VENABLE® LLP

Legal and Regulatory Myths Debunked for Credit Counseling Agencies

Association of Credit Counseling Professionals
Fall 2011 Conference
November 14, 2011, 9:15 am– 10:15 am ET
Westin Peachtree Plaza, Atlanta, Georgia

Jonathan L. Pompan, Esq.
Venable LLP, Washington, DC

IMPORTANT INFORMATION ABOUT THIS PRESENTATION

This presentation is for general informational purposes only and does not represent and is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to specific fact situations.

This presentation does not represent any undertaking to keep recipients advised as to all or any relevant legal developments.

This presentation will be available at www.venable.com/ccds/publications starting on Tuesday, November 15, 2011

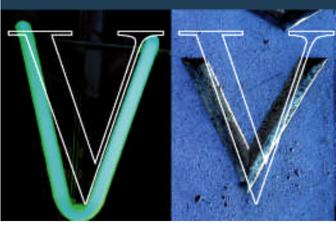
© 2011 Venable LLP

Introduction

- Federal and state laws governing consumer credit counseling agencies continue to evolve and create potential pitfalls and new compliance requirements.
- In response, the industry has responded with self regulation and many agencies limit their activities due to fear of crossing the lines set by regulators, law enforcement, and the Internal Revenue Service.

© 2011 Venable LLP

- Has the law restricted services so much that consumers are being harmed, is your organization being held back, and are the requirements becoming too much?
- Though the general legal and regulatory landscape is well known, **myths** still surround them.
- **Definition of "Myth:"** an unfounded or false notion or an unproved or false collective belief



© 2011 Venable LLP

Myth #1 – The Consumer Financial Protection Bureau is the most powerful potential regulator of credit counseling, but hasn’t done much yet to regulate or promote its own programs.

© 2011 Venable LLP

Dodd-Frank Wall Street Reform and Consumer Protection Act
and the
Bureau of Consumer Financial Protection

100 days and counting….

© 2011 Venable LLP

Office of the Director

Chief Operating Officer
Associate Director

- Consumer Response
- Operations & Facilities
- Procurement
- CTO
- CIO
- CFO
- Human Capital
- Inclusion
- FOIA, Privacy & Records

Consumer Education & Engagement
Associate Director

- Financial Education
- Consumer Engagement
- Older Americans
- Servicemembers
- Students
- Financial Empowerment

Research, Markets & Regulations
Associate Director

- Research
- Regulations
- Cards Markets
- Mortgage Markets
- Installment & Liquidity Lending Markets
- Deposits, Collections, & Credit Information Markets

Supervision, Enforcement, Fair Lending & Equal Opportunity
Associate Director

- Fair Lending & Equal Opportunity
- Large Bank Supervision
- Non-bank Supervision
- Enforcement

General Counsel
Associate Director

- Principal Deputy GC
- Deputy GC
- Deputy GC
- ALJ Staff Director

External Affairs
Associate Director

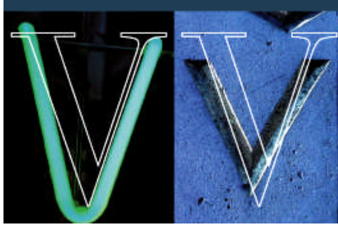
- Media Relations
- Legislative Affairs
- Small Business, Community Banks & Credit Unions
- Intergovernmental Affairs
- Ombudsman
- Consumer Advisory Boards
- Community Affairs

DRAFT
9/21/2011

© 2011 Venable LLP

The CFPB's Objectives

- To ensure that consumers have timely and understandable information to make responsible decisions about financial transactions;
- To protect consumers from unfair, deceptive, or abusive acts or practices, and from discrimination;
- To reduce outdated, unnecessary, or overly burdensome regulations;
- To promote fair competition by enforcing the Federal consumer financial laws consistently; and
- To advance markets for consumer financial products and services that operate transparently and efficiently to facility access to innovation.



© 2011 Venable LLP

What is the CFPB doing?

- February 2011 – “Open for Suggestions”

CFPB > Consumer Financial Protection Bureau - Microsoft Internet Explorer provided by Venable LLP

http://www.consumerfinance.gov/

cfpb Consumer Financial Protection Bureau

About | How do I... | Learn

2358 1321 3455 8914

submit a credit card complaint

Building the cfpb

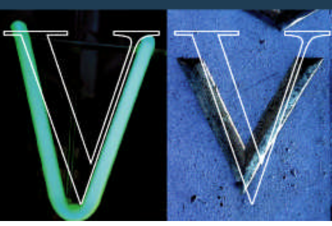
a progress report

tell your story

Know Before You Owe student loans

Student debt repayment assistant

Know your options



What is the CFPB doing? (Cont'd)

Credit CARD Act Conference

Overview

One year ago today, on February 22, 2010, many of the provisions of the Credit Card Accountability, Responsibility, and Disclosure Act (CARD Act) took effect.

When the CARD Act was signed into law in May 2009, it was clear the credit card market was in need of serious reform. Congress concluded that certain practices in the credit card industry were not fair and transparent to consumers, and the CARD Act passed with very strong bipartisan support in both the House and the Senate. As President Obama said when he signed the CARD Act into law, the Act was intended to uphold "basic standards of fairness, transparency, and accountability."

Later this summer, the new Consumer Financial Protection Bureau (CFPB) will assume responsibility for administering the CARD Act. To help guide it in performing these responsibilities, the CFPB has convened a conference, *The CARD Act: One Year Later*. To provide a factual basis for the discussion, the CFPB conducted a voluntary survey of the nine largest card issuers, who together represent approximately 90 percent of the credit card marketplace, about their current practices and future plans. Several other studies were also developed for this conference, including a report by the Office of the Comptroller of the Currency (OCC) that looks specifically at changes in the pricing practices of card issuers. To explore the impact of the CARD Act's new disclosure requirements on the consumer experience, the CFPB also commissioned a survey of cardholders.

