DEPARTMENT OF
CORPORATIONS

STUDY OF THE CONSUMER CREDIT COUNSELING INDUSTRY IN CALIFORNIA AND RECOMMENDATIONS TO THE LEGISLATURE REGARDING THE ESTABLISHMENT OF FEES FOR DEBT MANAGEMENT PLANS AND DEBT SETTLEMENT PLANS

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BY THE DEPARTMENT OF CORPORATIONS

April 8, 2003

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EXECUTIVE SUMMARY

Background

AB 2293 (Chap. 779, Stats. 2002) requires the Department of Corporations ("Department") to conduct a study of the consumer credit counseling industry in California and make recommendations to the Legislature regarding the establishment of fees for debt management plans and debt settlement plans. This report is the Department's study of the industry and recommendations regarding fees.

Consumer credit counselors provide credit counseling, debt reduction services and financial education to debtors. The Department licenses persons engaged in "prorating," or distributing a debtor's money among the debtor's creditors – a service offered by most consumer credit counselors. However, nonprofit consumer credit counselors are exempt from licensing if they meet specified regulatory requirements, including certain limitations on the fees that they may charge debtors. Under the licensing exemption, a consumer credit counselor may charge a debtor no more than 6.5% of the money disbursed to creditors or $20 monthly, whichever is less, for a "debt management plan." Under a debt management plan, a consumer credit counselor negotiates with the creditors of a debtor for concessions in the terms of the debtor's accounts, such as reduced interest rates, waived late and over-the-limit fees, and lowered monthly payments. The debtor pays a single amount to the consumer credit counselor monthly, and the consumer credit counselor distributes the money to the debtor's creditors.

To rely upon the licensing exemption, a consumer credit counselor may charge a debtor for counseling and education no more than a one-time sum of $50. Finally, the licensing exemption limits the amount that may be charged for a debt settlement plan (the settlement of debts in a single lump-sum payment) to 15% of the amount of the debt forgiven.

Study and Recommendations

The Department conducted a study of the industry by examining the history of the licensing law and exemption for nonprofit organizations, the current state of the industry, and the fee restrictions in other states. The Department also conducted a survey of consumer credit counselors, consumer groups, and debtors regarding the fees in the industry, statutory caps, and whether increases to fee caps are needed in California.

In the Department's report, the Department recommends the Legislature consider: (1) increasing the existing fee cap for a debt management plan from the lesser of 6.5% of the amount disbursed monthly or $20, to the lesser of 6.5% of the amount disbursed monthly or $35, for consumer credit counseling organizations that do not charge a fee for education and counseling; (2) maintaining the existing fee cap of $50 for education and counseling; and (3) maintaining the existing fee cap of 15% of the debt forgiven for a debt settlement plan, but allowing an up-front fee of up to $300 or 5% of the debtor's total debt, whichever is less.

INTRODUCTION

In the 2001-2002 legislative session, Assembly Member Liu sponsored AB 2293 (Chap. 779, Stats. 2002), a bill that substantially amended the licensing exemption for certain nonprofit organizations providing debt management services. Under existing law, a person providing debt management services is defined as a "prorater," and required to be licensed under the Check Sellers, Bill Payers and Proraters Law (the "CSBPPL").[1] However, an exemption exists for nonprofit organizations meeting specified requirements, including limitations on fees charged to debtors. AB 2293 clarified and increased the standards that the nonprofit organizations must meet in order to qualify for the exemption. AB 2293 also set forth a permissible fee of $50 for education and counseling in connection with a debt management or debt settlement plan, and a permissible fee of 15% of the amount of the debt forgiven for a negotiated debt settlement plan. However, AB 2293 retained the existing fee limitation for a debt management plan of $20 monthly or 6.5% of the money disbursed monthly, whichever is less.

The fee permitted under the law was last increased in 1982, effective 1983,[2] and the consumer credit counseling industry raised a concern about the need for a fee increase during the consideration of AB 2293. To address this concern, a provision was added to AB 2293 requiring the Department to conduct a study of the consumer credit counseling industry in California and make recommendations to the Legislature on or before March 1, 2003, regarding the establishment of fees for debt management plans and debt settlement plans. AB 2293 directed the Department to conduct the study in consultation with the consumer credit counseling industry and consumer organizations.

This report includes the Department's study and resulting recommendations.

