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Senate Bill 664 (as enrolled)
Sponsor: Senator Shirley Johnson
Senate Committee: Banking and Financial Institutions
House Committee: Insurance and Financial Services

PUBLIC ACT 255 of 2000

Date Completed: 3-13-01

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 (DCIS).

The Act had not been amended since its enactment, despite a number of developments that had occurred in 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 in 1975. 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 was not reflected in the original Act.

It was suggested that the Act be updated to accommodate developments in the business of debt management.

CONTENT

The bill amended the Debt Management Act to do the following:

- Delete the maximum length of a contract between a licensee and a client.
- Specify individuals who must be investigated when an application is filed and fees are paid.
- Require a license applicant to pass an examination before a license is granted.
- Allow electronic record-keeping, and specify that trust accounts may be reconciled electronically or by other methods.
- Require licensees annually to verify payments to selected creditor accounts and review certain items.
- Allow licensees to collect an initial \$25 fee upon establishing a debt management plan, and require the fee to be returned if 51% of the creditors do not approve a debt management plan.
- Provide that a creditor's consent to a debt management plan may 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 after the contract is entered into.
- Require a licensee to notify a debtor of a sale, transfer, or assignment of a contract to another licensee.
- Provide that a debtor has the right to cancel

the contract within three business days.

-- Define "department" as the Office of Financial and Insurance Services (within the DCIS).

License Application

Previously, under the Act, an applicant for a license had to file an application with the Department of Consumer and Industry Services, 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 retains these fee requirements, but requires 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 Office of Financial and Insurance Services (OFIS), but not less than \$25,000 or more than \$100,000. The surety bond must 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 must be approved by the OFIS.

The bill also retains provisions under which the OFIS may by rule provide for an appropriate deposit of cash or securities or the assignment of coverage of other surety bonds, in lieu of the surety bond, if the Department is satisfied that comparable or more extensive coverage results.

Previously, a licensee had to 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 submit all changes for approval to the DCIS. The bill deleted this provision.

The bill retains the requirement that an applicant file an appointment of the Director as the applicant's agent for service of process in this State. The bill deleted a provision that service upon the Director would be sufficient service upon any licensee if the person seeking service upon the licensee certified 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 is 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 has a board of directors or the equivalent, the Director may not require information concerning a member of the board of directors or equivalent, or require the member to satisfy the Act's

examination provisions, if that member does 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

Previously, the Act allowed certain persons to be granted an exemption order from any requirement of the Act. These included tax-exempt nonprofit corporations formed to advise and assist individuals in solving their financial difficulties (which had to file annually for an exemption and pay an annual exemption fee); and a person who was performing a debt management service without compensation. The bill deleted these exemption provisions. 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 may still be granted an exemption if the exemption is in the public interest.

Investigation

The Act requires the Department to investigate an applicant's 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 must include at least the following, as applicable:

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

Budget Analysis

Under the Act, before a licensee and a debtor form a contract, the licensee must compile a budget analysis. Previously, the budget analysis had to indicate the amount of money the debtor could reasonably pay toward his or her obligations. Under the bill, a budget analysis must 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; monthly home mortgage or rental payment; 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; a description of and amount owed for any outstanding garnishments and judgments; and periodic amount available for payment toward a debt management plan. (If the home mortgage payment does not include an escrow for real estate taxes, the budget analysis must contain the amount and due dates of the real estate taxes on the property.)

Trust Accounts

Previously, payments received by a licensee from or on behalf of a debtor for the benefit of a creditor had to be held in trust in a separate bank account maintained for the benefit of the debtor. The bill requires these payments to be held in trust in a separate account maintained for the benefit of the licensee's Michigan clients at a financial institution within the State whose deposits are insured by a U.S. government agency.

Previously, a licensee could not commingle a payment with its own property or funds, but could deposit a specified amount of its own funds in the separate trust account upon approval of the Director. The bill deleted these provisions but retains requirements that disbursements to the debtor or the creditors be made from the trust account, and that payments from or on behalf of a debtor be deposited in the account within two business days after receipt. The bill also states that a "sweep arrangement" may be used if the trust account is insured for 100% or more of the balance in it. (The bill defines "sweep arrangement" as an arrangement that provides 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 occurs or is fulfilled.)

The bill retains a requirement a trust account be reconciled at least once a month. Previously, this had to 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 may be done electronically or by any other appropriate method, and must be done within 45 business days after receipt of the bank statement. An electronic or other appropriate notation of the reconciliation must be kept as a permanent record of the licensee and must be considered in compliance with this section of the Act. Each trust account must

be individually scheduled in a licensee's reconciliation records.

The bill also provides that if the trust account is maintained at a financial institution located outside of the State, the licensee must furnish a surety bond or irrevocable letter of credit to the State in an amount equal to or exceeding 100% of the average amount of deposits held in the account from month to month and in a form approved by the OFIS. This requirement is in addition to an applicant's obligation to provide a surety bond for licensure.

