Date of Hearing: April 15, 2021

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Timothy Grayson, Chair
AB 1405 (Wicks) – As Amended March 25, 2021

SUBJECT: Debt settlement practices

SUMMARY: This bill establishes the Fair Debt Settlement Practices Act (Act) to prohibit debt settlement companies from engaging in specified practices or acts and to authorize a harmed consumer to bring a civil action against the provider by debt settlement companies. Specifically, **this bill**:

1) Prohibits a debt settlement provider (provider), as defined, from engaging in the following false, deceptive, or misleading act or practice when providing debt settlement services, as defined:

    a) Make or allow another entity to publicly make on behalf of the provider, a statement or representation that is false, deceptive, or misleading.

    b) Post directly, or indirectly cause to be posted, an online review or ranking on an internet website if the provider, or its agent, provided anything of value in exchange for favorable treatment in that review or ranking.

    c) Commit the knowing omission of any material information.

2) Requires a provider to give a consumer specified disclosures, including a cautionary disclosure containing information such as there is no guarantee that a particular debt or all debt will be reduced or eliminated and that the consumer is still required to pay all bills unless the creditor states otherwise. Each contract must list each debt to be serviced, the estimated time it will take the consumer to complete the contract's required payments, and the method the provider will use to calculate charges and fees.

3) Prohibits a provider in engaging in the following abusive or deceitful acts or practices:

    a) Failing to comply with restrictions in Proraters Law that prohibits a prorater from lending money or credit.

    b) Offering payment in exchange for a referral.

    c) Accepting any cash or compensation from any person other than the consumer in connection with the service.

4) In addition to the acts defined in #3, specifies the following acts or practices are abusive or deceitful when a debt settlement provider engages in them or knows, or has reason to know, that another debt settlement company providing debt settlement services to the same consumer engages in them:

a) For a provider that offers services to assist a consumer with debt settlement or modifying the terms of an extension credit, failing to comply with the fee structure defined in Proraters Law.

b) Failing to distribute a statement of accounting on the specified schedule

c) Failing to include specified information in the statement of accounting.

5) Authorizes a consumer to terminate a contract for services at any time without a fee or penalty of any sort by notifying the provider by specified means, which will deemed effective immediately upon being sent. The provider must immediately cancel the contract and refund the consumer all unearned money held in the consumer's settlement account within three business days.

6) Specifies that the contract between the consumer and provider is void if the consumer is sued by a credit for a debt that is included in the contract. The provider must return all charges and payments, excluding payments already distributed to a creditor, received from the consumer.

7) Exempts from the Act any tax-exempt nonprofit that does not receive compensation for providing services, attorney sand law firms that meet specified criteria, including that the attorney's services do not result in charges or costs regulated by the Act.

8) Authorizes a consumer who suffers damage as a result of a provider may bring a civil action against the provider. The consumer may be awarded civil penalties between $1,000 and $5,000 per violation, compensatory damages, reasonable attorney's fees and costs, and injunctive relief. Any action taken must commence within four years after either the last payment by, or on behalf of, the consumer pursuant to the contract or the date on which the consumer discovered the facts given rise to the claim.

EXISTING LAW:

1) Provides the Check Sellers, Bill Payers, and Proraters Law, administered by the Department of Financial Protection and Innovation (DFPI), which requires a prorater to be licensed and subject to provisions of the Proraters Law, as specified (Financial Code Section 12000 et seq.).

a) Defines a prorater as 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 among creditors in payment or partial payment of the obligations of the debtor (Financial Code Section 12002.1).

b) Limits the fees that may be charged by a prorater, or by any other person for the prorater's services, to an origination fee of up to $50, plus 12% of the first $3,000 distributed by the prorater to the creditors of a debtor; 11% of the next $2,000; and 10% of any of the remaining payments, except for payments made on recurrent obligations, as defined (Financial Code Section 12314).

c) Requires a contract between a prorater and debtor to list every debt to be prorated with the creditor's name and disclose the total of all such debts, provide payments reasonably

within the ability of the debtor to pay in precise terms, disclose in precise terms the rate and amount of the prorater's charge, and disclose the approximate number and amount of installments required to pay the debts in full (Financial Code Section 12319).