These studies demonstrated that one year after the effective date of many provisions of the CARD Act, industry practices have changed in four significant ways.

- The long-standing practice of hiking interest rates on existing cardholder accounts has been dramatically curtailed.
- The amount of late fees consumers are paying has been substantially reduced.
- Overlimit fees have virtually disappeared in the credit card industry.
- Consumers report that their credit card costs are clearer, but significant confusion remains.

Interest Rate Hikes Dramatically Curtailed

Background: Prior to the enactment of the CARD Act, it was quite common for credit card companies to raise customers' interest rates, including the rates applied to existing balances. Often the hike was put into effect with little or no advance notice. The CARD Act has two provisions to address increases in interest rates:

1

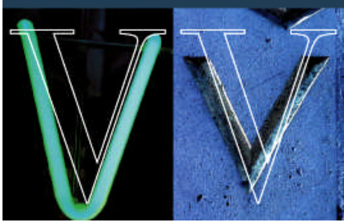
- Recent Trends in the Credit Card Industry – Argus Information & Advisory Services.
- The Supply of Credit in the Card Market – Comperemedia
- Credit Card Profitability Under Pressure – Credit Suisse
- Origination Metrics – Experian
- Reframing Behavior: The Impact of the CARD Act on Cardholder Repayment Rates – Gartenberg
- Impact on Pricing and Fees – OCC
- Consumer Perceptions and Reactions to the CARD Act – Synovate
- A Perspective on Credit Card Usage and Consumer Performance – TransUnion

© 2011 Venable LLP

After a year of the Credit CARD Act…

- In 2010, that trend turned around. Credit card marketing expanded and credit standards were relaxed, although the level of marketing has still not returned to pre-recession levels and credit standards are tighter than they were before the recession began.
- While the overall cost of credit has remained constant, overall credit use has decreased. The total amount of credit card debt declined in 2009 and again in 2010, with a cumulative decline of 15 percent.
- The average bankcard debt per cardholder declined from roughly $3,500 in 2007 to approximately $2,750 in 2010. The decrease was the result of both higher levels of "chargeoffs" – debt that card issuers write off as uncollectible – compared to 2007 and lower new balances than in 2007.
- The decrease was concentrated in the near prime and subprime segments.

Source: CFPB Credit CARD Act Report



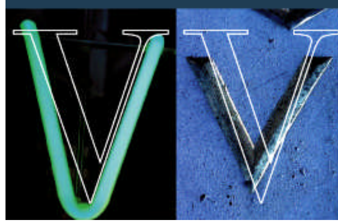
© 2011 Venable LLP

What is the CFPB doing? (Cont'd)

May 2011

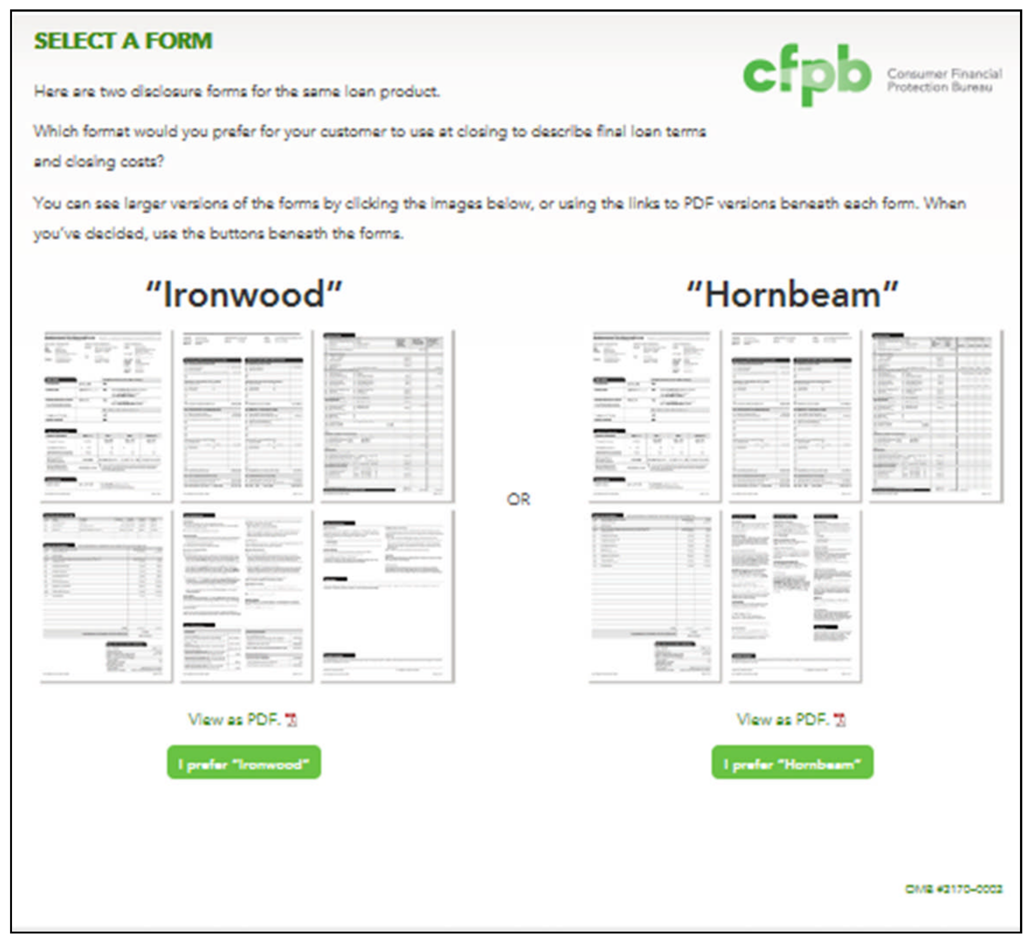
- **"Know Before You Owe" – Mortgages**

- An effort to combine two federally required mortgage disclosures into a single, simpler form that makes the costs and risks of the loan clear and allows consumers to comparison shop.
  - Several rounds of testing
  - 3 rounds of web input so far
  - Over 18,000 comments on the form



