HB 1223

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 1223 (Delegate Feldman)
Economic Matters

Credit Regulation - Debt Settlement and Debt Management Services Providers

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This bill adds debt settlement services to the services currently licensed and regulated by the Commissioner of Financial Regulation under the Maryland Debt Management Services Act and renames the statute to be the "Maryland Debt Management and Debt Settlement Services Act." In addition to the bill's specific requirements, debt settlement services providers are subject to the existing licensing, examination, and regulatory requirements that currently apply to debt management services providers.

Fiscal Summary

State Effect: General fund revenues could increase minimally as a result of the bill's imposition of existing penalty provisions. Special fund revenues could increase by approximately $14,700 in FY 2009 as a result of licensing and investigation fee payments. Special fund expenditures could increase by approximately $44,900 in FY 2009 due to additional staff for the Commissioner of Financial Regulation. Future year estimates reflect the biennial licensing cycle, triennial examinations, annualization, and inflation.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	-	-	-	-	-
SF Revenue	14,700	9,700	2,000	10,700	2,000
GF Expenditure	-	-	-	-	-
SF Expenditure	44,900	55,400	58,200	61,200	64,300
Net Effect	($30,200)	($45,700)	($56,200)	($50,500)	($62,300)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local revenues could increase minimally as a result of the bill's imposition of existing penalty provisions.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill defines "debt settlement services" as acting, offering to act, or attempting to act, for consideration, as an intermediary between a consumer and the consumer's creditors for the purpose of settling or in any way altering the terms of payment of any debt. Under the bill, debt settlement services do not include debt management services, and only debt management services providers are required to be nonprofit organizations. The bill requires providers of debt management and debt settlement services to adhere to the licensing and regulatory requirements of the Maryland Debt Management and Debt Settlement Services Act.

The bill requires a person who provides both debt management services and debt settlement services to meet the individual requirements of and obtain separate licenses for each type of service. The bill amends the current licensing exceptions in order to exempt only those attorneys at law who are admitted to practice in the State and are not principally engaged as debt management or debt settlement services providers.

The bill requires both debt management and debt settlement services providers to be examined by the commissioner in accordance with a schedule established by the commissioner. In addition, the bill requires debt settlement services providers to meet the bonding requirements that currently apply to debt management services providers. Also, debt settlement services providers are subject to existing licensing and examination fees, as well as annual reporting requirements and criminal background checks.

The bill allows a person providing debt settlement services to Maryland consumers on the effective date of the bill to continue to provide such services without being licensed, until the commissioner approves or disapproves the person's license application, if the person applies for a license within 30 days after license applications are available and complies with all other provisions of the bill.

Specific Debt Settlement Licensee Requirements: In addition to other existing requirements, a licensed debt settlement services provider is required to provide consumer customers with a consumer education program. This program may be provided via the Internet if specific criteria are satisfied. Through an independently certified debt settlement counselor, the licensee is also required to • prepare a financial analysis of and an initial budget plan for the consumer's debt obligations; and • provide a copy this analysis and plan to the consumer. Furthermore, the licensee has to provide to the consumer, for all creditors identified by the consumer, a list of • the creditors that the licensee reasonably expects to participate in the settlement of the consumer's debt under the debt settlement services agreement; and • the creditors that the licensee reasonably expects not to participate. This information must be provided to the consumer and an agreement containing specific required information and disclosures must be executed before the debt settlement services provider may begin providing services to the consumer.

Prohibitions: The bill prohibits a debt settlement services licensee from • making a representation that a consumer's debt will be settled for a specific amount or reduced by a specific percentage; or • requiring or advising a consumer to stop making payments to any creditor of the consumer. Funds used to pay creditors in debt settlement must be deposited into an account not controlled by the debt settlement services provider.

Permitted Fees: A debt settlement services provider may only charge a consumer a consultation fee of $50 or less, and, upon completion of services, a maximum fee of 15% of the total amount by which the consumer's debt to creditors was reduced due to the services provided under the debt settlement services agreement. Licensees may accept voluntary contributions from a consumer for debt settlement services only if the aggregate amount of the contribution does not exceed the aforementioned authorized fee amounts. The bill allows a licensee to charge the consumer the amount allowable under current law for all dishonored checks.

Right of Rescission: A consumer may modify or rescind a debt settlement services agreement if the consumer is notified that a creditor listed as participating in the agreement declines to participate, and the licensee is required to provide the consumer with this notification. Upon rescission, a consumer is entitled to a refund of all unexpended funds that the consumer has paid to the debt settlement services licensee for the settlement of the consumer's debt.

Current Law: Under the Maryland Debt Management Services Act, providers of debt management services are required to be licensed by the Commissioner of Financial Regulation. Requirements for debt management services agreements between providers and consumers are established by the Act, which also establishes surety bond requirements for licensees and enforcement powers for the commissioner. "Debt management services" are defined by the Act as receiving funds periodically from a consumer under an agreement with the consumer for the purpose of distributing the funds among the consumer's creditors in full or partial payment of the consumer's debts.

A debt management services licensee must execute a debt management agreement with a consumer before collecting any fees for debt management services from the consumer. The licensee must provide to the consumer a list of • those services that are provided free of charge to consumers with a debt management services agreement, but for a charge to other consumers; and • those other services that the licensee provides along with the relevant charges. Licensees must also furnish a consumer with a written accounting of any fees. A licensee may only charge the fees authorized for debt management services, which are a consultation fee of up to $50 and a monthly maintenance fee of up to $8 for each creditor listed in the agreement, up to $40 per month.

