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Senate Bill 664 (Substitute S-2 as reported)  
Sponsor: Senator Shirley Johnson  
Committee: Banking and Financial Institutions

Date Completed: 3-8-00

### **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 debt management program that is acceptable to the debtor's creditors, collects money on the debtor's behalf, and disburses payment to the creditors. The debt management program can lower existing monthly debt payments, consolidate all debt payments into one monthly bank deposit amount, reduce or eliminate interest, bring delinquent accounts current, eliminate late fees and over-the-limit fees, stop harassing phone calls, and improve personal credit ratings. A debt management business may be nonprofit or for-profit, and must be licensed by the Department of Consumer and Industry Services.

The Act has not been amended since its enactment, and a number of developments have occurred in the past 25 years. For example, limited liability companies and out-of-State debt management companies that primarily operate and assist clients through the phone and electronic communication did not exist at the time the law was first enacted. In addition, reportedly it is common and accepted practice for debt management companies to use a "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 updated to accommodate developments in the business of debt management.

### **CONTENT**

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

- Delete the maximum term length of a contract between a licensee and a client.
- 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 debtor's initial \$25 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.
- Require information about the debtor in a budget analysis.
- Allow a licensee to use a sweep arrangement under certain circumstances.
- Require a licensee to give the debtor a written statement every 90 days, instead of within 120 days, after the contract was entered into.
- Require a licensee to furnish a debtor with a written notice of a sale, transfer, or assignment of a contract to another licensee.

#### 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 for each office and a \$50 investigation fee, and furnish a \$5,000 surety bond for each office established by the applicant. The bill would retain these fee requirements, but require an applicant to furnish a surety bond equaling or exceeding the total amount of Michigan clients' funds in the applicant's or licensee's trust account at the time of application for license or renewal as determined by the DCIS, but not less than \$25,000 or more than \$100,000. The

surety bond would be conditioned upon the faithful accounting of all money collected upon accounts entrusted to a licensee engaged in the business of debt management or the licensee's employees and agents, and would have to be approved by the DCIS.

The bill also specifies that, in lieu of the surety bond, 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 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 DCIS. The bill would delete this provision.

The bill 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.

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 a licensee had a board of directors or the equivalent, the Director could not require information concerning a member of the board of directors or equivalent 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.

#### Licensure Exemption

Currently, the Act allows certain persons to be granted an exemption order from any provisions of the Act. These include tax-exempt nonprofit corporations formed to advise and assist individuals in solving their financial difficulties (which must file annually for an exemption and pay an annual exemption fee); a person who is performing a debt management service without compensation; and a person who is performing a debt management service and receiving compensation primarily from governmental organizations, governmentally

sponsored organizations, charitable trusts, or tax-exempt foundations. The bill would delete the exemption provisions for nonprofit corporations and persons performing a debt management service without compensation. Persons performing a debt management service and receiving compensation primarily from governmental organizations, governmentally sponsored organizations, etc., could still be granted an exemption.

#### 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.
- The partners of the partnership, if the applicant were a partnership.
- The officers of the association, if the applicant were an association.
- The manager or managers, if the applicant were a limited liability company.
- The manager or other person designated to control the operation, if the applicant were any other legal entity.

#### Budget Analysis

Currently, before a licensee and a debtor form a contract, the licensee must compile a budget analysis that indicates the amount of money the debtor can reasonably pay toward his or her obligations. Under the bill, a budget analysis also would have to contain the following information about the debtor: name and address; marital status and number of dependents; amount and source of all employment compensation, payments from government programs, child support and alimony payments, and other income; number of exemptions claimed on the debtor's most recent Federal income tax return; gross income per pay period, type and amount of all payroll deductions, and net income per pay period; type and amount of all other fixed periodic payments; type and amount of food, clothing, utility, vehicle, insurance, and all other living expenses; list of creditors included in the plan; description of and amount owed for any outstanding garnishments and judgments; periodic amount available for payment toward a debt management plan, and monthly home mortgage or rental payment. (If the home mortgage payment did not include an escrow for real estate taxes, the budget analysis would have to contain the amount and due dates of the real estate on the property.)