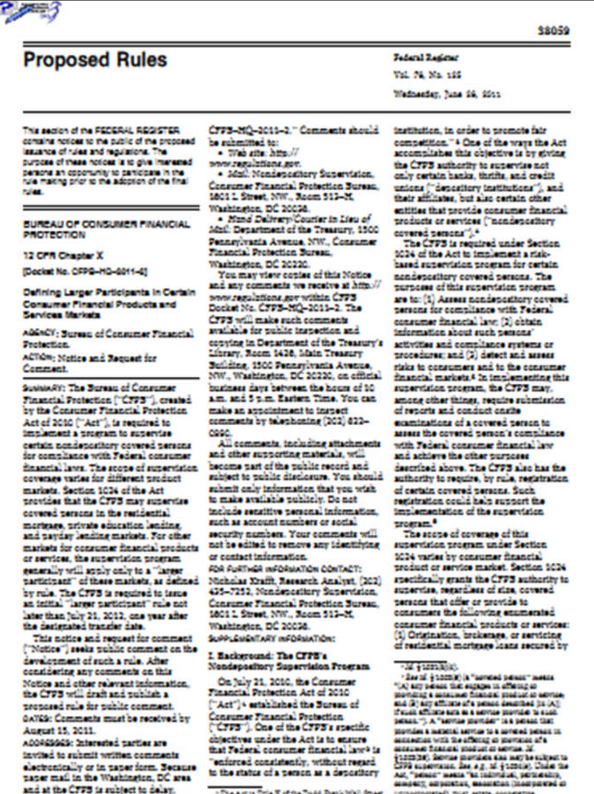
© 2011 Venable LLP

Know Before You Owe - Mortgages



Nonbank Supervision Rulemaking

- June 2011
  - Notice and Request for Comment on "larger participant" issue (e.g., nonbank supervision) – credit counseling and debt relief services targeted
  - Under the new law, the nonbank supervision program will be able to look at companies of all sizes in the mortgage, payday lending, and private student lending markets.
  - But for all other markets—like consumer installment loans, money transmitting, and debt collection, and debt relief services —the CFPB generally can supervise only larger participants.



38059

Proposed Rules

Federal Register
Vol. 76, No. 125
Wednesday, June 29, 2011

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Chapter X

[Docket No. CFPB–HQ–2011–2]

Defining Larger Participants in Certain Consumer Financial Products and Services Markets

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Notice and Request for Comment.

SUMMARY: The Bureau of Consumer Financial Protection ("CFPB"), created by the Consumer Financial Protection Act of 2010 ("Act"), is required to implement a program to supervise certain nondepository covered persons for compliance with Federal consumer financial laws. The scope of supervision coverage varies for different product markets. Section 1024 of the Act provides that the CFPB may supervise covered persons in the residential mortgage, private education lending, and payday lending markets. For other markets for consumer financial products or services, the supervision program generally will apply only to a "larger participant" of these markets, as defined by rule. The CFPB is required to issue an initial "larger participant" rule not later than July 21, 2012, one year after the designated transfer date.

This notice and request for comment ("Notice") seeks public comment on the development of such a rule. After considering any comments on this Notice and other relevant information, the CFPB will draft and publish a proposed rule for public comment.

DATES: Comments must be received by August 15, 2011.

ADDRESSES: Interested parties are invited to submit written comments electronically or in paper form. Because paper mail in the Washington, DC area and at the CFPB is subject to delay, commenters are encouraged to submit comments electronically. Comments should refer to "CFPB Docket No. CFPB–HQ–2011–2." Comments should be submitted to:

- Web site: http://www.regulations.gov.
- Mail: Nondepository Supervision, Consumer Financial Protection Bureau, 1801 L Street, NW., Room 513–M, Washington, DC 20036.
- *Hand Delivery/Courier in Lieu of Mail:* Department of the Treasury, 1500 Pennsylvania Avenue, NW., Consumer Financial Protection Bureau, Washington, DC 20220.

You may view copies of this Notice and any comments we receive at http://www.regulations.gov within CFPB Docket No. CFPB–HQ–2011–2. The CFPB will make such comments available for public inspection and copying in Department of the Treasury's Library, Room 1428, Main Treasury Building, 1500 Pennsylvania Avenue, NW., Washington, DC 20220, on official business days between the hours of 10 a.m. and 5 p.m. Eastern Time. You can make an appointment to inspect comments by telephoning (202) 622–0990.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. You should submit only information that you wish to make available publicly. Do not include sensitive personal information, such as account numbers or social security numbers. Your comments will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT: Nicholas Kraft, Research Analyst, (202) 435–7252, Nondepository Supervision, Consumer Financial Protection Bureau, 1801 L Street, NW., Room 513–M, Washington, DC 20036.

SUPPLEMENTARY INFORMATION:

I. Background: The CFPB's Nondepository Supervision Program

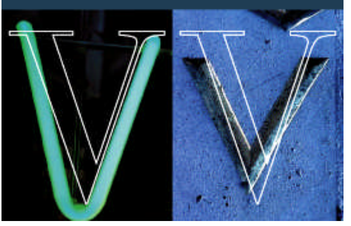
On July 21, 2010, the Consumer Financial Protection Act of 2010 ("Act")[1] established the Bureau of Consumer Financial Protection ("CFPB"). One of the CFPB's specific objectives under the Act is to ensure that Federal consumer financial law[2] is "enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition."[3] One of the ways the Act accomplishes this objective is by giving the CFPB authority to supervise not only certain banks, thrifts, and credit unions ("depository institutions"), and their affiliates, but also certain other entities that provide consumer financial products or services ("nondepository covered persons").[4]

