

THE NEW UNIFORM DEBT-MANAGEMENT SERVICES ACT

In 2005, the National Conference of Commissions on Uniform State Laws approved the Uniform Debt-Management Services Act to address problems that have arisen in the credit counseling business. UDMSA will be introduced in state legislatures this year and will enable states to take a uniform approach to regulating a business that generally is national in scope. The 2005 Bankruptcy Code Amendments, which require credit counseling assistance prior to Chapter 7 filing, and several state laws that require credit counseling in connection with high cost mortgages and payday loans, have made adoption of the UDMSA urgent.

What Is Debt Management?

The UDMSA regulates 2 separate services offered to consumers in financial distress: *credit counseling* and *debt settlement*.

Credit counseling agencies help consumers with budgeting skills and enroll consumers in debt management plans. The goal of a debt management plan is to pay the full principal through regular, smaller monthly payments. Today's debt management plan generally debits a consumer's total monthly payments to the consumer's unsecured creditors from the consumer's deposit account and then disburses payments to the consumer's creditors. After a consumer has made several DMP payments, creditors typically give "concessions" in the form of reduced interest rates or forgiven late and other charges.

Credit counseling agencies are supported by fair share payments made by creditors, historically a percentage of the amount repaid to the creditor, and by consumer fees. Most of the existing credit counseling agencies have been organized as tax exempt entities to qualify for creditor payments and because many state laws prohibit debt adjustment, with exemptions from the prohibitions for tax exempt organizations, among others.

Debt settlement companies, on the other hand, negotiate with creditors to settle consumer debts for less than the full amount of the consumer's debt. The consumer is counseled to save up a war chest, and then the debt settlement company makes an offer to the creditor on the consumer's behalf to settle the debt. Debt settlement companies may or may not control the consumer's funds. Debt settlement companies are organized as taxable entities.

Why Was a Uniform Law Needed?

In the past 10 years, consumer debt has more than doubled. Between 2000 and 2003, the number of credit counselors more than doubled. Millions of people contact credit counseling agencies each year. The endorsement of credit counseling by state and federal legislatures assumes that, in fact, credit counseling benefits the consumer, but in 2003, this assumption began to be seriously questioned.

In their 2003 report, *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants*, the National Consumer Law Center and the Consumer Federation of America allege that debt management plans are increasingly expensive to consumers, educational and other services are not being provided by credit counselors and consumers are inappropriately enrolled in debt management plans. In addition, the report questions whether credit counseling agencies serve educational or charitable purposes and deserve tax exempt status. The Internal Revenue Service also issued a report examining abuses in the credit counseling industry in 2003. The Federal Trade Commission took action against several counseling agencies for engaging in unfair and deceptive trade practices and, finally, the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, United States Senate, began an investigation into the credit counseling industry in September 2003, resulting in its 2005 report on *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling*.

As a result of these concerns, the Internal Revenue Service currently is in the process of revoking the tax exempt status of over 50% of the industry, based on the number of debt management plans. In addition, United States Senate Bill 2020, the Tax Relief Act of 2005, proposes to limit the income credit counseling agencies may derive from debt management plans to 25% of overall income. If enacted, this restriction could drive the remaining tax exempt credit counselors out of business. All of this is happening at the same time that the Bankruptcy Code Amendments and state laws will require more consumers than ever to seek the services of non-profit credit counseling agencies.

How Does UDMSA Help?

No comprehensive federal law regulates credit counseling agencies or debt settlement companies. The federal Credit Repair Organization Act regulates organizations claiming to offer “credit repair services,” but unless debt management plans are marketed as a means to improving the consumer’s credit history, credit record or credit rating, most credit counselors do not offer credit repair services and are not subject to the CROA.

The states have a hodge podge of laws concerning debt management. Most state laws either prohibit or regulate debt management. Some states prohibit it, except for certain categories of persons, including, in some states, non-profit credit counselors. Other states license and regulate credit counselors, others license and regulate debt settlement companies and others license and regulate both. Most states that license and regulate set maximum fees for the activity. Some states have no law at all.

Faced with imminent loss of over half of the tax exempt credit counseling agencies, and possible loss of all of the tax exempt credit counseling agencies, many states with prohibitory laws will need to take immediate action. States that permit only tax exempt credit counseling will need to authorize for profit providers. Otherwise, credit counseling may not be available. The UDMSA fills an urgent need.

Highlights of the UDMSA

The UDMSA accommodates both for profit and tax exempt debt management services providers. The UDMSA regulates providers who enter into agreements with individuals to create plans. Provided that the individual is a natural person, the Act will apply, whether or not the debts involved are for business or consumer purposes. A number of businesses, including banks and their regulated affiliates, are exempt.

To provide debt management services to a state resident, the provider must be registered or licensed within the state. To register, the applicant must provide the regulatory authority with comprehensive background information, maintain insurance, post a surety bond, and meet levels of competency.

With respect to entering an agreement with the consumer, the UDMSA specifies certain important disclosures and terms of the agreement. Maximum fees are specified. A number of consumer protections are required. The UDMSA requires providers: to act in good faith; to maintain toll-free communications that permit clients to speak with a counselor during business hours; and to determine that the debt management plan is suitable for the consumer. Consumer funds must be held in a trust account.

Both private and public enforcement, including recovery of minimum, actual and punitive damages, are included.

Because many providers offer services on a nationwide basis, the UDMSA has very clear rules on which state law applies to particular transactions.

Closing

The Consumer Financial Services Committee was well represented during the drafting process. Michael M. Greenfield was the reporter and I served as the American Bar Association Advisor. I have the pleasure of representing tax exempt and for profit credit counselors and a debt settlement company and am very familiar with the challenges facing debt management service providers. If anyone has questions about the UDMSA, credit counseling or debt settlement, feel free to get in touch with me at cwitzel@gfirlaw.com.