

Date of Hearing: May 19, 2020

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Monique Limón, Chair

AB 2524 (Wicks) – As Introduced February 19, 2020

SUBJECT: Proraters

SUMMARY: Amends the Check Sellers, Bill Payers and Proraters Law with the intent to ensure a provider of debt settlement services is required to be licensed as a prorater pursuant to the law. Restricts charges that a prorater can receive to five percent of the savings from a completed settlement and specifies requirements and prohibitions related to debt settlement services.

Specifically, **this bill:**

- 1) Amends the definition of “prorater” to mean a person or entity who, for compensation and on behalf of a debtor, engages in whole or in part in the business of receiving or soliciting money or evidences thereof, or processing payment for the purpose of distributing the money or evidences thereof among creditors in payment or partial payment of the obligations of the debtor.
- 2) Defines “debt settlement services” to mean any of the following:
 - a. Offering to provide advice, or offering to act or acting as an intermediary between a debtor and one or more of the debtor’s creditors, if the primary purpose of that advice or action is to obtain a settlement for less than the full amount of debt, whether in principal, interest, fees, or other charges, incurred primarily for personal, family, or household purposes including, but not limited to, offering debt negotiation, debt reduction, or debt relief services.
 - b. Advising, encouraging, assisting, or counseling a debtor to accumulate funds in an account for future payment of a reduced amount of debt to one or more of the debtor’s creditors.
- 3) Defines “settlement account” as a depository account used for the purpose of holding funds of a debtor to be distributed to a creditor in the event of a settlement of the debtor’s debt with the creditor.
- 4) Restricts the exemption in current law related to attorneys to apply only to attorneys and law firms that meet the following criteria:
 - a. The services rendered by the attorney or law firm do not result in charges or costs regulated by the Check Sellers, Bill Payers and Proraters Law (hereafter referred to as “the Proraters Law” in this analysis).
 - b. The fees and disbursements are not charges or costs shared, directly or indirectly, with the prorater or check seller.
 - c. Any of the following are true:

- i. The attorney or law firm is retained by the debtor for the purpose of legal representation in consumer debt litigation.
 - ii. The attorney or law firm provides debt settlement services pursuant to representation by retainer for a debt collection matter that does not involve consumer debt.
 - iii. The attorney or law firm is retained by the debtor primarily for purposes other than the settlement of consumer debt.
- 5) Exempts from the Proraters Law any nonprofit business organization that is certified as tax-exempt by the Internal Revenue Service and that does not receive compensation from the debtor for providing debt settlement services.
- 6) Amends the information required to be contained in an application for a license to include information about an applicant's history of legal actions related to financial fraud or misuse and a copy of each form of agreement and the schedule of fees and charges that the applicant will use with debtors.
- 7) Repeals the provision of the Proraters Law that restricts a license from being issued to any entity except a corporation organized under the laws of California.
- 8) Repeals the provision of the Proraters Law that restricts a licensee from engaging in business activity covered by the Proraters Law at any location outside of California.
- 9) Prohibits a prorater from specified acts related to deception or misrepresentations.
- 10) Restricts the charges that a prorater can receive to percent of the savings from a completed settlement, calculated as the difference between the amount of debt at enrollment and the settlement amount.
- 11) Restricts the total monthly payment by a debtor into a debt settlement trust account to a maximum of 10 percent of the debtor's monthly net income, as specified.
- 12) Provides that if a debtor is sued by a creditor for a debt that is included in the contract with the prorater, the prorater's contract with the debtor shall be void, and the prorater shall return to the debtor all charges and payments, excluding payments distributed to a creditor, received from the debtor for all debts placed with the prorater for settlement.
- 13) Permits a debtor to terminate a contract with a prorater at any time without penalty, as specified.
- 14) Requires a contract between a debtor and prorater to include specified disclosures.
- 15) Requires a prorater to send specified forms to a debtor related to federal income taxes.
- 16) Requires a prorater to provide a monthly statement containing specified information related to activity covered by the debt settlement services contract.
- 17) Requires a prorater to file an annual report with the Department of Business Oversight that contains specified information about the prorater's debt settlement activities.