The CFPB is required under Section 1024 of the Act to implement a risk-based supervision program for certain nondepository covered persons. The purposes of this supervision program are to: (1) Assess nondepository covered persons for compliance with Federal consumer financial law; (2) obtain information about such persons' activities and compliance systems or procedures; and (3) detect and assess risks to consumers and to the consumer financial markets.[5] In implementing this supervision program, the CFPB may, among other things, require submission of reports and conduct onsite examinations of a covered person to assess the covered person's compliance with Federal consumer financial law and achieve the other purposes described above. The CFPB also has the authority to require, by rule, registration of certain covered persons. Such registration could help support the implementation of the supervision program.[6]

The scope of coverage of this supervision program under Section 1024 varies by consumer financial product or service market. Section 1024 specifically grants the CFPB authority to supervise, regardless of size, covered persons that offer or provide to consumers the following enumerated consumer financial products or services: (1) Origination, brokerage, or servicing of residential mortgage loans secured by

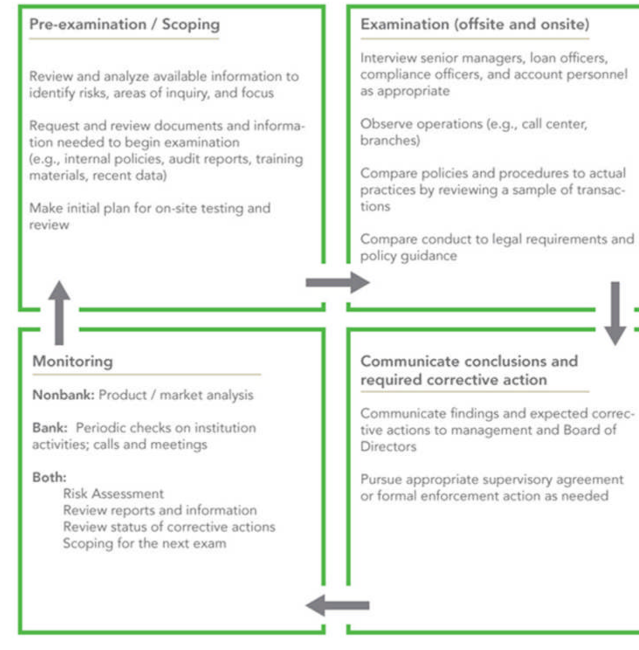
[1] The Act is Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

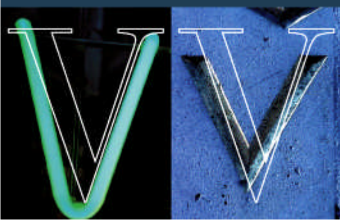
[2] See Act § 1002(14) (defining "Federal consumer financial law").



CFPB Supervision and Examination Manual

- The first part describes the supervision and examination process.
- The second part contains examination procedures, including both general instructions and procedures for determining compliance with specific regulations.
- The third part presents templates for documenting information about supervised entities and the examination process, including examination reports.





© 2011 Venable LLP

Supervision and Examination Basics

- **Principles:** There are three main principles that guide the CFPB supervision process: (1) focus on consumers; (2) data driven; and (3) consistency.
- **Examination Schedule:** Nondepository consumer financial services companies will be identified on the basis of risks to consumers. Examinations will be coordinated with State and prudential regulators. Supervised entities will generally be notified in advance of an upcoming examination.
- **Supervision and Examination Cycle:**
- **Referrals and Tax Law Noncompliance**: The CFPB is required by law to refer information identifying possible tax law non-compliance to the IRS.
- **Compliance Rating:** "The CFPB has adopted the FFIEC Uniform Consumer Compliance Rating System. Under this system, after an examination a supervised entity is assigned a confidential consumer compliance rating based upon an evaluation of its present compliance with Federal consumer financial law and the adequacy of its systems designed to ensure compliance on a continuing basis.
  - The rating system is based upon a scale of 1 through 5 in increasing order of supervisory concern. Thus, "1" represents the highest rating and consequently the lowest level of supervisory concern, while "5" represents the lowest, most critically deficient level of performance and therefore the highest degree of supervisory concern.

© 2011 Venable LLP

Additional Reports

Remittances

JULY 20, 2011

Report on remittance transfers

Report to the President, the Senate Committee on Banking, Housing, and Urban Affairs, and the House of Representatives Committee on Financial Services

Recommendations regarding the transparency and disclosure to consumers of exchange rates; analysis of the potential use of remittance histories in the calculation of credit scores

cfpb Consumer Financial Protection Bureau

Credit Scores

JULY 19, 2011

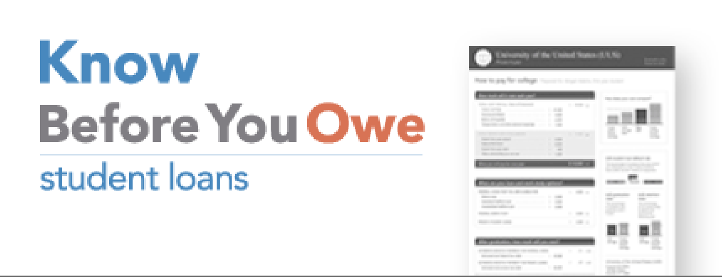
The impact of differences between consumer- and creditor-purchased credit scores

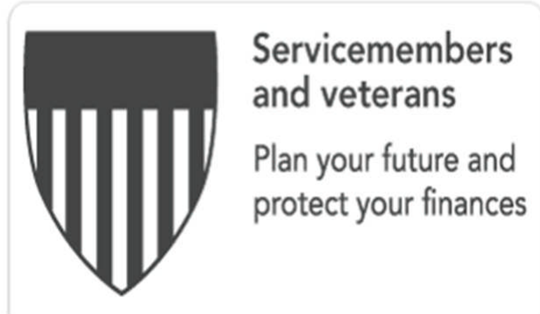
Report to Congress

cfpb Consumer Financial Protection Bureau

© 2011 Venable LLP

Student Loan, Servicemembers and Older American Initiatives

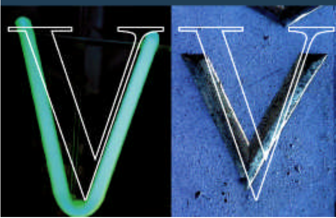




© 2011 Venable LLP

Early Warning Notice of Potential Enforcement

- The *Early Warning Notice* is not required by law, but CFPB believes it will promote even-handed enforcement of consumer financial laws. The decision to give notice in particular cases is discretionary and will depend on factors such as whether prompt action is needed.



