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SFA**BILL ANALYSIS**

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Senate Bill 1056 (Substitute S-2 as passed by the Senate)

Sponsor: Senator Michael J. Bouchard

Committee: Financial Services

Date Completed: 5-29-98

RATIONALE

The Debt Management Act was enacted in 1975 and replaced a 1961 law that regulated debt management businesses, or credit counselors. Essentially, a debt management business enters into a contract with a debtor to manage the payment of his or her financial obligations. The business develops a payment plan that is acceptable to the debtor's creditors, collects money on the debtor's behalf, and disburses payments to the creditors. A debt management business may be nonprofit or for-profit, and must be licensed by the Department of Consumer and Industry Services. Apparently, there are approximately eight nonprofit and two for-profit licensees in Michigan.

The Act has not been amended since its enactment, and a number of developments have occurred in the past 20-some years. For example, some nonprofit debt management businesses evidently have trouble finding voluntary directors because of the rigorous investigation of licensees' officers and directors that the Department must conduct. Also, after a debtor's obligations have been paid, the debtor sometimes will return to the debt management business for additional assistance; the Act does not provide for the business to charge a fee under these circumstances, however. In addition, reportedly it is common and accepted practice for debt management companies to use a so-called "sweep arrangement" in which some payments received from or on behalf of debtors are briefly placed in interest-bearing accounts before being distributed to creditors. This practice apparently arose after the law was enacted and is not reflected in the Act.

It has been suggested that the Act should be revised to accommodate these and other situations.

CONTENT

The bill would amend the Debt Management Act to do the following:

- Increase the maximum term of a contract between a licensee and a client from 24 to 60 months.
- Provide for the waiver of additional surety bonds if an applicant for licensure had more than 10 offices.
- Specify individuals who would have to be investigated when an application was filed and fees were paid.
- Provide for electronic record-keeping, and specify that trust accounts could be reconciled electronically or by other methods.
- Require licensees annually to verify payments to selected creditor accounts and review certain items.
- Provide that a client's fee would have to be returned if 51% of the creditors did not approve a debt management plan.
- Provide that a creditor's consent to a debt management plan could be sought by telephone, facsimile, electronic mail, or first-class mail.
- Allow a licensee to charge a fee for providing advice or materials or making a referral.
- Allow a licensee to use a sweep arrangement under certain circumstances.

License Application

Under the Act, an applicant for a license must file an application with the Department of Consumer and Industry Services (DCIS), pay a \$50 license fee and a \$50 investigation fee, and furnish a \$5,000 surety bond for each office established by the applicant. The bill would retain these requirements, but provides that if an applicant established more than 10 offices engaged in the business of debt management in this State and for which a surety bond had been furnished, the surety bond prescribed by the Act would be waived for any additional office subsequently established.

The bill also specifies that, in lieu of the surety bond, the Corporation, Securities, and Land Development Bureau (in the DCIS) could by rule provide for an appropriate deposit of cash or securities or the assignment of the coverage of other surety bonds if the Department Director were satisfied that comparable or more extensive coverage would result.

Currently, a licensee must submit for approval concurrently with the application a blank copy of the contract form to be used between the debtor and the licensee, the budget analysis form, and the creditor's agreement form, and must submit all changes for approval to the Bureau. The bill provides, instead, that a contract form or other form could not be used without the Bureau's approval, and any change in a form would have to be submitted to the Bureau.

The bill also would retain the requirement that an applicant file an appointment of the DCIS Director as the applicant's agent for service of process in this State. The bill would delete a provision that service upon the Director is sufficient service upon any licensee if the person seeking service upon the licensee certifies to the Director that a diligent attempt was made to effect personal service upon the licensee and that this effort was unavailing. Under the bill, service of process upon the Director would be considered service upon an applicant or licensee.

The bill would prohibit the Director from accepting an application or issuing a license that included a business name that was the same as or similar to an existing business name on file with the Department.

Under the Act, if an applicant is a corporation, the application must include the name and address of each of its officers and directors. The bill specifies that if an licensee were a corporation, the Director could not require information concerning a member of the board of directors if that member did not receive a salary, stock dividend, or other financial benefit from that corporation other than reimbursement of the actual expenses incurred in carrying out the duties of a director of the corporation.