BACKGROUND AND HISTORICAL PERSPECTIVE

A. The Licensing of Proraters

The CSBPPL is a licensing law enacted in 1947.[3] As originally enacted, the CSBPPL was called the "Check Sellers and Cashers Act," and it did not contain a definition of "prorater." The activities regulated included "selling checks or cashing checks, drafts or money orders or of receiving money for the purpose of paying to a person other than the check seller or casher bills, invoices, or accounts of an obligor."[4] The definition of "prorater" was added in 1957.[5] In addition to a definition of "prorater," the 1957 amendments to the CSBPPL added numerous regulatory requirements for persons engaging in the business of prorating.

The CSBPPL defines a prorater as follows:

> "A prorater is a person who, for compensation, engages in whole or in part in the business of receiving money or evidences thereof for the purpose of distributing the money or evidences thereof among creditors in payment or partial payment of the obligations of the debtor."[6]

In September of 1957, soon after the definition of "prorater" was added to the CSBPPL, the Attorney General considered the question of whether applicants for licenses as proraters were

[1] Financial Code § 12000 et seq.
[2] Chapter 963, Statutes of 1982.
[3] Chapter 914, Statutes of 1947.
[4] Section 2 of Chapter 914, Statutes of 1947.
[5] Section 1 of Chapter 498, Statutes of 1957.
[6] Financial Code § 12002.1.

required to be incorporated.[7] In addressing that question, the Attorney General's Opinion set forth the history of the provisions regarding proraters. The Attorney General's Opinion stated, "[a] prorater is a person who enters into an agreement with a debtor by which the prorater for a fee receives money from the debtor and distributes the money in payment to the latter's creditors. The vast expansion in credit buying in recent years and the resulting involvement by persons into heavy indebtedness beyond their means has brought forth this new business. […] Prior to 1957, some proraters were licensed by the Commissioner of Corporations under the Check Sellers and Cashers Law […]."

The Opinion cited the definition of "check seller" as the basis for the licensing of proraters prior to the enactment of the definition of "prorater" in 1957. The Opinion further stated that "[t]he 1957 Session of the Legislature resulted in extensive amendments to the Check Sellers and Cashers Law to provide specifically for the licensing of proraters and to establish rules of conduct for such licensees […]."

In addressing the question of whether a prorater was required to be incorporated, the Attorney General's Opinion stated that the purpose of the legislation adopting the separate regulatory provisions for proraters must be considered. According to the Opinion:

> "The thrust of the legislation appears to have been:
> (1) To eliminate the problem of dual jurisdiction over proraters by the Commissioner of Corporations and the Division of Collection Agencies;
> (2) To provide specifically for special and general proraters' licenses, a distinction not previously made; and
> (3) To establish certain substantive requirements for the conduct of the business of a prorater."

The Opinion further provided:

> "It should be noted that this legislation did not bring under the jurisdiction of the Commissioner a wholly new class of persons not previously subject to his jurisdiction. Rather the legislation clarified the jurisdiction of the Commissioner."

A July 27, 1968, letter in the Governor's Chaptered Bill File for AB 1806[8] from Morris Rabinowitch, President of the California Association of Credit Counsellors, to the Governor indicates that the legislation setting forth specific licensing and regulatory requirements for proraters was the result of Interim Committee studies in 1956.[9]

B. The Exemption for Nonprofit Consumer Credit Counseling Organizations

When the definition of prorater and the accompanying regulatory requirements were added to the CSBPPL in 1957, the licensing law did not include an exemption from licensure for nonprofit consumer credit counseling organizations. The legislative history indicates that the nonprofit consumer credit counseling organizations in existence in California at that time were not subject to the CSBPPL, because these organizations did not charge a fee for services. As set forth in a July 29, 1968 letter from the Consumer Credit Counselors of Ventura County, Inc.

[7] 30 Ops.Cal.Atty.Gen. 122 (1957).
[8] Chapter 1208, Statutes of 1968.
[9] This letter is attached to this report as Exhibit 1.

to the Governor requesting signature on AB 1806, the organizations were supported "entirely by contributions from local banks, finance companies, store[s], credit bureau members and doctors."

AB 1806 enacted the exemption from licensing into law for nonprofit consumer credit counseling organizations. The purpose of the bill was to allow these entities to charge a fee for services without becoming subject to the licensing requirement of the CSBPPL. According to the opposition letter from the California Association of Credit Counsellors, the legislation "was a very hotly contested and highly controversial matter in the Senate. It took three ballots before the proponents were able to secure the 21 votes necessary to bring [the] measure to [the Governor's] desk."