2) Provides the California Consumer Financial Protection Law (CCFPL), which authorizes DFPI to require covered persons to register with the department (Financial Code Section 90000 et seq.).

   a) Defines "covered person" as a person that engages in offering or providing a consumer financial product or service to a resident of this state and affiliates or service providers, as specified. Includes in the definition of "financial product or service" a service to assist a consumer with debt management or debt settlement, modifying the terms of any extension of credit or avoiding foreclosure (Financial Code Section 90005).

FISCAL EFFECT: This bill is keyed nonfiscal by Legislative Counsel

COMMENTS:

1) PURPOSE

According to the author:

> With many Californians struggling financially from the COVID-19 pandemic, it is important to ensure that consumers who are facing economic challenges are protected from predatory companies that may worsen their financial situations. Debt settlement companies have been loosely regulated and target vulnerable consumers with misleading advertisements and deceptive practices. Current law has not reflected the changing practices of this industry, which has made enforcement more difficult. AB 1405 will provide oversight and regulation on bad actors in the debt settlement industry by updating current law to provide essential guardrails and provide basic consumer protections for Californians to prevent vulnerable consumers from predatory business practices.

2) BACKGROUND

According to the Federal Trade Commission (FTC), debt settlement is an example of debt relief services where a company claims to settle customers' debts for less than the full balance. The FTC provides the following example:

> Company A advertises a program to help people settle their credit card debts for less than what they owe. It requires customers to set aside monthly payments as savings. Company A waits until there is enough money in the account to make an offer to the creditor or debt collector. It negotiates an offer from the creditor or debt collector to settle the debt and gets the customer's approval. The customer pays the reduced amount to settle the debt.

Industry stakeholders argue that debt settlement companies provides a valuable service to individuals and households overwhelmed by debt and creditors. According to the American Fair Credit Council (AFCC), debt settlement companies advocate on behalf of consumers by negotiating directly with their creditors to achieve reductions in the amount they owe.

Importantly, the AFCC acknowledges that debt settlement programs "are not for everyone" and that debt settlement companies do not accept every consumer requesting their services.[1] According to the industry, debt settlement companies accept just between 10-20 % of individuals seeking their services, and companies conduct a thorough suitability assessment before taking on a new customer.

While debt settlement companies may provide a valuable service to a certain cohort of consumers, advocates and governmental bodies have sounded the alarm on some of the harmful practices within the industry. The federal Consumer Financial Protection Bureau (CFPB) notes that a consumer may be worse off financially after using a debt settlement service than before and issues the following warnings to consumers about the industry:

- Debt settlement companies often charge expensive fees.
- Some of your creditors may refuse to work with the company you choose.
- In many cases, the debt settlement company will be unable to settle all of your debts.
- If you do business with a debt settlement company, the company may tell you to put money in a dedicated bank account, which will be managed by a third party. You may be charged fees for using this account.
- Working with a debt settlement company may lead to a creditor filing a debt collection lawsuit against you.
- Unless the debt settlement company settles all or most of your debts, the built up penalties and fees on the unsettled debts may wipe out any savings the debt settlement company achieves on the debts it settles. [2]

3) SOME RECENT HISTORY

This bill follows a series of efforts over the past few decades to establish clear state oversight over debt settlement companies and their activities. Some of these attempts have tried to use an existing framework established under the Prorater's Law, which governs the activities of proraters (someone who, for compensation, distributes a debtor's funds among creditors in full or partial payment). Other attempts have tried to create entirely new licensure programs for debt settlement companies.

