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A Legal Update for Debt Settlement Companies and Service Providers

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INTRODUCTION

- The Laws that Apply to Debt Settlement
- State Debt Adjusting Laws
 - Overview
 - UDMSA
 - Recent Developments
- State Credit Services Organization Acts
- Attorney Model and the Unauthorized Practice of Law
- Recent State Enforcement Actions, Lawsuits, and Private Lawsuits
- Practical Tips to Help Avoid State Enforcement Actions and Private Lawsuits



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Overview of State Debt Adjusting Laws



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Debt Adjusting Statutes[†]

49 States*

*Subject to change

Typical triggers may include, among others, receipt and disbursement of consumer funds destined for creditors; serving as an intermediary between a debtor and creditor; effect the adjustment, compromise, or discharge of any unsecured account, note, or other indebtedness of the debtor

**Some states may limit whom can provide services.

Exemptions and Exclusions

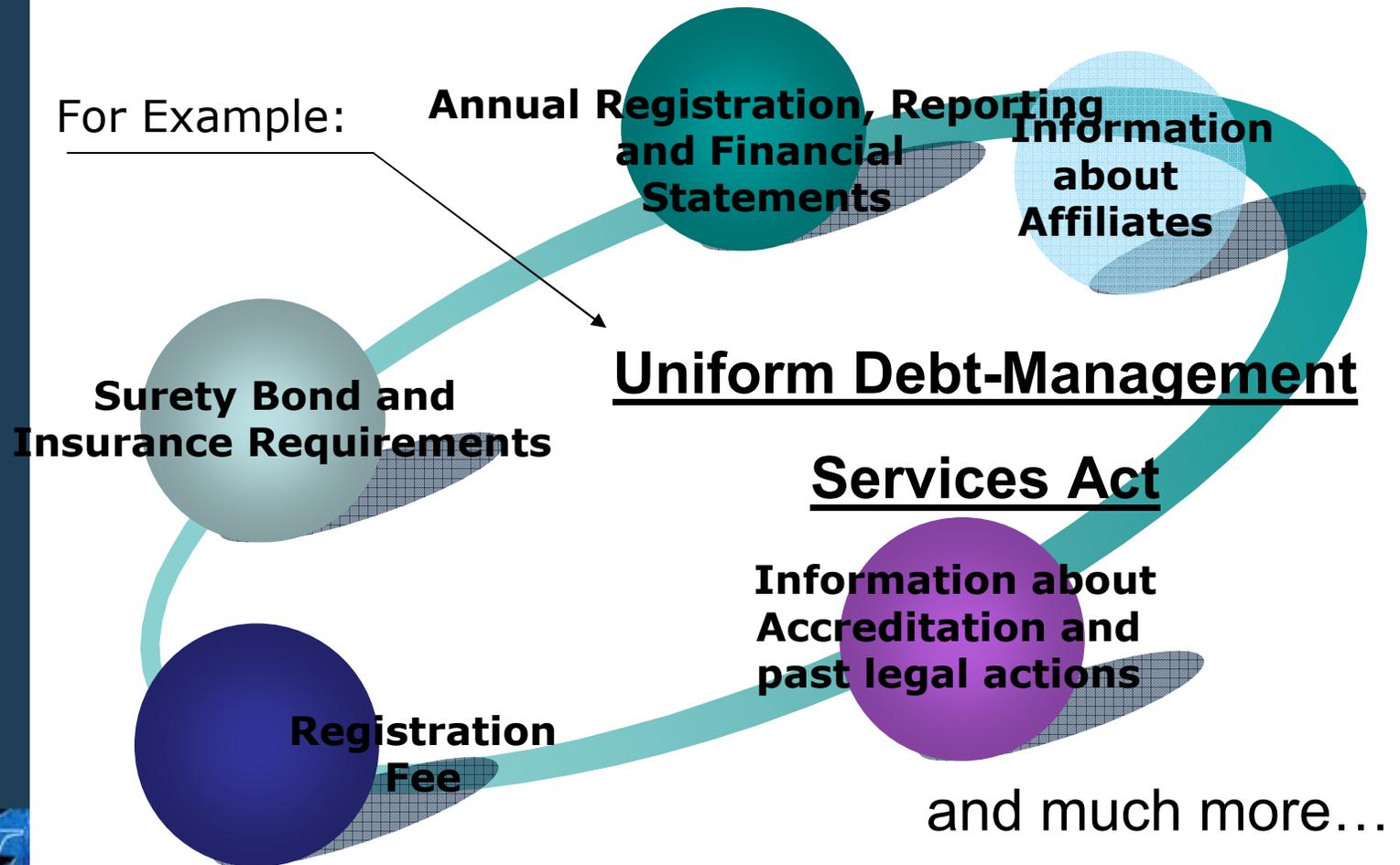
Vary from state to state (in some cases, depends on whether debt settlement company touches or controls client funds destined for creditors).