The Assembly Finance and Insurance Committee analysis for AB 1806 states that at that time there were eight nonprofit consumer credit counseling organizations in California. In describing the bill, the analysis provides that the bill "would permit these organizations in administering debt [settlement] plans to charge the lesser of 5% of the money dispersed monthly or $10 monthly." The analysis provides:

> "It should be observed, however, that one of the primary functions of the consumer credit organizations founded by creditors is to keep people from filing for bankruptcy which would of course, in many cases, relieve them of their debts, and establish a payment plan which will completely pay off their debts. Therefore, [to] some extent, a debtor will be paying the counseling organization for the privilege of not declaring bankruptcy and allowing counseling organization to arrange for extended payments to creditors who of course would have the most to lose if the debtor did declare bankruptcy."

While the legislative history indicates that AB 1806 was opposed by the California Association of Credit Counsellors and Caspar Weinberger, who had authored the legislation setting forth the regulatory requirements for proraters while he served in the Legislature, it was supported by the California Retailers Association and its sponsor, the Consumer Credit Counselors of California. The Department recommended that the legislation be signed, and the legislative history indicates that the California Association of Credit Counsellors withdrew its objections after the Department's Commissioner Volk met with the objectors and gave them a commitment that the whole matter would be studied.[10]

C. Increases in the Fee Cap

In the years following the enactment of the exemption, the statutory cap on the fees that a consumer credit counseling organization may charge was increased on two occasions. In 1980, AB 1301 (Bannai, Chap. 171, Stats. 1980) increased the permissible fee from 5% of the money disbursed monthly or $10, whichever is less, to 6.5% of the money disbursed monthly or $12, whichever is less. A letter from Assemblyman Bannai to the Governor, dated June 10, 1980, states, "[n]o request has been made for an increase in client fees in over 11 years despite the enormous impact inflation has had on such organizations' ability to operate efficiently and accept additional client volume especially during the present period of economic down-swing and increased client demand for these services. Let me point out that the greatest share of the operating budget for these nonprofit consumer assistance organizations come

[10] See Enrolled Bill Memorandum to Governor, Assembly Bill No. 1806, dated August 5, 1968.

from private contributions. Client charges bring in perhaps 12 to 15% of necessary funds for operation." The Senate Democratic Caucus bill analysis indicates the proponents of the bill were the Consumer Credit Counselors of California (the sponsor), the California Consumer Finance Association, and the Department.

A letter from Consumer Credit Counselors of California to the Governor in support of the bill, dated June 4, 1980, provides "[o]ur organization, consisting of 13 offices throughout California, is the only one of its kind." The Department's Enrolled Bill Report states that "[a]pproximately 80 percent of the revenue of nonprofit community service organizations is derived from participating lenders and retailers. Fees from clients amount to about 20 percent of the revenue. The average debt counseling account pays about $4.50 to $5.00 per month in fees. It is estimated that this bill will increase the average fee from $5.00 to $6.00 per month."

In 1983, SB 2046 (Marks, Chap. 963, Stats. 1982) increased the fee cap from 6.5% of the money disbursed monthly or $12, whichever is less, to 6.5% of the money disbursed monthly or $20, whichever is less – the current ceiling. According to the Department's Enrolled Bill Report, "although there could be increased cost to consumers, the fee increase is modest, would appear to be justified purely on inflationary factors, and will assist in defraying a portion of the cost of a valid consumer service." The Consumer Credit Counselors of California sponsored SB 2046, and the Senate Democratic Caucus bill analysis indicates Household International was a proponent of the bill.

D. Changes in the Industry

The consumer credit counseling industry has changed dramatically since the 1950s and 1960s. The number of licensed proraters in California has dwindled and currently only a single licensee remains. The reasons for this decline appear to be twofold. First, the regulatory requirements for a prorater prohibit a prorater from receiving "any cash, fee, gift, bonus, premium, reward, or other compensation from any person other than the debtor in connection with his activities as a prorater."[11] Thus, licensed proraters are unable to receive "fair share contributions"[12] from creditors. Over the years, the ability of certain nonprofit consumer credit counseling organizations to provide services to debtors under the licensing exemption with creditors subsidizing the cost of the services appears to have resulted in the disappearance of the market for licensed proraters. Second, in addition to state law prohibiting licensed proraters from accepting compensation from creditors, the Department is advised that most creditors providing fair share contributions require the organizations receiving the payments to be nonprofit organizations. Also, many other states prohibit entities other than nonprofit organizations from engaging in these activities.