© 2011 Venable LLP

Myth #2 – Credit Counseling Agencies are not money transmitters

The answer will depend upon…

© 2011 Venable LLP

Depending upon the state a DMP may trigger a money transmission licensing requirement.

- 48 states have "Money Services Business Acts" or similar statutes
- 18 U.S.C. 1960 makes it a federal crime to not have a license if a state requires one

- What does this mean?
  - Self Audit Compliance with statutes
  - Obtain licenses
  - Understand the federal implications
  - Good news: no fee caps

© 2011 Venable LLP

Myth #3 – Tax-Exempt Credit Counseling Agencies are prohibited from seeking contributions

© 2011 Venable LLP

Tax-Exempt Organizations Can Solicit Contributions Depending upon the Situation

- A tax-exempt credit counseling organization cannot solicit contributions from consumers during initial counseling process, or while a consumer is receiving services from the organization.
- An organization may charge reasonable fees for education, individual counseling sessions, or debt management plan services.
- This prohibition does not affect government or foundation grants and contributions from individuals who are not customers.
- That being said, there are limits on the amount of creditor support one can receive related to debt management plan services, including certain housing related activity. As a result, agencies with a high level of creditor support should carefully review their overall revenue streams and consult the relevant tax sections on donations and creditor funding generally.

© 2011 Venable LLP

Charitable Contributions Means Registration with Most States

Charity Registration in the States

- States that accept the common form
- States that require charities to register but don't accept the common form
- States that do not require registration

Source: Multi-State Filer Program

Map by Jasmine Stewart, Courtesy of the Chronicle of Philanthropy

© 2011 Venable LLP

Myth #4 – Credit counseling agencies should stop Charging Fees and Subsist Solely on Contributions

© 2011 Venable LLP

Compliance with Fee Related Regulation remains Critical

- For for-profit and nonprofit providers, the fee models used are likely going to come into greater scrutiny by the CFPB and possibly other regulators.
- On top of this, compliance with requirements related to the timing and collection of fees remains important and this area of regulation is evolving as states look conform their statutes to the FTC's Telemarketing Sales Rule ("TSR") (often disregarding that the TSR was written to regulate for-profit entities), state enforcement authorities look to the TSR for guidance in how to enforce their own consumer protection statutes.
- In addition, the Uniform Law Commission has just amended the Uniform-Debt Management Services Act to enact an advance fee prohibition and is already promoting its revised language to states for adoption.

© 2011 Venable LLP

Myth #5 – Tax-exempt credit counseling agencies don't need to worry about the IRS any longer…

© 2011 Venable LLP

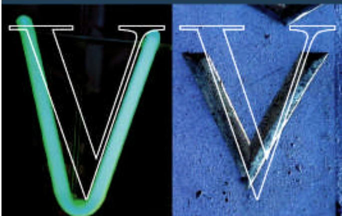
Tax-Exempt Agencies Cannot Afford to Ignore the Tax Code

- Although the IRS' multi-year compliance project is at its end having audited virtually the entire active credit counseling industry, the IRS is still very much going to be scrutinizing the activities of tax-exempt CCAs for compliance with Code Section 501(q).

- Code Section 501(q) has been in existence for 5 years and compliance with the provision remains fraught with traps and pitfalls. For example, one issue that affects a good portion of the credit counseling industry is the limitation on creditor revenue attributable to debt management plan services.

- The IRS may reconcile the broad language of Code Section 501(q) with the evolving activities of housing counseling agencies, which to be approved by the U.S. Department of Housing and Urban Development are tax-exempt despite not always being thought of as CCAs.

- The IRS continues to compile information from Forms 990s on CCA activity, as well as other sources, and can initiate exams of credit counseling agencies on an individual basis or more widespread basis, as needed. As a result, compliance with the Code prohibitions on impermissible private benefit, private inurement, and Code Section 501(q), among other requirements remains essential.



© 2011 Venable LLP

Myth #6 – There is nothing credit counseling agencies can do about the threat of a lawsuit based on the Credit Repair Organizations Act

© 2011 Venable LLP

Credit Repair Organizations Act

The **Credit Repair Organizations Act** became effective on April 1, 1997, and is directed to the credit repair industry.

The term "**credit repair organization**"—

(A)means any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—

> **(i)** improving any consumer's credit record, credit history, or credit rating; or
>
> **(ii)** providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

(B) does not include –

(i) any nonprofit organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;

© 2011 Venable LLP

Zimmerman v. Puccio, No. 09-1416 (1st Cir. 2010).

- Held that a tax-exempt, nonprofit credit counseling agency operated as a "credit repair organization" within the meaning of CROA and that certain principals of the organization were personally liable under CROA.
- The *Zimmerman* decision adopts a sweeping interpretation of CROA that equates credit counseling agencies with credit repair organizations.
  - As the First Circuit observed, "credit counseling aimed at improving future creditworthy behavior is the quintessential credit repair service."
- Some courts have adopted a two-part test for the CROA exemption for *bona fide* tax-exempt nonprofit credit counseling agencies, requiring such agencies to: (1) be recognized by the IRS as being exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code; and (2) actually operate as a *bona fide* nonprofit organization.

© 2011 Venable LLP

CROA: Requirements

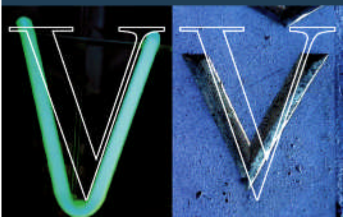
- CROA requires full disclosure regarding consumer rights before any contract for credit repair services is executed. A written statement must be provided and signed by all prospective customers, and must be retained by the credit repair organization for at least two years after the statement is signed.
- Written Contract
- Notice of Cancelation Right
- Advance Fee Prohibition – What does this mean in light of lower court decisions in Colorado and California?