- 18) Provides a private right of action to a debtor who is a party to a contract that does not comply with specified sections of the Proraters Law.
- 19) Provides remedies that may be sought by a plaintiff, including civil penalties in an amount to be determined by the court of no less than one thousand dollars (\$1,000) and no more than five thousand dollars (\$5,000) per violation, compensatory damages, reasonable attorney's fees and costs, and injunctive relief.

EXISTING STATE LAW:

- 1) Provides the Check Sellers, Bill Payers, and Proraters Law, administered by the Department of Business Oversight (DBO), which requires a prorater to be licensed and subject to provisions of the Proraters Law, as specified. (Financial Code Section 12000 et seq.)
- 2) 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)
- 3) 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 percent of the first \$3,000 distributed by the prorater to the creditors of a debtor; 11 percent of the next \$2,000; and 10 percent of any of the remaining payments, except for payments made on recurrent obligations, as defined. (Financial Code Section 12314)
- 4) Prohibits a prorater from receiving any fee unless they have the consent of at least 51 percent of the total amount of indebtedness and of the number of creditors listed in the prorater's contract with the debtor, or unless a like number of creditors have accepted a distribution of payment. (Financial Code Section 12315)
- 5) 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)
- 6) Provides for administrative penalties of up to \$2,500 per violation of the Proraters Law, and states that any licensee or person who willfully violates any provision of the law, or any rule or order adopted pursuant to the law, is liable for a civil penalty of up to \$10,000, enforceable by the Commissioner of DBO. (Financial Code Section 12105)

EXISTING FEDERAL LAW:

- 1) Provides the Telemarketing Sales Rule, enforced by the Federal Trade Commission, which regulates a broad range of sales activities conducted over the telephone, including prohibiting for-profit companies that sell these services over the telephone from charging a fee before they actually settle or reduce a consumer's debt, prohibiting debt relief providers from making misrepresentations, and requiring that debt relief providers disclose key information that consumers need in evaluating debt relief services.

FISCAL EFFECT: Unknown.

COMMENTS:

1) PURPOSE

According to the author:

California consumers have been falling victim to online, direct mail, and radio advertisements of unlicensed debt settlement companies. Consumers who look to debt settlement companies to help get out of debt often find themselves in more trouble with damaged credit scores and increased lawsuits. AB 2524 will allow the state to hold these companies accountable by fixing language that restricts licensing of debt settlement companies and updates the law to protect consumers against deceptive practices from deceptive debt settlement companies.

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.

Since at least the early 2000s, debt settlement companies have operated in California without state oversight. Around 2005, the Commissioner of the Department of Corporations (a predecessor to DBO) sought to enforce the licensure requirement of the Proraters Law against debt settlement companies that were engaging in business activity that fell under the definition of a "prorater," but few companies complied. Over the past two decades, state and local law enforcement agencies have succeeded in stopping several debt settlement companies from operating without a license, but the Proraters Law contains several deficient provisions that complicate the implementation of the licensing law related to debt settlement services, including a broad exemption for attorneys and a requirement for a prorater to be incorporated in California.

The nature of debt relief services and the risks these services pose to consumers' financial well-being have changed substantially since the Proraters Law was drafted. The initial provisions of the Proraters Law were enacted in 1947 with specific provisions related to proraters being added in 1957. 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, 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. The major issue that could not garner legislative consensus was whether or how to institute a fee cap on what a provider may charge for their services.

This bill represents the first attempt since 2011 to enact a regulatory framework for debt settlement services. Partially due to the poor statutory construction of the Proraters Law, DBO currently licenses only two companies as proraters, despite dozens of debt settlement companies widely advertising their services to California consumers. Based on information provided by industry participants, it is likely that tens of thousands of Californians engage with unlicensed debt settlement companies each year.