While evidence exists that for-profit entities are engaging in prorating activities, the Department has not received any applications for licensure. Thus, if any activity were occurring in

[11] Financial Code § 12324(b).

[12] A "fair share contribution" is the industry term for the money paid by creditors to consumer credit counseling organizations. This contribution is equivalent to a fractional share of the amount of a debtor's money paid to the lender in satisfaction of the debtor's debt, through a debt management plan administered by the consumer credit counseling organization. This contribution subsidizes the services provided to debtors by consumer credit counseling organizations, but is not without controversy (see, for example, the article by Stephen Gardner in Advancing the Consumer Interest, Consumer Credit Counseling Services: the Need for Reform and Some Proposals for Change, (Fall 2001/Winter 2002), calling the contribution a "kickback" and equating the organizations to debt collection agencies).

California, it would constitute unlicensed activity in violation of the CSBPPL.[13] The majority of the consumer credit counseling industry appears to be nonprofit entities.

As noted above, when AB 1806 was enacted in 1968, there were eight nonprofit consumer credit counseling organizations in California, under the umbrella of the Consumer Credit Counselors of California. The consumer credit counseling organizations in California have traditionally been members of the National Foundation for Credit Counseling, Inc. (the "NFCC"). When the licensing exemption was enacted in 1968, it was directed towards the activities of NFCC member organizations.

According to the NFCC, the NFCC was founded in 1951 and has nearly 150 member agencies with more than 1300 offices throughout the country. Its members are nonprofit organizations that provide free or low-cost confidential money management, debt reduction, and financial educational services. Most of the funding for these agencies comes from voluntary contributions from creditors, and many of the agencies also receive funding through government and foundation grants, other nonprofit and charitable organizations, and private fund-raising.

The NFCC indicates that from the 1970s through the late 1980s, credit counseling was a small industry of about 200 nonprofit credit counseling agencies known mostly as Consumer Credit Counseling Service in their geographic area. All of the agencies were members of the National Foundation for Consumer Credit, which changed its name to the National Foundation for Credit Counseling in December 2000.

The NFCC states:

> "The late 80's and early 90's led to an explosion of consumer credit and bankruptcies; which led to a significant increase in the growth of credit and debt counseling organizations. As a cheaper way of doing business, many of the new entrants to the credit counseling industry have chosen to offer telephone consultations through a remote central operation, instead of operating as community-based agencies delivering thorough face-to-face sessions that help consumers learn skills to better manage their money. They typically dispense with in-depth, meaningful budget and credit counseling and focused primarily on debt reduction services."[14]

In the 1990s, the growth of consumer credit counseling agencies was also spurred by antitrust litigation against the NFCC. According to the American Banker, among other litigation, 13 plaintiffs accused the industry establishment, the NFCC, of monopolistic practices. The independent consumer credit counseling agencies accused the NFCC of having creditors on its board, with these creditors directing customers to NFCC affiliates.[15] The antitrust litigation

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[13] See the Department's Desist and Refrain Order against Briggs and Baker.

[14] The NFCC information is from its Web page.

[15] See Jane Adler, Credit Counseling In the Spotlight, June 1997, Credit Card Management. Note that the licensing exemption in the CSBPPL has always required that the membership of the nonprofit organization consist exclusively of retailers, creditors in the consumer credit field, educators, attorneys, social service organizations, employers' or employees' organizations, and related groups. See Financial Code Section 12100(j) prior to January 1, 2003, and Financial Code Section 12104, as amended by AB 2293. The exemption was intended for low-cost services provided by organizations formed by creditors, where the majority of funding for the services is provided by the creditors. (See the Governor's Chapter Bill File for AB 1806 (Chap. 1208, Stats. 1968).)

also included Discover Card Services, Inc., Citicorp, Chase Manhattan Bank, and other lenders.[16] Among other things, it was alleged that Discover had refused to do business with credit counseling agencies that operated independently from the credit counseling umbrella organization, the NFCC.[17] Discover settled the suit and agreed to pay other agencies fair share contributions.

