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PRESENTATION OF THE
OFFICE OF CONSUMER PROTECTION

TO THE HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

AND

THE HOUSE COMMITTEE ON JUDICIARY

TWENTY-SEVENTH LEGISLATURE
REGULAR SESSION OF 2013

MONDAY, FEBRUARY 11, 2013
2:30 P.M.

TESTIMONY ON HOUSE BILL NO. 1319
RELATING TO DEBT SETTLEMENT SERVICES

TO THE HONORABLE ANGUS L.K. MCKELVEY AND KARL RHOADS, CHAIRS, AND TO THE HONORABLE DEREK S.K. KAWAKAMI AND SHARON E. HAR, VICE CHAIRS, AND MEMBERS OF THE COMMITTEES:

The Department of Commerce and Consumer Affairs ("DCCA"), Office of Consumer Protection ("OCP") appreciates the opportunity to appear today and testify on H.B. 1319, Relating to Debt Settlement Services. My name is Bruce B. Kim and I am the Executive Director of OCP. **OCP opposes H. B. 1319**.

H.B. 1319 establishes a new registration program within the department for debt

settlement service activity. The department opposes this bill because debt settlement services are already regulated by Chapter 446, Hawaii Revised Statutes. Chapter 446, commonly referred to as the Debt Adjuster law, prohibits for-profit debt adjusting in the state and renders for-profit debt adjustment contracts void and unenforceable. Violators may be fined not more than $500 or imprisoned not more than six months, or both. The registration program proposed in H.B. 1319 does not prohibit for-profit activity. A copy of Chapter 446, Hawaii Revised Statutes is attached to this testimony.

In 1967, the Hawaii State Legislature passed H.B. 33 which became HRS Chapter 446, making for-profit debt adjusting illegal in Hawaii. House and Senate committee reports noted at the time that:

1. [Debt adjustment] service is available to those needing debt advice from civic organizations and private financial institutions at far less, or no cost.
2. Debt adjusting intrinsically involves practice of law; no one can effectively represent a debtor badgered by creditors without performing functions constituting practice of law, e.g., legal determination of:
    a. Validity of contracts;
    b. Propriety of interest charges and credits;
    c. Compromise of debts;
    d. Availability and use of wage-earner's act proceedings or rights under the Bankruptcy Act;
    e. Validity of secured creditors' liens;

f. Extent of property exempt from execution all of which matters only lawyers can properly consider and furnish counsel for a debtor.

3. **Prohibition is the only feasible way to control the abuses of debt adjusting** (emphasis added).
4. A usual sequence of events is that either the creditors, or some of them, fail to accept the plan or the debtor finds it impossible to live with; and as a consequence the only thing the debtor gains is the additional debt incurred by virtue of the fee payable to the adjuster.
5. The nature of the business lends itself to fraud. The debt adjuster promises nothing; whereas the debtor unconditionally becomes obligated to pay a fee to the debt adjuster.
6. It deals unfairly among creditors.

All of these serious concerns are just as relevant today as they were 46 years ago.

The bill's sponsor, Representative George W. T. Loo, said of debt adjusting at the time that he sought to ban such practices when he learned of a "commercial debt adjusting firm [that] had over 4,000 cases and that of these 4,000 cases only 10 to 15 percent were successfully completed." Rep. Loo stated that the "firm was taking money under false pretense by promising relief from creditors' harassment and was causing its

clients to sink further into debt."[1]

Now, decades after the Legislature saw fit to ban for-profit debt adjustment as a legal business activity in this state, for-profit debt adjusting is back despite serious concerns about the industry that led the Legislature to ban the practice in 1967.