Debt management services providers are subject to a biennial licensing fee schedule. The fee for the full two-year license ranges from $1,000 to $8,000 based on the applicant's gross annual revenue. New licensees in even-numbered years pay the full two-year fee, while new licensees in odd-numbered years pay half of the two-year fee, and all licenses expire at the end of December in odd-numbered years. All licensees pay a $100 fee for each location in the State at which services are provided, upon initial application and license renewal. In addition, all initial license applicants are required to pay a $1,000 investigation fee. Licensees are subject to examination by the commissioner and are required to pay for examination costs incurred by the commissioner.

Violations of the Act are felonies, subject to a fine of up to $1,000 for the first violation and $5,000 for each subsequent violation, up to five years' imprisonment, or both. The Act also authorizes a private right of civil action to seek damages for a violation, with court costs and reasonable attorneys' fees. The commissioner may impose a civil penalty of up to $1,000 for violations of cease-and-desist orders.

Background: Debt management and debt settlement services providers act as intermediaries between debtors and creditors. Debt management services providers typically offer to assist individual consumer debtors by helping them obtain lower interest rates, waivers of late fees, and favorable debt repayment plans. These companies often charge a single monthly payment from the debtor and use these funds, minus a commission fee, to repay the debtor's creditors. In some cases, such service providers are also able to supplement the commission earned from the debtor with rebates obtained from creditors. It is not unusual for debt management commissions to be 10% or more of the debtor's monthly payment.

Debt settlement services providers, on the other hand, typically attempt to negotiate on behalf of a debtor with the debtor's creditors in order to obtain a lump-sum pay-off amount that is much lower than the outstanding debt. In many cases, the debt is lowered by 30% to 70% of the outstanding balance. Debt settlement services providers also charge the debtor a substantial fee for their services.

The number of organizations providing debt management and settlement services, both nonprofit and for-profit, has risen dramatically in the past decade as the national rate of consumer debt has soared. In 2003, Maryland created a licensing and regulation system for debt management services providers through Chapters 374 and 375, and established a debt management regulation special fund that is administered by the Commissioner of Financial Regulation. In 2005, Chapter 574 amended the licensing requirements in order to determine the biennial license fee based on the gross annual revenue of a debt management services provider. Debt settlement services providers were not included in any of these pieces of legislation, because they do not receive payments from a consumer periodically.

Under current State law, for-profit entities are not permitted to be licensed as debt management services providers. Recently, the Internal Revenue Service revoked the tax-exempt status of a number of debt management firms because they were deemed to be for-profit entities, and as a result several such companies lost their State licenses. When debt management services began to grow in popularity, many believed that for-profit companies would charge exorbitant commissions and that nonprofits would simply be performing a public service, but as the IRS discovered, many debt management services providers have used their nonprofit classification fraudulently.

There are currently 36 debt management services companies licensed in Maryland, 9 of which are still challenging determinations by the IRS that revoked their tax-exempt status. SB 646 of 2008 would allow for-profit entities to become licensed by the State as debt management services providers. The Commissioner of Financial Regulation estimates that approximately 25 to 35 debt settlement services providers operate in Maryland, but that only 5 to 10 of these providers would continue to operate under the bill's licensing and regulatory scheme due to the bill's sharp limitations on profits that would likely reduce such companies' earnings by around 50%.

State Revenues: General fund revenues could increase minimally as a result of the bill's imposition of existing penalty provisions. Special fund revenues could increase by approximately $14,700 in fiscal 2009, due to license and investigation fees paid by debt settlement services providers. This estimate reflects the Commissioner of Financial Regulation's projection that approximately seven debt settlement services providers would become licensed under the bill's requirements in fiscal 2009, each paying the minimum initial licensing fees by December 2008 (or fiscal 2009), with initial renewal in December 2009 (or fiscal 2010) and subsequent renewals every two years thereafter. The estimate also reflects the commissioner's projection that no new debt settlement services providers would seek to become licensed in future years. Examinations are assumed to take place on the existing three-year rotation schedule used for debt management services providers beginning in fiscal 2010, with each new examinee paying a fee of at least $1,000 for the examination.

Thus, special fund revenues could increase by $9,700 in fiscal 2010, $2,000 in fiscal 2011, $10,700 in fiscal 2012, and $2,000 in fiscal 2013. To the extent the debt settlement services providers that become licensed have greater assets and operate at multiple locations, fee revenues would be greater.

State Expenditures: General fund expenditures could increase minimally as a result of the bill's imposition of existing penalty provisions. Special fund expenditures could increase by an estimated $44,936 in fiscal 2009, which accounts for the bill's October 1, 2008 effective date. This estimate reflects the cost of hiring one additional financial examiner to assist the Commissioner of Financial Regulation in examining and regulating debt settlement services providers. The estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses. The Department of Labor, Licensing, and Regulation reports that the current balance of the special fund is approximately $100,000.

Position	1
Salary and Fringe Benefits	$39,638
Operating Expenses	5,298
Total FY 2009 State Expenditures	**$**44,936

Future year expenditures reflect • full salary with 4.4% annual increases and 3% employee turnover; and • 2% annual increases in ongoing operating expenses.

Small Business Effect: To the extent that any debt settlement services providers are classifiable as small businesses, such providers would experience a significant negative financial impact. Debt settlement services providers, who typically charge fees of approximately 30% of the amount of debt reduction, would be limited to charging 15% plus a $50 consultation fee. In addition, such businesses would have a significant increase in costs due to licensing and investigation fees, examination fees, and bonding requirements.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

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