† Debt Adjusting statutes also may apply to companies that solicit or market debt adjusting services.

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Typical State Debt Adjusting Registration Requirements



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State Debt Adjusting Law Definitions

Example: Florida Credit Counseling Act, Section 817.801-817.806

- Debt management service means services provided to a debtor by a credit counseling organization for a fee to: (a) effect the adjustment, compromise, or discharge of any unsecured account, note, or other indebtedness of the debtor; or (b) receive from the debtor and disburse to a creditor any money or other thing of value.
- “Credit counseling services” means confidential money management, debt reduction, and financial educational services.
- Exemption Example: “Any debt management or credit counseling services provided in the practice of law in this state.”



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State Debt Adjusting Law Definitions (cont'd)

Example: Florida Budget Planning Statute

- **Definition:** Budget planning means the act of entering into a contract by any person, firm, corporation, or association with a particular debtor by the terms of which contract the debtor agrees to deposit periodically with such person, firm, corporation, or association a specified sum of money and said person, firm, corporation, or association agrees to distribute said sum of money among specified creditors of the debtor in accordance with an agreed plan for which service the debtor agrees to pay a valuable consideration.
- **Criminal Prohibition:** No person, firm, corporation, or association, shall engage in the business of budget planning; provided, the provisions of this part shall not be construed to affect any contract for services to facilitate accelerated payment of a mortgage loan.
- **Exceptions:** (1) "Person" as used in this part shall not include a person actively practicing law in Florida and who is also admitted to The Florida Bar, and any person who is currently a member of The Florida Bar. "Firm" as used in this part shall not include a partnership, all the members of which are admitted to practice law in this state, and who are current members of The Florida Bar.



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State Debt Adjusting Laws Definitions (cont'd)

Example: California

- “Prorater means a person who, for compensation, engages in whole or in part in the business of receiving money or evidences thereof for the purpose of **distributing the money or evidences thereof** among creditors in payment or partial payment of the obligations of the debtor.”
- In 2006, the Department of Corporations adopted an administrative decision indicating that the “Proraters Law” requires a company to be licensed if: (1) the company negotiates consumer debt for a fee, and (2) receives knowledge of the amount of funds the consumer has saved to negotiate the debt. See News Release at <http://www.corp.ca.gov/ENF/list/n/nw.asp>.



State Debt Adjusting Laws Definitions (cont'd)

Example: UDMSA (Delaware, Rhode Island, Utah and Colorado*)

"Debt-management services" means services as an intermediary between an individual and one or more creditors of the individual for the purpose of obtaining concessions, but does

Not include:

- (a) legal services provided in an attorney-client relationship by an attorney licensed or otherwise authorized to practice law in this state;
- (b) accounting services provided in an accountant-client relationship by a certified public accountant licensed to provide accounting services in this state; or
- (c) financial-planning services provided in a financial planner-client relationship by a member of a financial-planning profession whose members the administrator, by rule, determines

Are: (i) licensed by this state; (ii) subject to a disciplinary mechanism; (iii) subject to a code of professional responsibility; and (iv) subject to a continuing-education requirement."