The Government Accountability Office ("GAO"), in testimony before the U.S. Senate's Committee on Commerce, Science, and Transportation in April 2010, stated that:

> Our investigation found that some debt settlement companies engage in fraudulent, deceptive, and abusive practices that pose a risk to consumers already in difficult financial situations. The debt settlement companies and affiliates we called while posing as fictitious consumers with large amounts of debt generally follow a business model that calls for advance fees and stopping payments to creditors—practices that have been identified as abusive and harmful. While we determined that some companies gave consumers sound advice, most of those we contacted provided information that was deceptive, abusive, or, in some cases, fraudulent. Representatives of several companies claimed that their programs had unusually high success rates, made guarantees about the extent to which they could reduce our debts, or offered other information that we found to be fraudulent, deceptive, or otherwise questionable.[2]

Please note the similarities between the GAO's 2010 testimony and statements made by Rep. Loo almost fifty years ago.

OCP submits that this bill is unnecessary, would needlessly expose Hawaii consumers to a host of problematic financial issues, and would open the door to a flood of for-profit debt adjusting companies who work primarily from out of state call centers

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[1] George W. T. Loo, Hawaii Becomes 22nd State to Prohibit Commercial Debt Adjusting, 21 PERS. FIN. L.Q. REP. 108, 108 (1967)

or over the internet.

Thank you for the opportunity to testify in opposition on H.B. 1319. I will be happy to answer any questions that the members of the Committee may have.

[2] http://www.gao.gov/new.items/d10593t.pdf , pg. 7

CHAPTER 446
DEBT ADJUSTING

Section
446-1 Definitions
446-2 Debt adjusting prohibited; penalty; contracts void
446-3 Person not affected
446-4 Certain loan functions not affected

§446-1 Definitions. As used in this chapter:

(1) "Person" means an individual, partnership, corporation, firm, association, or any other legal entity;

(2) "Debt adjuster" means a person who for a profit engages in the business of acting as an intermediary between a debtor and the debtor's creditors for the purpose of settling, compromising, or in any way altering the terms of payment of any debts of the debtor and who:

(A) Receives money, property, or other thing of value from the debtor, or on behalf of the debtor, for distribution among the creditors of the debtor, or

(B) Otherwise arranges for payment to, or distribution among, the creditors of the debtor;

(3) "Debtor" means an individual and includes two or more individuals who are jointly and severally or jointly or severally indebted;

(4) "Nonprofit organization" means a corporation or association, no part of the net earnings of which may inure to the benefit of any private shareholder or individual. [L 1967, c 3, §2; HRS §446-1; gen ch 1985]

§446-2 Debt adjusting prohibited; penalty; contracts void. Any person who acts or offers to act as a debt adjuster in this State shall be fined not more than $500 or imprisoned not more than six months, or both. Any contract for debt adjusting entered into with a person engaged in the business for a profit shall be void and unenforceable and the debtor may recover from the debt adjuster all

sums or things deposited with the debt adjuster and not disbursed to the debtor's creditors. [L 1967, c 3, §3; HRS §446-2; gen ch 1985]

§446-3 Persons not affected. The following persons are not debt adjusters for the purposes of this chapter:

(1) An attorney licensed to practice law in this State, including the Legal Aid Society of Hawaii;

(2) A person who is a regular full-time employee of a debtor and who acts as an adjuster of the person's employer's debt;

(3) A person acting pursuant to any order or judgment of court or pursuant to authority conferred by any law of this State or of the United States;

(4) A nonprofit or charitable corporation or association who acts as an adjuster of a debtor's debts, even though the nonprofit corporation or association may charge and collect nominal sums as reimbursement for expenses in connection with such services. [L 1967, c 3, §4; HRS §446-3; gen ch 1985]

§446-4 Certain loan functions not affected. Nothing in this chapter is intended to exclude, nor shall it exclude, or prohibit, any bank, financial services loan company, credit union, or any other person or firm licensed by the county, state, or federal government to make loans from paying off the existing debts of any debtor to any other person or firm in connection with, or as a condition precedent to, making a loan to such debtor, if done at the debtor's request or with the debtor's consent or agreement. [L 1967, c 3, §5; HRS §446-4; gen ch 1985; am L 1989, c 266, §3]

PRESENTATION OF THE
BOARD OF PUBLIC ACCOUNTANCY

TO THE HOUSE COMMITTEE ON
CONSUMER PROTECTION AND COMMERCE

AND

TO THE HOUSE COMMITTEE ON JUDICIARY

TWENTY-SEVENTH LEGISLATURE
Regular Session of 2013

Monday, February 11, 2013
2:30 p.m.