Licensee Responsibilities

The Act lists certain responsibilities of a licensee. Previously, a licensee had to make and keep for six years the accounts, correspondence, memoranda, papers, books, and other records, which were subject to reasonable periodic, special, or other examinations by the examiners or other representatives of the DCIS. The bill provides, instead, that a licensee must create and maintain records of the accounts, correspondence, memoranda, papers, books, and other records of the debt management business. If the licensee elects not to retain original records, the licensee may use electronic, photocopy, or computerized methods of record-keeping. The licensee must make all of these records available for examination by OFIS examiners, and preserve the records for at least six years.

The bill retains 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 previously was required to give a written statement *or* a verbal accounting). The bill requires the licensee to give the debtor a written statement at least every 90 days, instead of within 120 days, after the contract is entered into.

Previously, the Act required a licensee to deliver to the debtor a receipt for a payment within five days after receiving it, although the DCIS could waive this requirement upon a showing of acceptable alternative notice. Under the bill, a licensee must deliver a receipt to the debtor upon receiving cash or within three days after receiving a noncash payment from a debtor, and at least monthly beginning with the first month after contracting with a debtor, deliver a statement that includes the dates and amounts received and disbursed on behalf of the debtor.

The bill also requires 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.

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

Fees

Previously, a licensee could not charge or receive a fee until at least 51% in number and dollar amount of all the creditors of the debtor had consented or had accepted a payment. The bill states, instead, that a licensee may 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 do not consent to the debt management plan within 45 days, the fee must be returned to the debtor and the account closed.

The Act provided that consent could be sought by mail. Under the bill, a licensee may 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.

As previously provided, a licensee may charge a reasonable fee for debt management services, and the fees and charges of the licensee may not exceed 15% of the amount of the debt to be liquidated during the term of the contract. Also, the licensee may require the debtor to make an initial payment of up to \$25, which is part of the total fees and charges.

The bill also retains a provision that, in the event of cancellation or default on the performance of the contract by the debtor, the licensee may collect \$25 in addition to fees previously received. The bill deleted a provision that this charge did not apply to total payment of the contract before the term of the contract expired. The bill specifies that the \$25 fee is not subject to the 15% limitation on fees and charges of the licensee. In addition, a licensee may not collect this additional fee if the debtor cancels within three business days, as allowed by the bill.

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. The bill deleted a 24-month maximum on the length of a contract.

Previously, a contract had to 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 close-out fee could 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 OFIS and except for an amount due for one or more monthly fees or a close-out fee, a licensee must distribute to the debtor's creditors, at least monthly, all money received from or on behalf of the debtor.

Previously, a contract was not effective until the debtor had made a payment to the licensee for distribution to his or her creditors. The bill provides, instead, that a contract is in effect when it is signed by the licensee and the debtor and the debtor has made a payment to the licensee. The bill also provides that a debtor has the right to cancel the contract by midnight of the third business day after the first day the contract is in effect, by delivering a written notice to the licensee.

Previously, if a debtor failed to make payments for 60 days, or missed four consecutive payments, the contract was considered canceled. In the event of extraordinary circumstances, the debtor could file with the licensee a letter of continuation of the contract for a specific period, which kept the contract in effect. Under the bill, if a debtor fails to make a payment to a licensee within 60 days after a payment is due, the contract is considered canceled by the debtor. A debtor may file a letter of continuation, to which all of the following apply:

- A debtor may file only one letter of continuation with a licensee for any contract.
- A letter of continuation must contain a detailed explanation of the reason or reasons for the missed payment or payments.
- A contract for which a letter is filed remains 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 must provide for one letter by a debtor.
- A debtor may not file a letter with a licensee at the beginning of a contract.

Prohibited Conduct

The Act prohibits a licensee 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 is not subject to this prohibition.

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

Other Provisions

Under the Act, attorneys, banks, fiduciaries, savings and loan institutions, credit unions, title insurers, abstract companies, employees and agents of licensees, 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 exempts a certified public accountant who provides 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 Department of the place where the books and records are kept, and to report a change of their location. The bill requires a licensee to report a change of location within 10 business days after the change (rather than “promptly”).

Previously, the Act required an individual applicant, office manager, or counselor to pass an examination within the first 180 days of employment. The bill applies this provision only to a counselor, but requires an applicant to pass an examination administered by the Director or his or her designee before a license is granted.

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

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 updates the Act to reflect current practices. For example, electronic transactions and communication have become quite popular and widely accepted; the bill provides for electronic

record-keeping and electronic communication with creditors. The bill also gives statutory permission for sweep arrangements, as long as an account is 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 deletes the maximum length of 24 months for a contract between a licensee and a client, since the length 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 requires detailed information about the debtor in a budget analysis to provide a better overview of the debt management program.

The bill also permits 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 previously could not charge a fee until 51% of a client's creditors had consented or accepted payment, licensees lost 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 requires 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 requires too much detailed information and leaves no room for determination on an individual basis.

Legislative Analyst: N. Nagata

FISCAL IMPACT

The bill will 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.