One challenge for policymakers is that the nature of debt relief services has changed substantially since the Proraters Law was drafted nearly 70 years ago. In 2005, the Commissioner of the Department of Corporations (a predecessor to DFPI) sought to enforce Prorater's Law licensure requirements against certain types of debt settlement companies, but few companies complied. And while some state and local law enforcement agencies have succeeded in stopping several debt settlement companies from operating without a license, the Proraters Law contains several deficient provisions that complicate the implementation of the licensing law related to debt settlement services. Those provisions included a broad exemption for attorneys and, until last year, a prohibition on licensees engaging in activities outside of California.

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[1] https://americanfaircreditcouncil.org/facts-about-debt-settlement/

[2] https://www.consumerfinance.gov/ask-cfpb/what-are-debt-settlementdebt-relief-services-and-should-i-use-them-en-1457/

As modern debt settlement services proliferated in the 2000s, the Legislature considered three industry-sponsored bills that would have enacted an updated approach to regulating debt settlement activities through a new licensure program, starting with AB 2611 (Lieu) of 2008. After the three industry-sponsored measures failed passage, consumer groups sponsored SB 708 (Corbett) of 2011, but the bill also failed passage. One major issue that could not garner legislative consensus was whether or how to institute a fee cap on what a provider may charge.

4) EFFORTS IN 2020 AND THE CREATION OF DFPI

This bill is a direct follow-up to AB 2524 (Wicks), Chapter 159, Statutes of 2020, which was initially introduced to update the Prorater's Law to ensure the proper licensure of debt settlement companies. The earlier versions of AB 2524 proposed a fee cap and other disclosure and reporting requirements for licensees. Like previous legislative efforts, one major source of contention was how to place a fee cap on these services. When AB 2524 reached the Senate, the bill's original provisions were removed, and the new version of the bill deleted sections in Prorater's Law – discussed above in Comment #3 – prohibiting a licensee from doing business outside of California. While the chaptered version of AB 2524 did not reflect the author's original intent, it nevertheless made a necessary change in Prorater's Law to possibly allow for more oversight of debt settlement in California.

As AB 2524 was moving through the legislative process, the Legislature was also considering the Governor's proposal to reorganize the Department of Business Oversight (DBO) into a renamed department with broader authority to regulate consumer financial products. AB 1864 (Limon), Chapter 157, Statutes of 2020, established DFPI and the new California Consumer Financial Protection Law (CCFPL). The CCFPL authorizes DFPI to increase its activity in several areas, such as overseeing and regulating unlicensed financial products and services licensed. Debt settlement services is just one of the services covered under DFPI's new authority.

We do not yet know the full impact of AB 2524 or AB 1864 on debt settlement companies. DFPI is in the early stages of implementing the CCFPL and indications are that the department will start registering newly covered entities in 2022-23. According to the department's website, the department intends to file the proposed registration rulemaking package with the Office of Administrative Law by the end of 2021.

DFPI's new authority raises the question of whether AB 1405 is strictly necessary. In response to this question, the California Low-Income Consumer Coalition (CLICC) argues the following:

> The DFPI is of course able to monitor, supervise, or promulgate rules to regulate debt settlement companies as covered persons under AB 1864. Any such rules could not contradict, but could supplement, the provisions of AB 1405. It's worth noting that the Department would likely take years to promulgate a rule, while the need for this bill is urgent -- the pandemic and recession have put millions of Californians into debt and the debt settlement industry has them in its sights. Providing guardrails for an industry that puts consumers at such risk (even when it works as intended) is a pressing *legislative* matter.

5) WHAT THIS BILL DOES

This bill creates the Fair Debt Settlement Practices Act to establish rules on debt settlement activities and to give harmed consumers additional legal tools. Notably, this bill's provisions are located in the Civil Code, similar to other programs that address consumer financial products or services, such as the Consumer Legal Remedies Act, the Fair Debt Buying Practices Act, the Student Borrower Bill of Rights, and check cashers law.