* Effective January 1, 2008



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Violations of State Debt Adjusting Statutes

- Common failures to adhere to specific statutory requirements include:
 1. Licensure/Registration, if applicable
 2. Fee Caps
 3. Compliance with Other Aspects of the Statute
- Using unfair or deceptive acts or practices or engaging in fraudulent conduct that creates a likelihood of confusion or misunderstanding.



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State Debt Adjusting Statutes Fines and Penalties

Example - UDMSA



The law authorizes the imposition of restitution and penalties of up to \$10,000 per violation (or more). In addition, the law authorizes private remedies against debt settlement companies not registered under the Act (e.g., actual and punitive damages and attorneys fees). (Some violations of debt adjusting statutes carry criminal penalties.)



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Uniform Debt-Management Services Act

- Effective in Delaware, Rhode Island, Utah and Colorado
- Considered in Other States
- Roadmap for other states to either adopt/amend and/or interpret existing debt adjusting statute



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Uniform Debt-Management Services Act (Colorado, Delaware, Utah and Rhode Island)

- Regulates debt-management companies by requiring them to register with the state.
- To obtain a certificate of registration, a provider must supply information about itself, obtain insurance against employee dishonesty, and post a surety bond to safeguard any money that it receives from individuals for payment to creditors.
- Excludes professional services provided by attorneys or certified public accountants, but only if the attorney is licensed or otherwise authorized to practice in this state or the accountant is licensed by this state
- Enforcement both by a state agency and by private individuals, including rule-making authority on the part of the administrator and recovery of minimum, actual and, in appropriate cases, punitive damages in private enforcement actions (e.g., class actions).



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UDMSA Tip: Advertising

- The UDMSA requires providers to make certain disclosures when advertising. The required disclosures include the impact of debt-management services on credit ratings and the likelihood of collection efforts in an easily comprehensible manner. ***Under the UDMSA, a third party advertiser on behalf of a provider is viewed as an agent, and the provider can be liable if the advertisement fails to comply with these requirements.***



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UDMSA: Liability for the Acts of Third Parties

- The provisions of the UDMSA impose duties and obligations on providers and on independent contractors, if they fall under the definition of provider, or as a person that caused the provider to violate the UDMSA.



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UDMSA: Summary of Bond, Insurance and Fee Restrictions

UDMSA	Colorado	Utah	Rhode Island	Delaware
\$50,000 bond	\$50,000 bond	\$100,000 bond	\$50,000 bond	\$50,000 bond
\$250,000 insurance	\$1 million insurance	\$250,000 insurance	\$250,000 insurance	\$500,000 insurance
Fee cap: total fees limited to 30% of the difference between the principal amount of debt and the eventual settlement	Fee cap: total fees limited to 18% of the principal amount of the debt	Fee cap: total fees limited to 30% of the difference between the principal amount of debt and the eventual settlement	Fee cap: total fees limited to 30% of the difference between the principal amount of debt and the eventual settlement	Fee cap: total fees limited to 18% of the principal amount of the debt



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Update on State Debt Adjusting Law Developments

- Texas
- Indiana
- Maine
- Missouri
- North Carolina
- Rhode Island
- California
- Utah
- Colorado
- Delaware
- New Hampshire
- Maryland
- Idaho
- Others



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Maine Debt Management Services Act

“Debt management service provider” means a person, wherever located, that provides or offers to provide to a consumer in this State any debt management services, in return for a fee or other consideration, and a person located in this State that provides or offers to provide to a consumer who is not a resident of this State any debt management services, in return for a fee or other consideration.

“Debt Management Service”

- (1) The receiving of money from a consumer for the purpose of distributing one or more payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligation;
- (2) Arranging or assisting a consumer to arrange for the distribution of one or more payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligation;
- (3) Exercising control, directly or indirectly, or arranging for the exercise of control over funds of a consumer for the purpose of distributing payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligation; or
- (4) Acting or offering to act as an intermediary between a consumer and one or more creditors of the consumer for the purpose of adjusting, settling, discharging, reaching a compromise on or otherwise altering the terms of payment of the consumer's obligation.