© 2011 Venable LLP

CROA: Prohibitions

The statutory scheme provides further protection for consumers with a list of prohibitions. CROA prohibits any person, credit repair organizations, as well as their employees and agents, from:

- misrepresenting the organization's services
- making or enticing consumers to make untrue or misleading statements either to the credit reporting agencies or to the consumer's creditors
- advising consumers to attempt to change their credit identities
- accepting payment or other valuable consideration for their services in advance of fully performing those services



© 2011 Venable LLP

CROA: Penalties

- CROA includes civil penalties for violations and procedures for administrative enforcement by both the FTC and the states.
- CROA includes a private right of action.

© 2011 Venable LLP

CROA: Waiver of Rights

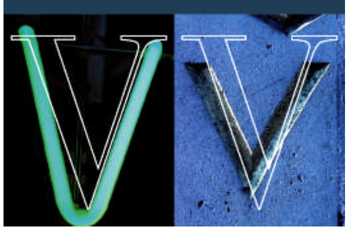
A consumer cannot waive his rights under CROA.

- Any waiver of any protection afforded by CROA is treated as void, and contracts that are not in compliance with the Act's provisions may not be enforced by any federal or state court.

© 2011 Venable LLP

Threat of Private Lawsuits

- Private litigation, especially potential class-action lawsuits, can be “bet the company” litigation that most CCAs simply cannot afford. To avoid them, the simplest step to take is always to maintain a high degree of customer satisfaction and open channels of communication.



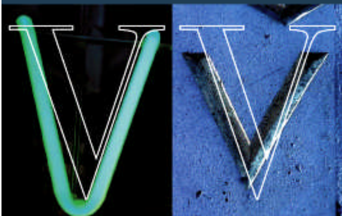
© 2011 Venable LLP

Arbitration Provisions and Class-Action Waivers Offer Some Protection

- In AT&*T Mobility, LLC v. Concepcion* the Supreme Court struck down a California rule that invalidated most class action waivers in consumer contracts and ushered in a clear path for CCAs to follow to limit class-action lawsuits under most consumer protection statutes. To do so, companies will need to use well-written arbitration provisions and class-action waivers. While not bullet proof, a carefully drafted arbitration provision and class-action waiver can really take enthusiasm away from class-action attorneys and be customer friendly at the same time.

- The Supreme Court will soon decide *CompuCredit Corp. v. Greenwood*, which asks the question: "Whether claims arising under the CROA are subject to arbitration pursuant to a valid arbitration agreement." The case will likely decide a circuit split about the meaning of the requirement that credit repair organizations provide their customers with a disclosure document informing them that they "have the right to sue a credit repair organization that violates" CROA against the provided "[a]ny waiver by any consumer of any protection provided by or any right of the consumer under this subchapter" is void and unenforceable.

- If the Supreme Court finds in favor of the waiveability of rights under CROA and clarifies that arbitration is permitted then it could save tax-exempt CCAs from costly litigation. Now CCAs have to expend valuable resources to establish that they are not credit repair organizations or are exempt from CROA due to their tax-exempt status. One important caveat, implementation of any dispute resolution provisions into a DMP agreement would need to be done on a state-by-state basis to take into account differences in state debt adjusting laws that often regulate such contracts, as well as take into account specific company preferences.



© 2011 Venable LLP

Myth #7 – State debt adjusting law compliance is not important any longer now that there is the CFPB

© 2011 Venable LLP

State Debt Adjusting Law Trends

(Approx. Numbers Provided)

	December 2005	February 2007	July 2008	July 2010	November 2011
States w/o Debt Adjusting Laws	3	3	2	2	2
States with Debt Adjusting Prohibitions w/limited or no Exceptions	2	2	1	1	1
States that Allow For-Profit and Non-Profit Entities to Engage in Debt Adjusting Activities	28	30	36	39	39
States with Licensing/Registration Requirements	29	31	34	37 (including effective dates of 2010)	37
States that Require Nonprofit Corporate Status (including (c)(3) status)	18	16	12	9	9
States that require 501(c)(3) Status	9	7	2	1	1

* For purposes of this chart, the term debt adjusting generally is defined to mean the entering into or making of a contract with a particular debtor where the debtor agrees to pay a certain amount of money periodically to the organization, and the organization, for consideration, agree to distribute, or distribute the same among specified creditors pursuant to an agreement or plan. It is further defined to mean the business or practice of any organization that holds itself out as acting or offering or attempting to act, for consideration as an intermediary between the debtor and his or her creditors for the purpose of settling, compounding or in anyway altering the terms of payment of any debt.

© 2011 Venable LLP

Notable State Debt Adjusting Law Developments

- **Colorado UDMSA Amendments** (effective July 1, 2011)
- **Indiana Debt Management Services Act Amendments** (effective May 16, 2011)
- **Maryland Debt Settlement Services Act** (effective October 1, 2011)
- ***North Dakota HB 1038****, an act establishing regulation for debt settlement providers (effective August 1, 2011)*
- ***Virginia SB 786,*** *an act providing an exemption from definition of mortgage loan originator for housing counseling organizations certified or approved by HUD (effective July 1, 2011)*
- ***Virginia SB 930****, an act providing exemption from regulation as credit counselors for licensed public accountants and accounting firms from charitable solicitation registration (effective July 1, 2011)*
- **Nevada Uniform-Debt Management Services Act** (effective July 1, 2010)
- **Tennessee Uniform-Debt Management Services Act** (effective July 1, 2010)
- **Illinois Debt Management Service Act / Debt Settlement Consumer Protection Act** (effective Aug. 3, 2010)
- **Kentucky Debt Adjuster Act** Amendments (HB 166, July 15, 2010)
- **California Money Transmission Act** (AB 2789, effective Jan. 1, 2011)
- Note:
  - Several additional bills pending to amend the debt adjusting law to conform to the TSR Debt Relief Services Amendments.
  - Several mortgage foreclosure assistance relief services/mortgage foreclosure consulting bills pending.
  - Several state SAFE Act amendments pending