Notable areas of focus include:

a) Accurate information and marketing: This bill prohibits a debt settlement provider from making a false, deceptive, or misleading statement, knowingly omitting material information, or providing anything of value in exchange for favorable treatment in an online review or ranking.

b) Contract disclosures. This bill requires each contract between a provider and consumer to include a range of information related to the settlement process, such as information on fee and payment structures and possible risks to consumers.

c) A cap on fees charged to consumers This bill applies the existing fee cap for a prorater to all debt settlement providers. That fee structure is as follows: An origination fee of up to $50, plus 12% of the first $3,000 distributed by the prorater to the creditors of a debtor; 11% of the next $2,000; and 10% of any of the remaining payments, except for payments made on recurrent obligations.

d) Voiding the contract. This bill voids a contract between the consumer and the debt settlement company if a creditor sues the debtor for any debt included in the contract. In theory, this could encourage the company to settle debts as quickly as possible as well as make it less burdensome for the consumer to walk away from a contract that was not serving their best interests.

e) Private right of action: Under this bill, a harmed consumer may bring a civil action against a debt settlement company A private right of action will provide a debtor with an option to recover damages due to violations of the law by a debt settlement company.

6) PROPOSED AMENDMENTS

After discussions with the author's office, supporters, and opponents, the committee recommends the following amendments:

a) Strike out the provision that voids the contract when a customer is sued by a creditor (Sec 1788.302. (d)(2)).

Rationale: This bill provides that a contract between a debtor and a debt settlement company is void if a creditor sues the debtor for a debt that is included in the contract. This provision places significant liability risk on a debt settlement company. Even if the debt settlement company operates in good faith, some creditors may still refuse a settlement offer. In such a case, the creditor could sue the debtor for unpaid debts, and the debt settlement company would be required to refund all collected fees to the debtor.

b) Eliminate reference to fee in Proraters Law (Sec. 1788.302 (c)(4)(A)).

Rationale: This bill applies an existing fee structure in Proraters Law to debt settlement companies more broadly. A fee cap is appropriate, but this fee structure may not be suitable for all debt settlement companies. Importantly, this fee may still apply to some debt settlement providers who otherwise meet the definition of a prorater under current law.

7) ARGUMENTS IN SUPPORT

CLICC, a coalition of legal aid and consumer advocacy organizations, writes in support of the bill:

> AB 1405 would update current law to provide essential guardrails for an industry too often characterized by promises of relief that actually put already-struggling Californians at risk of further financial harm. Millions of Californians have been forced by the pandemic to take on large amounts of debt. This bill would help prevent them from falling victim to companies that seek to take advantage of their economic vulnerability. The bill provides clear guidelines to protect consumers – and honest competitors – from companies engaged in harmful business practices. The bill provides consumers with significantly more protection than they receive under current federal law while requiring modest but essential additional measures by debt settlement

8) ARGUMENTS IN OPPOSITION

AFFC, a trade association of debt settlement companies, writes in opposition of the bill:

> Consumer debt settlement serves a vital role for Californians and gives economic relief to those who are struggling financially. As the state emerges from the COVID-19 crisis, financially challenged consumers need more, not fewer, tools to address their financial needs. Prohibiting consumer debt settlement would eliminate the opportunity for such consumers to realize significant savings, potentially leaving them subject to debt collection lawsuits and, in many cases, forcing them into bankruptcy.

The letter also lists three aspects of AB 1405 that are most concerning to AFCC: the proposed fee structure, the voiding of a contract when a customer is sued by a creditor, and the bill's location in the Civil Code. Two of these issues are addressed through the committee's proposed amendments.

REGISTERED SUPPORT / OPPOSITION:

Support

California Low-Income Consumer Coalition
California Association for Micro Enterprise Opportunity
Consumer Federation of California
National Consumer Law Center
One Main Financial

Public Counsel

Opposition

American Fair Credit Council
Consumer Debt Relief Initiative
American Association of Senior Citizens
Finxera, INC.

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