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Minnesota Debt Management Services Act

"Debt management services provider" means any person offering or providing debt management services to a debtor domiciled in this state, regardless of whether or not a fee is charged for the services and regardless of whether the person maintains a physical presence in the state.

This term does not include services performed by the following when engaged in the regular course of their respective businesses and professions: . . . debt settlement providers.

"Debt management services" means the provision of any one or more of the following services in connection with debt incurred primarily for personal, family, or household services:

- (1) managing the financial affairs of an individual by distributing income or money to the individual's creditors;
- (2) receiving funds for the purpose of distributing the funds among creditors in payment or partial payment of obligations of a debtor; or
- (3) adjusting, prorating, pooling, or liquidating the indebtedness of a debtor.

Any person so engaged or holding out as so engaged is deemed to be engaged in the provision of debt management services regardless of whether or not a fee is charged for such services.

"Debt settlement provider" means any person engaging in or holding out as engaging in the business of negotiating, adjusting, or settling debt incurred primarily for personal, family, or household purposes without holding or receiving the debtor's funds or personal property and without paying the debtor's funds to, or distributing the debtor's property among, creditors.

Effective: January 1, 2008



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Missouri Debt Adjuster Act

- Debt adjuster means a person who acts or offers to act for a consideration as an intermediary between a debtor and his creditors for the purpose of settling, compounding, or in any wise altering the terms of payments of any debts of the debtor, and to that end receives money or other property from the debtor, or on behalf of the debtor, for payment to, or distribution among, the creditors of the debtor.
- The definition of debt adjusting “shall only apply to a person who collects funds from a debtor and delivers such funds to the debtor's creditors.”
- Effective August 28, 2007



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New Hampshire Debt Adjustment Services Act

- Debt adjustment means (a) Providing debt management advice or counseling to consumers for direct or indirect compensation; (b) Creating debt management plans for consumers for direct or indirect compensation; (c) Negotiating with creditors on behalf of consumers for direct or indirect compensation; or (d) Receiving, for a fee or compensation and as agent of a debtor, money or evidences thereof for the purpose of distributing such money or evidences thereof among creditors in full or partial payment of obligations of the debtor.”
- Licensure (fee caps, bonds etc.)
- Effective July 1, 2007



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STATE CREDIT SERVICES ORGANIZATION ACTS



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State Credit Services Organization Acts (CSOAs)

- $\frac{3}{4}$ of all states have CSOAs
- Broader Applicability (e.g., defer payment)
- Bonds
- Few Exemptions
- May have requirement inconsistent with typical debt settlement company business models
- Often Prohibition on advance payments (may be lifted in certain conditions)
- Registration
- Civil Enforcement and Privacy Right of Action
- Criminal Enforcement



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Example: Michigan Credit Services Protection Act

The MI CSPA defines a “Credit services organization”, unless otherwise exempt, to be “a person who...attempts to sell, provide, or perform 1 or more of the following: (i) The improvement of a person's credit record, history, or rating; (ii) The obtainment of an extension of credit; (iii) Advice or assistance regarding the improvement or repair of a person's credit record, history, or rating; (iv) Advice or assistance regarding the obtainment of an extension of credit; (v) Advice or assistance regarding foreclosure of a real estate mortgage; (vi) *Serve as an intermedate between a debtor and a creditor on behalf of the debtor regarding credit that was extended prior to any agreement to have the credit services organization serve as an intermedate.*” (emphasis added).

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UNAUTHORIZED PRACTICE OF LAW



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Attorney Model and Unauthorized Practice of Law

- All states have statutes, regulations and professional codes of conduct that govern attorney activity.
 - Prohibitions on Collaboration with Non-Attorneys
 - Prohibitions on Fee-Splitting and Compensated Referrals
 - Independent Judgment
 - Advertising Regulation
 - More...
- Nearly every state has a law which prohibits the unauthorized practice of law (“UPL”). UPL in most states is a criminal act. A number of states once considered debt adjusting UPL.