© 2011 Venable LLP

The State Law Landscape Continues to Evolve

- 2012 Bills Introduced (already):
  - Florida
  - Ohio
  - Pennsylvania
- New Proposed Regulations in Texas
- The UDMSA – Friend or Foe

© 2011 Venable LLP

Myth #8 – The new FTC TSR Debt Relief Services Provisions apply to everyone and everything

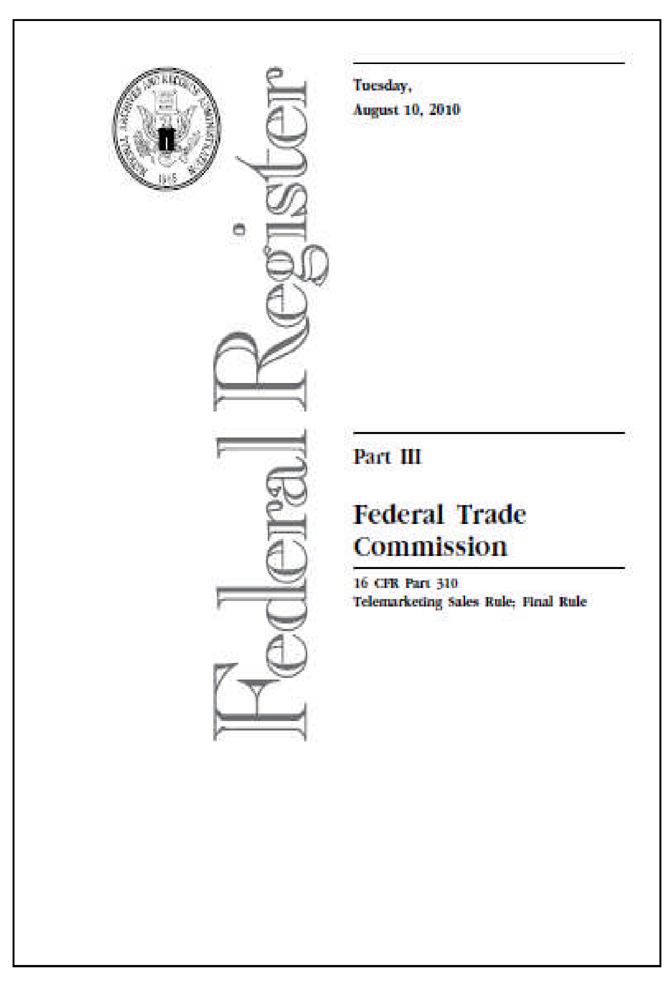
© 2011 Venable LLP

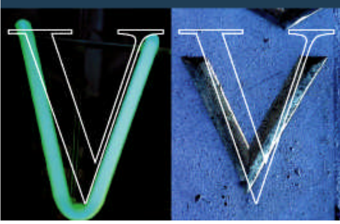
Final Rule – Debt Relief Amendments to the FTC's Telemarketing Sales Rule

- 16 C.F.R. Part 310: Telemarketing Sales Rule: Amendments Addressing the Telemarketing of Debt Relief Services: Final Rule and Statement of Basis and Purpose - Released on July 29, 2010

- Four Key Features:

  1. advance fee ban for debt relief services;
  2. require debt relief companies to make specific disclosures to consumers;
  3. prohibit them from making misrepresentations; and
  4. extends the Telemarketing Sales Rule to cover calls consumers make to these firms in response to debt relief advertising.





© 2011 Venable LLP

Types of Entities Subject to the Rule

- The new rule applies to for-profit sellers of debt relief services and telemarketers for debt relief companies. The TSR defines “telemarketing” as a “plan, program, or campaign . . . to induce the purchase of goods or services” involving more than one interstate telephone call.

- In addition, under the TSR, it is illegal for a person to provide “substantial assistance” to another seller or telemarketer when that person knows or consciously avoids knowing that the seller or telemarketer is engaged in any act or practice that violates the rule.

- Although the TSR generally exempts inbound calls placed by consumers in response to direct mail or general media advertising, there is no such exemption in the Final Rule. The Final Rule, consistent with the proposed rule, carves out inbound calls made to debt relief services from that exemption. As a result, virtually all debt relief transactions involving interstate telephone calls are now subject to the TSR.

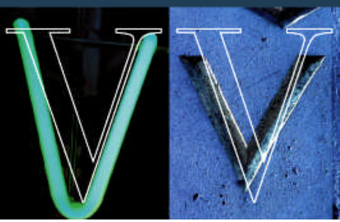
© 2011 Venable LLP

Definition of Debt Relief Services

- **Definition of "debt relief service"** - "*any service or program represented, directly or by implication, to renegotiate, settle, or in any way alter the terms of payment or other terms of the debt between a person and one or more unsecured creditors or debt collectors, including, but not limited to, a reduction in the balance, interest rate, or fees owed by a person to an unsecured creditor or debt collector.*"

- **Services -** The FTC's makes clear that the use of the term "service" is not intended to be limiting in any way. As a result, the Commission states that "regardless of its form, anything sold to consumers that consists [sic] of a specific group of procedures to renegotiate, settle, or in any way alter the terms of a consumer debt, is covered by the definition." Further, *"[t]he Commission believes that this definition appropriately covers all current and reasonably foreseeable forms of debt relief services, including debt settlement, debt negotiation, and debt management, as well as lead generators for these services.*"

- **Products -** The Final Rule does not include "products" in the definition of "debt relief services," but the Commission notes that this limitation should not be "*used to circumvent the rule by calling a service – in which a provider undertakes certain actions to provide assistance to the purchaser – a 'product.' Nor can a provider evade the rule by including a 'product,' such as educational material on how to manage debt, as part of the service it offers.*"



© 2011 Venable LLP

No Coverage of *Bona Fide* Nonprofits by the FTC…

I operate a non-profit organization. Does the new Rule apply to us?

