC Targets Claims Made Using the Disclaimers of Atypical Results Safe Harbor, Consumer Blogs, Celebrity and Expert Endorsements

At both the federal and state levels, there has been an increase in scrutiny of advertising claims related to credit counseling and debt settlement including several nonpublic investigations. The state attorneys general have alleged a wide variety of questionable practices, including false and unsubstantiated claims, deceptive trial offers with improper or unauthorized charges, falsely implied celebrity and expert endorsements, and fake consumer blogs.

The FTC has proposed revisions to its Endorsements and Testimonials Guides, to eliminate the safe harbor that allows advertisers to generally use truthful

testimonials in conjunction with disclaimers of atypicality—e.g., “results will vary”—and to require advertisers to substantiate and disclose the representative, rather than atypical, performance of the product or service.¹² The current Guides allow advertisers to use truthful testimonials, even if the testimonial does not generally represent what consumers can expect when using the advertised product, if the advertiser (1) clearly and conspicuously discloses what the generally expected performance would be, or (2) discloses the limited applicability of the endorser’s experience to what consumers may generally expect to achieve.

The FTC’s proposed revisions would also make clear that both advertisers and new media that promote advertised products (such as online reviews and blogs) could be held liable for false advertising claims, as well as for failing to disclose material connections to the advertisers involved.

Also of particular importance to the debt relief industries, affiliate-created blogs, review sites, and other web pages have proliferated in recent years, and have been filled with product claims, reviews, endorsements, and testimonials that increasingly drive consumer traffic to credit counseling and debt settlement services. When such web pages contain false or unsubstantiated claims (express or implied) or fail to disclose material connections with sellers, it is possible that affiliates and marketers could be held liable for deceptively driving sales and for any resulting consumer injury.

The FTC has consistently held that parties other than the advertiser may be liable for deceptive advertising if they played a role in the promotion. In fact, the FTC takes the position that a party may be responsible for any claims it makes that may be passed downstream to others: “It is [a] well settled law that the originator is liable if it passes on a false or misleading representation with knowledge or reason to expect that consumers may possibly be deceived as a result.”¹³

These proposed revisions to the Guides have not yet been approved and, if approved, will not have the force of law, but would be intended merely to guide advertisers in complying with Section 5 of the FTC Act. However, advertisers and marketers should take careful note of these new FTC principles, as noncompliance may draw the attention of FTC staff and be the basis for an investigation or law enforcement action.

Department of Housing and Urban Development

HUD on Outsourcing by Counseling Agencies

In April, the Department of Housing and Urban Development made a “special notice” to all approved housing counseling agencies that “agencies are prohibited from contracting out housing counseling services.”¹⁴ The announcement explicitly stated that “contracting out to companies that assist with loan modification and/or refinancing” is prohibited. In addition, HUD reminded agencies that it “has previously advised all participating agencies that they may not charge the client fees for default/mortgage delinquency counseling.” The notice “advised that this includes activities that may be associated with default counseling, including loan modification and other loss mitigation counseling. HUD-participating housing counseling agencies also may not receive fees for client referrals from 3rd party loan modification, refinancing assistance, or marketing companies.”

The notice further stated: “If participating agencies are currently contracting out housing counseling services, and/or are charging clients for activities

associated with default counseling, and/or are receiving fees for client referrals from 3rd party loan modification, refinancing assistance, or marketing research companies, they must immediately cease this practice in order to avoid termination from HUD's housing counseling program and possibly other sanctions."

Internal Revenue Service

Closing Agreement Guidance

The Internal Revenue Service ("IRS" or "Service") has issued new guidance for tax-exempt organizations that may want to enter into a closing agreement to resolve tax liability issues with finality. The new guidance provides that an exempt organization may initiate a closing agreement by sending a letter to the appropriate area office. The letter must explain:

- Why a closing agreement is appropriate;
- The advantages to the organization and how the government will sustain no disadvantages;
- A detailed description of the method proposed for correcting non-compliant activities;
- A narrative description of the correction method, providing specific information to support the suggested method;
- How the taxpayer will achieve future compliance; and
- Proposed methodology to calculate any tax, interest, and penalty for the tax periods in question.