WRITTEN TESTIMONY ONLY

TESTIMONY ON HOUSE BILL NO. 1319, RELATING TO DEBT SETTLEMENT SERVICES.

TO THE HONORABLE ANGUS L.K. MCKELVEY, CHAIR, AND
TO THE HONORABLE KARL RHOADS, CHAIR,
AND MEMBERS OF THE COMMITTEES:

My name is Nelson K.M. Lau, and I am the Vice-Chair of the Board of Public Accountancy ("Board"). The Board takes no position on this bill and offers the following comments and suggested amendments.

This bill proposes to require persons who act as providers of debt settlement services to be registered by the Department of Commerce and Consumer Affairs. The Board's comments are directed specifically to the definition of "debt settlement services" and the provision for the exemption of accounting services from the definition in Section 1 of the bill.

The Board would like to provide clarifying language to sub-section (2) of this definition (on page 3, lines 1 through 3) for the committee's consideration, as follows:

(2) Accounting services provided in an accountant-client relationship by [~~a~~] an individual certified public accountant or firm [~~licensed to provide accounting services~~] authorized to actively engage in the practice of public accountancy in this State, pursuant to section 466-7;

The proposed amendment will include both individual certified public accountants ("CPA") and CPA firms as entities that are authorized to engage in the practice of public accountancy in Hawaii. The language tracks section 466-7 of the Board's statutes relating to the requirement that a license and permit are required for an individual to practice, and that a permit is needed for a CPA firm to practice in Hawaii.

In addition, the Board proposes the deletion of the following provision in the definition of "debt settlement services" (on page 2, lines 11 through 18), as follows:

"Debt settlement services" means services as an intermediary between an individual and one or more unsecured creditors of the individual for the purpose of obtaining concessions where the contemplated concessions involve a reduction in principal of the individual's unsecured debt but does not include the following[~~; provided that the debt settlement services are not the primary business purpose of the person described herein~~]:"

The Board believes that this proviso language may not be necessary as CPAs are comprehensively and specifically regulated by chapter 466. It is also

believed that legal services and financial planning services are regulated separately as well.

Thank you for the opportunity to provide testimony on House Bill No. 1319.

Testimony of
Robert Linderman
Vice President of the Board of Directors of
American Fair Credit Council

DATE: February 11, 2013

TO: Representative Angus McKelvey
Chair, Committee on and Consumer Protection & Commerce
Representative Karl Rhoads
Chair, Committee on Judiciary
Submitted Via CPCtestimony@capitol.hawaii.gov

RE: **H.B. 1319 – Relating to Debt Settlement Services**
Hearing Date: Monday, February 11, 2013 at 2:30pm
Conference Room: 325

Dear Chair McKelvey, Rhoads and Members of the Joint Committees:

Thank you for the opportunity to speak in favor of HB 1319. I am submitting my remarks on behalf of the American Fair Credit Council (AFCC), the national trade association of consumer debt settlement companies.

The American Fair Credit Council. The AFCC represents not only the interests of the industry but also is a strong advocate for consumers' rights in the context of debt settlement and debt collection. The AFCC works closely with state legislatures and regulators, as well as with both the Federal Trade Commission and the Consumer Financial Protection Bureau to advance consumer protection in the debt resolution space.

The AFCC's mission is to promote good business practices in the debt settlement industry, protect the interests of consumers in debt, articulate fair operating standards for member companies and advocate for strong, consumer-centric legislation and regulation of debt relief companies. The standards AFCC upholds and promotes nationwide are available on its website at www.americanfaircreditcouncil.org.