Bona fide non-profit organizations aren't covered because the TSR applies only to for-profit companies. However, the Rule covers companies that falsely claim nonprofit status.

NOTE: **Dodd-Frank Act** amends the **Telemarketing and Consumer Fraud and Abuse Prevention Act** to provide for co-enforcement and rulemaking authority of the Telemarketing Sales Rule by the CFPB for providers of consumer financial products and services covered by the CFPA

© 2011 Venable LLP

Advance Fee Ban

- Effective October 27, 2010
- The Final Rule contains specific requirements for debt relief providers related to charging an advance fee before providing any services. It specifies that fees for debt relief services may not be collected until:
  1. the debt relief service successfully renegotiates, settles, reduces, or otherwise changes the terms of **at least one of the consumer's debts**;
  2. there is a **written** settlement agreement, **debt management plan**, or other agreement between the consumer and the creditor, and the consumer has agreed to it; and
  3. the **consumer has made at least one payment** to the creditor as a result of the agreement negotiated by the debt relief provider.
- **<u>What does this mean for a DMP provider?</u>**

© 2011 Venable LLP

Dedicated Accounts

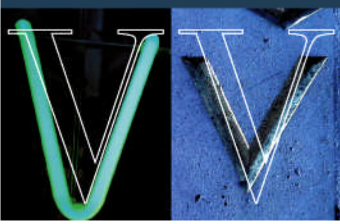
- May require consumers to set aside their fees and savings payments to creditors. Providers may only require a dedicated account as long as five conditions are met:
  1. the dedicated account is maintained at an insured financial institution;
  2. the consumer owns the funds (including any interest accrued);
  3. the consumer can withdraw the funds at any time without penalty;
  4. the provider does not own or control or have any affiliation with the company administering the account; and
  5. the provider does not exchange any referral fees with the company administering the account.

© 2011 Venable LLP

How does the advance fee prohibition apply to a DMP?

"CCAs renegotiate all of the consumer's eligible debts at one time, and creditors generally grant concessions immediately upon enrolling consumers in the DMP. Thus, CCAs do not renegotiate debts individually, and Final Rule § 310.4(a)(5)(i)(C) does not apply to them. CCAs commonly charge consumers not only an initial setup fee, but also periodic (usually monthly) fees throughout the consumer's enrollment in the DMP. Laws in most states cap these fees. Final Rule § 310.4(a)(5) prohibits CCAs from charging a set-up or other fee before the consumer has enrolled in a DMP and made the first payment, but it would not prevent the CCA from collecting subsequent periodic fees for servicing the account."

- (Internal citation omitted.) TSR Amended Rule 2010, 75 Fed. Reg. 48489 n.431 (Aug. 10, 2010). Footnote 431 to the SBP of the TSR is in connection with the statement, "For a DMP, the CCA must provide a debt management plan containing the altered terms and executed by the customer that is binding on all applicable creditors. The CCA also must have evidence that the consumer has made the first payment to the CCA for distribution to creditors."

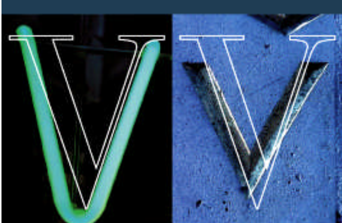


Important: Disclosures and Prohibited Misrepresentations

- Effective September 27, 2010.

- **Disclosures** - Under the Final Rule, providers will have to make several disclosures when telemarketing their services to consumers. Before the consumer signs up for any debt relief service, providers must disclose fundamental aspects of their services, including
  - how long it will take for consumers to see results,
  - how much it will cost,
  - the negative consequences that could result from using debt relief services,
  - and key information about dedicated accounts if they choose to require them.

- **Prohibition on Misrepresentations** - The Final Rule prohibits misrepresentations about any debt relief service, including success rates and whether the provider is a nonprofit entity.
  - The FTC's Statement of Basis and Purpose, which accompanies the Final Rule, provides extensive guidance about the evidence providers must have to make advertising claims commonly used in selling debt relief services.



© 2011 Venable LLP

Enforcement

- Federal Trade Commission
- State Attorneys General
- Consumer Financial Protection Bureau (covered products and services under CFPA)
- Private Persons (threshold of *$50,000 in actual damages)*

- Civil Penalties ($16,000 per violation)
- Injunction
- Damages

© 2011 Venable LLP

Myth #9 – There is nothing we can do to minimize our risk.

© 2011 Venable LLP

Steps to Help Minimize Your Legal Risk

- Are you appropriately insured for the services and products that you provide? (Not all policies are the same. Consider whether CGL is adequate?).
- Align Fee Structures with Applicable Law and Regulations (e.g., TSR, CROA, 501(q), and State Debt Adjusting Laws)
- Proactively Develop Pro-Consumer Alternative Dispute Resolution Contract Provisions
- Consider Legal Compliance Implications of all products and services
  - Housing
  - Bankruptcy Counseling/Debtor Education
  - LTFB Products
- Develop Internal Processes and Procedures for such areas as:
  - Advertising and Marketing
    - Internet
      - Social Media
    - Telemarketing
    - TV and Radio
    - Mobile
  - Creditor Relations
  - Consumer Contact
  - Conflict of Interest (and Board disclosures)
  - Privacy and Data Security
  - Payments and Remittances
  - Charitable Solicitation
- Due Diligence for mergers and acquisitions

© 2011 Venable LLP

QUESTIONS AND DISCUSSION

Jonathan L. Pompan, Esq.
jlpompan@Venable.com
(202) 344-4383

Venable LLP
575 7th Street, N.W.
Washington, DC 20004
www.Venable.com
1-888-Venable

To view Venable's index of articles and PowerPoint presentations on related legal topics, see www.Venable.com/ccds/publications.

© 2011 Venable LLP