The IRS guidance states that the Service may enter into a closing agreement where "there appears to be an advantage in having the case permanently and conclusively closed," or "where the taxpayer demonstrates good and sufficient reasons for desiring a closing agreement" and the IRS determines that the government will "sustain no disadvantage through consummation of such an agreement."¹⁵

From the State Legislatures

For 2009 we are tracking over seventy state legislative proposals on various issues that concern credit counseling agencies, debt management plan providers and debt settlement companies. While there is activity on any number of bills being considered daily, here is just a sampling of some of the recent developments we are following:

Iowa

Newly enacted amendments to the Iowa Debt Management Act, Iowa Code § 533A, take effect on July 1, 2009.¹⁶ The amended statute, among many changes, redefines the term "debt management" to include any attempt "to settle the amount of a debtor's debts with creditors for less than the amount owed on the debts." The statute will also include a new definition of "debt settlement." The changes also include revisions to the statutory fee caps (with language targeting fees paid by debtors to lead generators, marketing and selling services), and the length of a permissible contract for services. The law also includes a new requirement of specific verbal and written pre-enrollment disclosures to consumers. The Iowa Debt Management Act requires persons engaged in "debt management", unless exempt, to be licensed.

Maryland

A newly enacted amendment to the Maryland Commercial Law will provide generally that “a person is in violation of a specified provision of law prohibiting false advertising if the person causes an advertisement that misrepresents the location of the person to be published in a specified directory, or causes a telephone listing that misrepresents the location of the person to be listed in a specified directory; etc.”¹⁷ This new law takes effect on October 1, 2009.

Montana

On April 29, 2009, Montana Governor Brian Schweitzer signed H.B. 318, “An Act Regulating Debt Settlement Providers,” the first legislation passed in Montana to explicitly regulate the debt settlement industry. H.B. 318 amends the Montana Consumer Debt Management Services Act and requires debt settlement providers to maintain insurance, file an annual report with the state attorney general, and make certain written disclosures to consumers. The amendment also imposes fee caps and prohibits “false, misleading or deceptive statements or representations.” The new requirements take effect on October 1, 2009.

New Jersey

The New Jersey legislature is considering S.B. 2765, a new measure that would exempt counseling agencies from the licensing and regulatory requirements of the New Jersey Debt Adjusters Act if they are (1) certified by the U.S. Department of Housing and Urban Development as a housing counseling organization or agency, (2) participating in a housing counseling program approved by the New Jersey Housing and Mortgage Finance Agency, and (3) not holding or disbursing the debtor’s funds.¹⁸ The bill will also update the criminal statute governing unlicensed debt adjusting by making reference to the licensing requirements and exemptions in the Debt Adjusters Act, rather than maintaining a separate but identical definition in the criminal code.

UDMSA on the March

The Uniform Debt-Management Services Act (“UDMSA”) represents the first national effort at developing uniform rules to govern both consumer credit counseling and debt settlement services. The National Conference of Commissioners on Uniform State Laws approved the UDMSA in July 2005; amendments made to the UDMSA in March 2008 have prompted several state legislatures to introduce the UDMSA (or mimic aspects of the model law in original legislation) for adoption in their own jurisdictions. The UDMSA has been adopted in Colorado, Delaware, Rhode Island, and Utah. States where the UDMSA is under consideration include Maine, Missouri, Nevada, New Mexico, New York, North Dakota, Tennessee, Texas and Washington.

Utah

Earlier this year, the Utah Uniform Debt-Management Services Act was amended by Utah S.B. 167.¹⁹ The amendment takes effect on May 12, 2009. S.B. 167 amends the insurance requirements and content of advertising and disclosure requirements for debt management service providers.

State Investigations and Enforcement Actions²⁰

On May 7, 2009, New York Attorney General Andrew Cuomo announced a nationwide investigation into the debt settlement industry, issuing subpoenas to 14 debt settlement companies. A press conference held by Cuomo indicated that these investigations are focused generally on the accuracy and veracity of the claims made by settlement companies, whether the benefits of the program are overstated, whether the risks of the program are understated, whether claims can be supported by sufficient substantiation, whether consumers are misled about the program, and, whether certain debt settlement business models are inherently (per se) deceptive.

On the state debt adjusting law front, the Attorneys General of West Virginia and Illinois have each recently announced lawsuits against debt settlement companies. In addition, the Attorneys General of both Colorado and Vermont have publicized recent settlements reached with debt relief companies. Overall, we have seen an increase in enforcement actions in nearly every state—under foreclosure consultant protection acts, state debt adjusting statutes, and general consumer protection laws prohibiting unfair trade practices.