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STATE ENFORCEMENT ACTIONS AND PRIVATE LAWSUITS



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State Laws, Enforcement Actions and Private Lawsuits (and Class Actions)

- State Consumer Protection Laws
- State Credit Services Organization Acts
- State Debt Adjusting Laws
- Other State Marketing and Security Breach Laws (i.e., email)
- Contract Actions (Arbitration Provisions)
- Private Lawsuits May Include CROA and RICO claims, among other federal statutes.



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PRACTICAL TIPS TO HELP AVOID STATE ENFORCEMENT ACTIONS AND PRIVATE LAWSUITS



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Practical Tips to Help Avoid State Enforcement Actions and Private Lawsuits

- Comply with Federal and State Consumer Protection Laws.
- Evaluate and comply with each state's debt adjusting laws (based on residence of consumer) and all other applicable laws (including tax requirements).
- Obtain all required authorizations, licenses and registrations (e.g., debt adjusting, telemarketing, authority to do business, etc.).
- Train Management and Staff
- Appoint a Compliance Officer
- Private Lawsuits - Consider utilization of an arbitration provision that, among various points, (1) avoids a form contract and small, illegible print that is difficult to read," (2) ensures that consumer expressly agrees to the arbitration clause," (3) ensures that clause is not cost prohibitive.
- More...



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Get Informed and Get Help

- Training is the key
 - Become familiar with state and federal laws that could affect your business
 - Industry associations and private firms provide resources to keep you informed

- Find someone who can help you make compliance with applicable rules part of your business



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Develop a Compliance Plan

- Plans will vary based on the needs of your company
- Certain elements are universal
 - Classification of Services (what is your business model?)
 - System for Screening Customers
 - System for Assessing Red Flags
 - State Compliance Requirements
 - Advertising and Marketing Review
 - Systems Reviews
 - Training
 - Recordkeeping



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Sometimes One Size Does Not Fit All

- Know Your Company
- May be appropriate to tailor plans for each business unit, subsidiary, state or jurisdiction
- Objective: Establish plans that reflect realities of the business and afford greater flexibility



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Failure to Focus on the Big Picture

- Legal: Failure to take into account all applicable laws
 - Consumer Protection Statutes (FTC Act, “mini”-FTC Act)
 - General Business registrations
 - Other statutes: federal and state credit repair, privacy laws, security breach laws, CAN-SPAM email, fax, and telemarketing statutes and registration
 - Foreign laws
- Operational: Failure to include employees who fall outside the standard customer relations system
 - Human Resources/Facility Managers
 - Personnel who interact with vendors

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Failure to Focus on the Details

- Legal: Failure to take into account all applicable provisions of the governing regulations
 - Changes to State Debt Adjusting Laws (and enforcement actions) and other statutes
 - FTC Disclosure Requirements
 - Compliance with complicated license conditions
 - Lead Generation (telemarketing, CAN-SPAM, fax, privacy laws)
- Operational: Failure to include employees who are responsible for maintaining relationship with customers
 - Customer Relations Department
 - Due Diligence on Vendors



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A Few Compliance Plans to Avoid

- The I Have a Dream Plan
 - Unrealistic or overly burdensome commitments
- The Set it and Forget it Plan
 - Over-reliance on automated systems
- Party Plan
 - Launched with fanfare and then languishes
- We Did What?
 - Failure to keep a written account of each of the key activities carried out under a compliance plan
- Is it too late?
 - Launched after enrolling x clients on the heels of a an enforcement action



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Final Thoughts

- Don't be Penny-Wise and Pound Foolish
- There is no "one-stop-shopping" in state law compliance.
- Customer satisfaction lessens, but does not eliminate, enforcement risk.
- Penalties for violating federal and state laws applicable to debt settlement can be severe, including:
 - Civil/Administrative penalties;
 - Criminal penalties, including fines and jail time;
 - Bans for industry and impediment to licensures.



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QUESTIONS AND DISCUSSION

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