Investigation

The Act requires the Department to investigate an applicant's financial responsibility, experience, character, and general fitness, once an application is filed, the fees are paid, and the bond is approved. The bill specifies that an investigation

would have to include at least the following, as applicable:

- The officers and directors of the corporation, if the applicant were a corporation.
- All of the partners of the partnership, if the applicant were a partnership.
- All of the officers of the association, if the applicant were an association.
- The individual, if the applicant were an individual.

Trust Accounts

The Act provides that payments received by a licensee from or on behalf of a debtor for the benefit of a creditor must be held in trust in a separate bank account maintained for the benefit of the debtor. The licensee may not commingle a payment with its own property or funds, but may deposit a specified amount of its own funds in the separate trust account upon approval of the Director. The Act also provides that disbursements to the debtor or the creditors must be made from the trust account, and payments from or on behalf of a debtor must be deposited in the account within two business days after receipt.

The bill would delete the prohibition against commingling, and provides that a licensee could deposit its own money in the separate trust account if at all times the balance in the trust account were greater than the sum of the escrow balances of each debtor's account. The bill also states that a "sweep arrangement" could be used if the account were insured for 100% or more of the balance in it.

The bill would retain a requirement a trust account be reconciled at least once a month, but would delete a requirement that this be done within 45 days after receipt of the monthly bank statement, prepared on a form approved by the Director, and kept as a permanent record of the licensee. The bill specifies that the reconciliation could be done electronically or by any other appropriate method, and would have to be done within 45 business days after receipt of the bank statement. An electronic or other appropriate notation of the reconciliation would have to be kept as a permanent record of the licensee and would be considered in compliance with this section of the Act.

Licensee Responsibilities

The Act lists certain responsibilities of a licensee or an exempted person (a tax-exempt nonprofit corporation meeting certain criteria, a person performing a debt management service without compensation, or someone performing a debt management service and receiving compensation

primarily from governmental and other organizations). A licensee or exempted person must make and keep for six years the accounts, correspondence, memoranda, papers, books, and other records, which are subject to reasonable periodic, special, or other examinations by the examiners or other representatives of the DCIS. The bill provides, instead, that a licensee or exempted person would have to create and maintain records, in a manner approved by the Department, which would have to allow for electronic, photocopy, or computerized methods, of the accounts, correspondence, memoranda, papers, books, and other records of the debt management business. The licensee or exempted person would have to make all of these records available for examination by examiners of the Department at reasonable intervals or upon a special demand of the Department. The records would have to be preserved for at least six years.

The bill would retain requirements that a licensee or exempted person give the debtor a copy of the contract between the licensee and the debtor; give the debtor a written statement within five business days of a request for the statement (although the licensee or exempted person currently must give a written statement *or* a verbal accounting); and give the debtor a written statement within 120 days after the contract is entered into.

The Act requires a licensee or exempted person to deliver to the debtor a receipt for a payment within five days after receiving it, although the DCIS may waive this requirement upon a showing of acceptable alternative notice. Under the bill, unless the Department allowed an acceptable alternative method, a licensee or exempted person either would have to deliver a receipt upon receiving cash or within five days after receiving a payment from a debtor; or, at least quarterly beginning with the first quarter after contracting with a debtor, would have to deliver a statement that included the dates and amounts received and disbursed on behalf of the debtor.

The bill also would require a licensee or exempted person, at least annually, to verify or cause the verification of payments to selected creditor accounts and to do or designate another person to do all of the following: review each debtor's account file; review checks paid by the licensee; review procedures used by the licensee for processing checks and handling cash; review the complaint file maintained by the licensee; and review selected counselor records and work papers.

Fees

Currently, a licensee may not charge or receive a fee until at least 51% in number and dollar amount of the creditors of the debtor have consented or have accepted a payment. The bill states, instead, that a licensee could charge and receive a fee upon establishing a debt management plan for a client. If 51% in number and dollar amount of all of the debtor's creditors did not consent to the debt management plan, the fee would have to be returned to the client before the account was closed.