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For more information, please contact Jonathan L. Pompan at 202.344.4383 or jpompan@Venable.com or Jeffrey S. Tenenbaum at 202.344.8138 or jstenenbaum@Venable.com.

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For more information about this and related industry topics, see www.venable.com/ccds/publications.

For more information about Venable's credit counseling and debt settlement practice, see www.venable.com/ccds.

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¹ On March 24, 2009, the U.S. House Committee on Energy and Commerce's Subcommittee on Commerce, Trade, and Consumer Protection held a hearing on the subject of the role of the Federal Trade Commission in protecting the public, specifically in the area of consumer credit and debt. For more information, see our article "FTC Emphasizes Increased Enforcement Against Debt Relief Companies at Congressional Consumer Protection Hearing," available at <http://www.venable.com/ftc-emphasizes-increased-enforcement-against-debt-relief-companies-at-congressional-consumer-protection-hearing-03-26-2009/>.

² H.R. 1231, 111th Cong. (2009).

³ *Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud: Hearing before the Subcomm. on Housing and Community Opportunity of the House Comm. on Financial Services*, 111th Cong. (2009).

⁴ S. 117, 111th Cong. (2009).

⁵ See also, “Marketing Foreclosure Assistance to Homeowners? Watch Out for Mortgage Rescue Fraud Protection Acts”, available at <http://www.venable.com/marketing-foreclosure-assistance-to-homeowners-watch-out-for-mortgage-rescue-fraud-protection-acts-09-15-2008/>.

⁶ H.R. 1728, 111th Cong. (2009).

⁷ Press Release, Federal Trade Commission, “Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams” (April 6, 2009) (available at <http://www.ftc.gov/opa/2009/04/hud.shtm>).

⁸ “Foreclosure Rescue and Loan Modification Scams,” *Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud: Hearing Before the Subcomm. on Housing and Community Opportunity of the House Comm. on Financial Services*, 111th Cong. (2009) (statement of Peggy Twohig, Associate Director, Division of Financial Practices, Bureau of Consumer Protection, Federal Trade Commission) (available at <http://www.ftc.gov/os/2009/05/P064814foreclosurerescue.pdf>).

⁹ Press Release, Federal Trade Commission, “FTC Will Grant Three-Month Delay of Enforcement of ‘Red Flags’ Rule Requiring Creditors and Financial Institutions to Adopt Identity Theft Prevention Programs” (April 30, 2009) (available at: <http://www.ftc.gov/opa/2009/04/redflagrule.shtm>).

¹⁰ See 16 C.F.R. § 681.2.

¹¹ Press Release, Federal Trade Commission, “FTC Offers Pay-off Information to Consumers with Non-bank Credit Cards” (April 16, 2009) (available at: <http://www.ftc.gov/opa/2009/04/nonbankcc.shtm>).

¹² Press Release, “FTC Approved Federal Register Notice on Advertising Endorsements and Testimonials” (November 21, 2008) (available at: <http://www.ftc.gov/opa/2008/11/endorsements.shtm>).

¹³ Statement of FTC Chairman Pitofsky and Commissioners Anthony and Thompson, *In re Shell Oil Company* (1999).

¹⁴ U.S. Department of Housing and Urban Development, “Special Notice to All HUD Approved Housing Counseling Agencies” (email to FHA mailing list) (Apr. 27, 2009).

¹⁵ See Internal Revenue Manual 4.75.25, “Exempt Organizations Examination Procedures, Exempt Organizations Closing Agreements (last updated April 16, 2009) (available at <http://www.irs.gov/charities/article/0,,id=202556,00.html>).

¹⁶ “A Bill for an Act Relating to the Regulation of the Business of Debt Management and Making Penalties Applicable,” S.F. 311 (Iowa 2009).

¹⁷ “Consumer Protection – False Advertising – Misrepresentations in Advertisement and Telephone Directory Listings,” S.B. 10 (Md. 2009).

¹⁸ “An Act Concerning Certain Debt Adjusting Activities and Amending P.L.1979, c.16 and N.J.S.2C:21-19,” S.B. 2785 (N.J. 2009).

¹⁹ “Amendments to Uniform Debt-Management Services Act,” S.B. 167 (Utah 2009).

²⁰ See “A Legal Issues Primer for Credit Counseling Agencies, Debt Management Plan Providers, and Debt Settlement Companies,” available at: <http://www.venable.com/a-legal-issues-primer-for-credit-counseling-agencies-debt-management-plan-providers-and-debt-settlement-companies-10-16-2008/>.

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