3) UNLICENSED DEBT SETTLEMENT MAY POSE RISKS TO CONSUMERS

California law does not clearly authorize the state to require licensure and oversight of debt settlement companies despite the well-known risks that these companies can pose to consumers. The federal Consumer Financial Protection Bureau (CFPB) issued the following warning to consumers about debt settlement companies:

Debt settlement may well leave you deeper in debt than you were when you started. Most debt settlement companies will ask you to stop paying your debts in order to get creditors to negotiate and to collect the funds required for a settlement. This can have a negative effect on your credit score and may result in the creditor or debt collector filing a lawsuit while you are collecting settlement funds. And if you stop making payments on a credit card, late fees and interest will be added to the debt each month. If you exceed your credit limit, additional fees and charges may apply. This can cause your original debt to increase.¹

The CFPB also warns of the following additional risks to consumers:

- 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.

4) HOW THIS BILL APPROACHES THE PROBLEM

The author states her intent for this bill as to “hold [debt settlement] companies accountable by fixing language that restricts licensing of debt settlement companies and [updating] the law to protect consumers against deceptive practices from deceptive debt settlement companies.” To this end, the major provisions of the bill can be generally categorized in five buckets: limitations on charges for debt settlement services, monthly payment limitation,

¹ <https://www.consumerfinance.gov/ask-cfpb/what-are-debt-settlementdebt-relief-services-and-should-i-use-them-en-1457/>

enforcement mechanisms, transparency and reporting requirements, and amendments to licensing law to cover debt settlement companies.

Limitations on charges for debt settlement services

This bill proposes to cap charges for debt settlement services at five percent of the savings from a completed settlement, calculated as the difference between the amount of debt at enrollment and the settlement amount. As an example, take a debtor who enrolled \$30,000 of debt with a debt settlement company. The debt settlement company negotiates with the debtor's creditors and arrives at a settlement amount of \$20,000. In this example, a debtor would pay the debt settlement provider \$500 assuming the provider charged the maximum permitted by law, and the debtor would realize savings of \$9,500.

The preceding example assumes that a debt settlement company would provide the service if constrained by the proposed 5% cap on charges. Opponents of this bill assert that they would not provide debt settlement services in California if such a cap were enacted. Due to a lack of publicly available data on financial information related to providing debt settlement services, Committee staff cannot verify this assertion, but acknowledges that debt settlement activity is likely lower in states that restrict fees than in states that do not restrict fees. The proposed cap would probably incentivize debt settlement companies to provide services only to debtors with very high debt burdens, assuming that services are offered to California debtors at all.

Monthly payment limitation

This bill prohibits the monthly payment from a debtor into a debt settlement account from exceeding ten percent of the debtor's monthly net income. The purpose of this provision is to ensure a debtor has sufficient income to meet the monthly payment obligation to the settlement account, in addition to the debtor's other obligations and living expenses. If enacted, the proposed payment limitation may have a positive outcome for some debtors and negative outcome for other debtors. A debtor with a high income may desire to settle their debts as fast as possible, and the proposed limitation could prolong the period before the debt settlement company can negotiate with creditors. In order to mitigate the potentially negative effects of the monthly payment limitation, the author may consider an income threshold over which the payment limitation either does not apply or is a higher portion of monthly net income.

Enforcement mechanisms

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. The likely intent of this provision is to incentivize a debt settlement company to settle all outstanding debts enrolled in the settlement program. While well intended, this provision places significant liability risk on a debt settlement company. Even if the debt settlement company operates in good faith and negotiates strongly on the debtor's behalf, 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.

Unlike other licensing laws that DBO administers, this bill would provide a private right of action to a debtor for violations of specified acts under the Proraters Law. Typically, licensing laws administered by DBO provide enforcement tools and remedies solely to DBO.

In the case of the Proraters Law, very few entities are subject to licensure under the existing statute, and the law does not require DBO to conduct examinations of licensees. 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.