What is Debt Settlement? Debt settlement is the practice of negotiating, on behalf of financially challenged consumers, less than full balance resolutions of their unsecured debt, primarily credit card and other unsecured debt. Debt settlement is appropriate only for consumers in a verifiable state of financial hardship, consumers who (1) can no longer make their minimum monthly payments without severe hardship, (2) have sufficient income to set aside some portion of their monthly obligation towards pay-down of their debt and (3) wish to avoid personal bankruptcy. To date the debt settlement industry has resolved billions of dollars worth of credit card and other unsecured debt at around 60-65 cents on the dollar, including fees.

As specifically acknowledged by the Federal Trade Commission in the adopting release to the Amendments to the FTC's Telemarketing Sales Rules, debt settlement is recognized as an effective and much-needed debt relief option for consumers needing options for addressing unmanageable levels of unsecured debt. Debt settlement does not address issues involving mortgages, loan modifications, foreclosures or any other secured debt concerns. Debt settlement serves a very specific and needy constituency: consumers who cannot qualify for or afford other options, including traditional credit counseling.

Debt Settlement Pre- and Post-FTC Rules. Historically, debt settlement providers charged fees in advance of performing services, a business practice that encouraged some providers to charge fees but never deliver services. In October 2010, as a result of a two-year effort led by the Federal Trade Commission with active participation from the AFCC, the "advance fee" model was banned, with the result that virtually all of the "bad actors" fled the industry.

Under the FTC Rules, a debt settlement provider is prohibited from charging or accepting compensation of any sort whatsoever until three things have occurred: (1) the provider successfully negotiates a settlement of a consumer's debt; (2) the consumer accepts the offered settlement; and (3) the consumer ratifies his or her acceptance of the settlement by making at least one payment to the creditor in furtherance of the negotiated settlement. ***Under the FTC Rules, debt settlement has become the most tightly regulated and consumer-friendly financial service in the marketplace, with the provider's revenue event completely within the control of the consumer.***

Because the FTC Rules reach only providers operating in *inter-state* commerce, the AFCC advocates for states to adopt conforming legislation that tracks the FTC Rules, in order to prevent someone from evading the reach of the FTC Rules. HB 1319 contains language virtually identical to the FTC Rules, making exclusively Hawaii transactions subject to the same consumer protections found at the national level.

Debt Settlement v. Other Debt Relief Options. Debt settlement is extremely effective when compared to other debt relief options. The national rate of completion for confirmed Chapter 13 bankruptcy plans is less than 15%, according to the latest statistics released by the Federal bankruptcy trustee's office. Nonprofit credit counseling companies historically have an approximate success rate of 21-26%, according to statistics released by the National Federation of Credit Counselors. By comparison, debt settlement completion rates for AFCC members prior to the FTC action were significantly higher – approximately 32-37%; after two years of experience with the "no advance fee" model it appears that completion rates will be significantly higher, probably well above 40+% (debt settlement programs are generally 36-42 months so very few post-FTC programs have "completed" yet). Moreover, unlike credit counseling, even those who only complete part of the debt settlement plan often benefit tremendously: for example, someone who had 10 debts coming into the program and has resolved only seven may decide to leave the program comfortable that his or her remaining debt is manageable and without having paid any fee with respect to the remaining unsettled debts.

A significant difference between debt settlement and credit counseling is that debt settlement is a reduction in principal of the debt, not just a reduction in the interest rate, which yields very significant savings for financially strapped consumers. For example, a consumer with $15,000 of credit card debt may expect to pay about $23,250 over more than five years if they make just their minimum payments; entering a five-year credit counseling program the same consumer

should expect to pay approximately $18,750, including the 15% fee allowed by HRS 446-2(3). In a debt settlement program, however, the same consumer is likely to pay about $11,000 over three years, fees included. In 2009, the most recent year for which industry statistics are available, AFCC companies settled over $1 billion of debt nationwide for between 40-45 cents on the dollar. AFCC estimates that, in 2012, more than $1.5 billion of debt was settled, at a comparable rate.