The Act provides that consent may be sought by mail. Under the bill, a licensee could seek a creditor's consent by sending a notice of a debt management plan to the creditor by an appropriate means including telephone, facsimile, electronic mail, or first-class mail.

The Act provides that a licensee or an exempted person (a tax-exempt nonprofit corporation or a person performing a debt management service and receiving compensation from governmental and other agencies) may charge a reasonable fee for debt management services. The fees and charges of the licensee with respect to a debtor's account may not exceed 15% of the amount of the debt to be liquidated during the term of the contract. The licensee or exempted person may require the debtor to make an initial payment of up to \$25, which is part of the total fees and charges stated in the contract. In the event of cancellation or default on the performance of the contract by the debtor, the licensee or exempted person may collect \$25 in addition to fees previously received. The bill would delete references to an exempted person.

The bill states that a licensee or a person authorized by and on behalf of a licensee could charge a reasonable fee for providing advice or materials or making a referral about debt management. Before charging a fee under this provision, the licensee would have to file with the Bureau a plan setting out the type of advice and kind of materials or referrals to be provided, and the amount of fees to be charged.

Contract

Under the Act, a contract between a licensee and a debtor must contain certain information, including the beginning and ending dates of the contract, which may not be longer than 24 months. Under the bill, the term of a contract could not exceed 60 months.

A contract also must distribute to the creditors of a debtor monthly all funds received from or on behalf of the debtor, although no more than an amount

equal to one month's fee plus the closeout fee may be retained in the debtor's trust account at any time without the Department's approval. The bill provides instead that, unless otherwise approved by the DCIS and except for an amount due for one or more monthly fees or a closeout fee, a licensee would have to distribute to the debtor's creditors, at least monthly, all money received from or on behalf of the debtor.

Under the Act, if a debtor fails to make payments for 60 days, or misses four consecutive payments, the contract is considered canceled. In the event of extraordinary circumstances, the debtor may file with the licensee a letter of continuation of the contract for a specific period, which keeps the contract in effect. The bill would retain these provisions, but would delete reference to extraordinary circumstances.

Other Provisions

The Act requires a licensee to maintain complete books and records relating to its business, to notify the Bureau of the place where the books and records are kept, and to report promptly a change of location. The bill would require a licensee to report a change of location within 10 business days after the change.

The Act requires an individual applicant, office manager, or counselor to pass an examination within the first 180 days after employment. The bill would require an individual to pass an examination within 120 days after employment. The bill also provides that a person could not take the examination more than twice within a 12-month period.

The bill would repeal Section 27 of the Act, which repealed Public Act 135 of 1961.

MCL 451.412 et al.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bill primarily would update the Act to reflect current practices. For example, electronic transactions and communication have become quite popular and widely accepted; the bill would provide for electronic record-keeping and electronic communication with creditors. The bill also would give statutory permission for sweep arrangements, as long as an account was fully

insured. By temporarily placing funds in interest-bearing accounts, debt management companies (particularly those that are nonprofit) can offset some of their expenses. In addition, the bill would allow licensees to charge a reasonable fee for providing advice or materials or making a referral. This would address situations in which debtors return to a credit counselor for additional assistance; the debtor may receive a video, booklet, or quick debt management course, which can generate costs for the business. Further, the bill should help nonprofit debt management businesses to find voluntary directors, by limiting the State's investigations of corporate directors to those who received a financial benefit from the corporation.

The bill also would permit debt management companies to charge a fee without first receiving the consent of 51% of a client's creditors. These days, a licensee might spend hours with a client setting up his or her account, especially if the level of indebtedness is high and the case is complex. Since licensees presently may not charge a fee until 51% of a client's creditors have consented or accepted payment, licensees lose a lot of money waiting for consent. Typically, however, licensees have longstanding relationships with creditors and are familiar with what they will accept, so it is rare for consent to be withheld. Should that occur, though, the bill would require the licensee to return the client's fee.

Other changes include extending the duration of debt management contracts, specifying a time frame for licensees to report address changes, reducing the amount of time an individual has to pass an examination, and limiting the number of times a person may take an examination.

Legislative Analyst: S. Lowe

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: M. Tyszkiewicz

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.