Transparency and reporting requirements

Several provisions of the bill seek to increase transparency about debt settlement services, including at the time an application for licensure is reviewed by DBO, before a debtor enters an agreement with a debt settlement company, throughout the contractual relationship between the debtor and debt settlement company, and on an annual basis. These requirements are generally similar to requirements found in other licensing law administered by DBO. If enacted, the requirements would improve policymakers' understanding of how debt settlement companies serve California debtors. Additionally, the requirements would provide more information to a debtor about the value of debt settlement services.

Amendments to licensing law to cover debt settlement companies

This bill proposes to amend the Proraters Law to clarify its coverage of debt settlement services, rather than proposing a new, distinct licensing law for debt settlement companies. The bill makes several amendments to the Proraters Law that are intended to close loopholes or clarify vague language that could allow a debt settlement company to sidestep the law. These amendments include a slight modification of the definition of "prorater," the addition of definitions of "debt settlement services" and "settlement account," a narrowing of the exemption in current law related to attorneys, and repeals of state domicile requirements to ensure the Proraters Law covers companies organized or operating in other states.

5) ARGUMENTS IN SUPPORT

A coalition of legal aid and consumer advocacy organizations write in support of the bill:

A study by the Center for Responsible Lending shows that a consumer delinquent on her debts sees no improvement in her finances after three years of participating in a debt settlement program unless the program manages to settle more than two-thirds of her total debt. Existing law regulating debt settlement companies and the payment processors who work alongside is ambiguous in which entity involved in the debt settlement process should be held accountable for their broken promises of reducing or eliminating debt. AB 2524 will bring much needed clarification in law surrounding the regulation of ALL entities involved in the debt settlement company industry by:

- Clarifying the definition of prorater to include all actors
- Cap total fees to 5% of the savings to the customer
- Create a private right of action for consumers to sue proraters for damages
- Adopt required model disclosures so that consumers are aware of the consequences of entering into the contract
- Require regular reporting of information by proraters
- Require in-language contract conformity to Cal.Civ.Code §1632

- Remove limitation on Department of Business Oversight (DBO) licensing to only California entities

6) ARGUMENTS IN OPPOSITION

The American Fair Credit Council (AFCC), a trade association of debt settlement companies, writes in opposition of the bill:

As written, AB 2524 would make it impossible for the debt settlement industry to exist in California, leaving Californians in financial distress with no viable option for avoiding bankruptcy.

The letter states that AFCC opposes numerous provisions of the bill and identifies the most concerning provisions, as follows:

Capping fees at 5% of savings

Opposition states that the proposed fee cap is uneconomic, establishes perverse incentives for a debt settlement company to settle only the largest debts, and is confusing for debtors because they do not know the fee amount upfront.

Limiting monthly payment to 10% of net income

Opposition states that consumers should determine how much of their monthly income is devoted to settling their debts and that the proposed limitation is arbitrary.

Voiding contracts

Opposition states that unlimited economic risk would be created by the provision that requires a contract to be void if any creditor sues the debtor for a debt included in the contract with the debt settlement company. This provision would create a scenario where a debtor enrolls debts with five different creditors, settles four and then the remaining creditor sues, resulting in the entire contract being voided with all fees for the previously settled debts being refunded.

REGISTERED SUPPORT / OPPOSITION:

Support

California Low-income Consumer Coalition (Sponsor)

Bet Tzedek

California Asset Building Coalition

California Reinvestment Coalition

Californians for Economic Justice

Center for Responsible Lending

Consumer Federation of California

Consumer Reports

East Bay Community Law Center

Elder Law and Advocacy

Legal Aid Society of San Bernardino

National Consumer Law Center, INC.

New Economics for Women

Public Counsel

Public Law Center
Riverside Legal Aid
University of California Irvine, Consumer Law Clinic

Oppose Unless Amended

American Fair Credit Council (AFCC)

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