Need for Debt Settlement Services in Hawaii. Some quick research indicates that Hawaii, with approximately 0.44% of the United States population, has approximately 805,200 credit card holders; based on data available from the United States Census and from the three national credit bureaus, we have estimated that between 4500-5000 of Hawaii's card holders are in delinquent status, with each card holder owing about $6,400 of delinquent balances; those balances are growing by approximately 18% per annum (the default interest rate for delinquent accounts). Thus, we estimate that there are as many as 5,000 Hawaii residents holding as much as $32,000,000 of delinquent credit card debt who could benefit from our services. Settlement at our historic norms could save these people more than $9,000,000, after fees.

Consumer Protections in HB 1319. In addition to providing strong enforcement authority to the regulator, as well as a private right of action to the consumer, backed by a surety bond in favor of the state, H.B. 1319 requires:

1. **Strong licensing requirements**, including the filing of personal information of officers and directors, including disclosure of any criminal history.
2. **Mandatory disclosures** of all program risks, not just the benefits.
3. **Financial Analysis**: A financial analysis must be performed by the debt settlement provider to ensure that consumers enrolling in its program are appropriate for debt settlement.
4. **Form of agreement**: The bill mandates that certain information be spelled out in service agreements with consumers including disclosure of all fees to be charged, the payment schedule, and how the consumer can obtain reports from the provider.
6. **Prohibited activity**: There are over 20 prohibitions against certain types of activity including misrepresentations regarding the service to be provided, misrepresentations regarding program benefits and misrepresentations in the marketing of the services.

Response to Objectors.

The Consumer Protector, in his letter to the Senate Committee on Commerce and Consumer Protection, has raised several objections, none of which were raised to us when we met with him in the first week of December of 2012 and all of which are, sadly, based on imperfect information and without factual basis.

Most disturbing is that, by saying, as he did, on page 3 of his letter, that "all of these serious concerns (referring to an enumerated list) are just as relevant today as they were 46 years ago," the Consumer Protector is failing to recognize, or to inform the Committee, that the implementation of the FTC Rules has completely addressed all of the concerns that led to the original 1967 adoption of HRS 446-1 et seq. In fact, in 1967 the debt settlement industry did not exist – HRS 446-1 was passed to prevent abuses in the provision of credit counseling services.

More specifically, the Consumer Protector has made the following assertions:

1. **Debt adjusting services are available from civic organizations and private financial institutions at far less or no cost.** This is not accurate. Because consumer credit counseling does not address the principal of the debt, it costs more and takes longer than a comparable debt settlement program. Further, generally speaking, people who qualify for consumer credit counseling are not in the state of financial hardship that qualifies them for debt settlement (in other words, we serve a different client base). Finally, the Internal Revenue Service has held numerous times that debt settlement services may not be offered by non-profit providers (because the relief of indebtedness creates imputed income in the hands of the debtor, debt settlement is a violation of the 501(c)(3) charitable purpose exemption).

2. **Debt adjusting intrinsically involves the practice of law.** This is not accurate. Just as CPAs or financial planners negotiate on behalf of a consumer without "practicing law," a debt settlement service provider does the same. This is consumer advocacy, not the practice of law, a conclusion supported by the Federal Trade Commission. Debt settlement providers do not (a) analyze the validity of a contract, (b) draw any conclusions as to the propriety or legitimacy of interest rates, (c) offer any legal advice of any sort on the compromise of debts, (d) give bankruptcy advice, (e) analyze the validity of a lien, secured or otherwise or (f) do any analytic or advisory work on the availability of exemptions from execution.

3. **Prohibition is the only way to control abuses.** The Federal Trade Commission found a simple rule – the advance-fee prohibition – to be supremely effective in controlling abusive practices and now, in a regulated environment, supports and encourages the development of a robust and competitive marketplace for debt settlement services.