### 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 bill provides that the account would be maintained for the benefit of the licensee's Michigan clients at a financial institution within the State whose deposits were insured by a U.S. government agency.

Under the Act, a 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. ("Sweep arrangement" would mean an arrangement that provided for a temporary or permanent transfer of funds from one trust account to another trust account when a predetermined time, account balance, or other condition occurred or was fulfilled.)

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. Each trust account would have to be individually scheduled in a licensee's reconciliation records.

### Licensee Responsibilities

The Act lists certain responsibilities of a licensee or an exempted person. 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 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 would have to make all of these records available for examination by DCIS examiners 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 give the debtor a copy of the contract between the licensee and the debtor and give the debtor a written statement within five business days of a request for the statement (although the licensee currently must give a written statement or a verbal accounting). The bill would require the licensee to give the debtor a written statement every 90 days, instead of within 120 days, after the contract was entered into.

The bill also provides that if a contract with a debtor were lawfully sold, transferred, or assigned to a licensee from another licensee, the licensee would have to furnish to the debtor a written notice of the sale, transfer, or assignment. The notice would have to contain the name and address of the licensee and the name and address of the counselor authorized by the licensee to manage the contract.

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 either would have to deliver a receipt upon receiving cash or within three 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, 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; verify payments to selected creditor accounts; 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 an initial \$25 fee upon establishing a debt management plan for a debtor. If 51% in number and dollar amount of all of the debtor's creditors did not consent to the debt management plan within 45 days, the fee would have to be returned to the debtor 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 (other than a person performing a debt management service without compensation) 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 a provision that this charge does not apply to total payment of the contract before the term of the contract expires. The bill specifies that the \$25 fee would not be subject to the 15% limitation on fees and charges of the licensee. The bill also would delete references to an exempted person.

### 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. The bill would delete the maximum length of a contract.

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. The bill specifies that the following would apply to a letter of continuation:

- A debtor could file only one letter of continuation with a licensee for any contract.
- A letter of continuation would have to contain a detailed explanation of the reason or reasons for the missed payment or payments.
- A contract for which a letter was filed would remain in effect and subject to cancellation for any future failure to make a payment or payments.
- A contract between a licensee and a debtor clearly would have to provide for one letter by a debtor.
- A debtor could not file a letter with a licensee at the beginning of a contract.

### Prohibited Conduct

The Act prohibits a licensee or exempted person from engaging in certain conduct, including offering, paying, or giving any cash, fee, gift, bonus, premiums, reward, or other compensation to a person for referring a prospective customer to the licensee. The bill provides that a payment by the licensee for the lawful sale, transfer, or assignment of a contract to the licensee from another licensee would not be subject to this prohibition.

The bill also would prohibit a licensee from conducting the business of debt management without a surety bond, or deposit or assignment satisfactory to the DCIS in lieu of a surety bond, in place.

The bill would delete reference to an exempted person.

#### Other Provisions

Under the Act, attorneys, banks, fiduciaries, savings and loan institutions, credit unions, title insurers, abstract companies, employees and agents of licensees or exempt persons, and judicial officers are exempt from obtaining a debt management license when engaged in the regular course of their respective businesses and professions. The bill also would exempt a certified public accountant who provided debt management advice incidental to his or her accounting practice.

The Act requires a licensee to maintain complete books and records relating to its business, to notify the DCIS 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 remove office managers from this provision.

Under the bill, the Director could, at his or her discretion, provide for electronic filing of any document filed with the Director or Department under the bill.

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. Further, the bill would delete the maximum term length of 24 months for a contract between a licensee and a client, since a term length

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of a contract is usually determined between a licensee and a client and is flexible depending on the debt management plan. In addition, the bill would require detailed information about the debtor in a budget analysis to provide a better overview of the debt management program.

The bill also would permit debt management companies to charge an initial \$25 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.

**Response:** A budget analysis should remain simple and flexible enough to get the debtor into a debt management program. The bill would require too much detailed information and would leave no room for determination on an individual basis.

Legislative Analyst: N. Nagata

#### FISCAL IMPACT

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

Fiscal Analyst: M. Tyszkiewicz