4. **The "usual sequence" is that creditors fail to accept a plan, leaving the debtor worse off.** In a debt settlement program, creditors don't participate in a "plan" – this is a term reserved for consumer credit counseling. Rather, a debt settlement provider represents the consumer in negotiating with the debtor. Further, it is hard to understand how, under the FTC Rules, a consumer could be worse off since the consumer pays nothing until a debt has been settled AND the consumer has accepted the settlement. In point of fact, the "usual sequence" is that the consumer enters a debt settlement program and, within two to four months, receives his or her first negotiated settlement.

5. **The nature of the business lends itself to fraud.** Debt settlement is a regulated financial service in more than 20 states and recognized as a valuable consumer benefit by the Federal Trade Commission and the Consumer Financial Protection Bureau. The numbers speak for themselves: billions of dollars of credit card debt settled for around 40-45 cents on the dollar, before fees, saving consumers literally hundreds of millions of dollars and, in the process, keeping those consumers out of bankruptcy and remaining productive, taxpaying members of their communities.

6. **It deals unfairly among creditors.** It is hard to understand this objection. The creditors, as negotiating partners, always have the right to say "no" to a proposed settlement. Presumably, if they agree to a proposed settlement, they are making a rational financial decision that the offered settlement amount is more than they are likely to recover in a lawsuit or a bankruptcy proceeding.

In support of his positions, the Consumer Protector cites to a study performed by the General Accounting Office and released in April 2010, a full three months before the FTC Rules were released. The GAO study, which was based on a review of a relatively small number of enforcement actions taken by the FTC and various states attorneys general, was used by the FTC and the AFCC as a reference point during the discussions that led up to the FTC Rules; in fact, the FTC Rules were designed specifically to address the concerns articulated in the GAO study. That none of the GAO, the FTC or the CFPB have expressed continuing concerns since the adoption of the FTC Rules is a strong indicator that those concerns have been addressed and are no longer relevant.

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To help ensure accuracy, transparency and compliance with the AFCC's disclosure standards, the AFCC maintains a "secret shopping" program wherein each AFCC member company is contacted by an AFCC representative posing as a consumer. Additionally, each AFCC member company is randomly examined, with website reviews, marketing compliance checks and, for accredited members, an annual audit conducted by a third-party licensing entity. The AFCC has disciplined, and even terminated, the membership of, companies found to be non-compliant. Further, where AFCC has found non-compliant material being used by non-member companies an enforcement referral to the appropriate agency (FTC, CFPB and/or one or more states Attorneys General).

The AFCC supports stringent regulation of debt settlement companies on the state level and is responsible for helping pass laws that provide significant consumer protection in almost 20 states. In the past two years, Texas, Colorado, Utah, Missouri, and Maryland have passed bills supported by AFCC that contain protections similar to H.B. 1319, and similar legislation is currently pending in seven additional states.

The AFCC and the industry we represent urge the Committee to recognize that SB 1319 offers consumers not only access to a badly needed service but in making this service accessible would enact strong, market-based regulation to ensure that the FTC Rules work for every citizen of Hawaii. HB 1319 would encourage a robust and competitive marketplace for debt settlement services and, in the process, give consumers a strong, independent advocate for the resolution of their debts.

Thank you for your time and attention.

kawakami2 - Rise

From: mailinglist@capitol.hawaii.gov
Sent: Thursday, February 07, 2013 9:14 PM
To: CPCtestimony
Cc: tabraham08@gmail.com
Subject: *Submitted testimony for HB1319 on Feb 11, 2013 14:30PM*

HB1319
Submitted on: 2/7/2013
Testimony for CPC/JUD on Feb 11, 2013 14:30PM in Conference Room 325

Submitted By	Organization	Testifier Position	Present at Hearing
Troy Abraham	Individual	Support	No

Comments:

Please note that testimony submitted less than 24 hours prior to the hearing , improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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