Adding to the growth of consumer credit counseling agencies, in 1993, the Association of Independent Consumer Credit Counseling Agencies ("AICCCA") was formed by a handful of independent agencies, thereby organizing the NFCC's competition.[18] (It is estimated that AICCCA members and other independent organizations now represent about 45% of the credit-counseling business.)[19] Finally, as implied by an article in the American Banker in 1996, the NFCC's franchise-style manner of allocating service areas to members may have left some markets underserved, thereby leading to competition in these areas as the antitrust litigation induced creditors to pay fair share contributions to more organizations than just NFCC members.[20]

According to the NFCC, today it is reported that more than 1,000 credit and debt management organizations service unsecured consumer debt. Until AB 2293 became effective on January 1, 2003, the Department had no means of identifying the number of organizations operating in California pursuant to the licensing exemption. AB 2293 enacted certain filing requirements, and the Department has currently received notice from close to 50 consumer credit counseling agencies regarding their reliance on the licensing exemption in engaging in business in California. However, this number does not accurately reflect the number of consumer credit counseling organizations that have been doing business in California in the past years, since many businesses have ceased doing business in California as a result of the regulatory requirements in AB 2293.[21]

E. <u>Industry Problems, AB 2293, and Increased Regulatory Requirements</u>

The increase in consumer credit counseling organizations, the unwinding of the NFCC's influence over the industry, and the profitability of the not-for-profit industry has spawned controversy and inquiry into the practices of (1) the industry as a whole, and (2) certain "black sheep" within the industry that the traditional organizations accuse of giving the industry a blackeye. While the majority of press on the consumer credit counseling industry is favorable and praises the assistance the industry provides to debtors, the industry has also received some unfavorable press.

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[16] Lisa Fickenscher, <u>Debt Cutters Line Up to Counsel Consumers</u>, January 18, 1996, The American Banker.
[17] See Lisa Fickenscher, <u>Discover's Parent Settles Suit by 13 Independent Credit Counselors</u>, July 18, 1997, The American Banker.
[18] See Jane Adler, <u>Credit Counseling In the Spotlight</u>, June 1997, Credit Card Management, and Lisa Fickenscher, <u>Debt Cutters Line Up to Counsel Consumers</u>, January 18, 1996, The American Banker.
[19] <u>Pushed Off the Financial Cliff</u>, July 2001, Consumer Reports.
[20] Lisa Fickenscher, <u>Debt Cutters Line Up to Counsel Consumers</u>, January 18, 1996, The American Banker.
[21] As a result of AB 2293 and recent enforcement actions brought by the Department, the Department has received numerous inquiries from organizations engaging in consumer credit counseling activities in California. It is clear that most organizations were not aware that California had a licensing law, and that the exemption for nonprofit entities under that licensing law requires the organizations to comply with various regulatory requirements, including the limit on fees charged to debtors.

The most broadly circulated article appears to be Consumer Reports' July 2001 article, Pushed off the Financial Cliff.[22] This article identified some problems in the industry, including agencies engaging in the following acts or practices:

- Having an interest in their own financial well-being that is placed before the debtors' interests;
- Engaging in deceptive lending practices;
- Having conflicts of interest with for-profit entities that are steered business;
- Requiring hundreds of dollars in fees masked as "voluntary" contributions;
- Harming a debtor's credit record and causing late-payment charges;
- Engaging in high-pressure sales tactics;
- Failing to send payments to creditors accurately; and
- Lacking credit counseling training and skills.

A fall 2001 article in Advancing the Consumer Interest[23] raised concerns that some consumer credit counseling organizations were engaging in the following activities:

- Failing to advise consumers on the option of bankruptcy, and often having a set policy to not refer debtors to bankruptcy;
- Failing to account to consumers for money received from them and disbursed to creditors, thereby hiding the money retained by the organizations; and
- Providing improper advice to consumers that often directly benefits creditors.

The article also suggested that the organizations are deceptive to consumers, providing debt collection services to various creditors and assisting the creditors in collecting debts from the consumers who sought the services of the counseling organizations.

An October 29, 2001, article in BusinessWeek Online, entitled "A Debt Trap for the Unwary," accused the "billion-dollar" credit counseling industry of being deeply troubled. According to the article:

> "Some clients end up in worse financial shape after using agencies. The fees they pay, usually labeled 'voluntary contributions,' are often steep. Some agencies are fraudulent; others are run by executives with questionable backgrounds. The agencies, which mostly operate as nonprofits, often pay their executives lavish salaries and make cushy deals for goods or services with related companies. They also steer consumers to affiliated for-profit companies that make debt-consolidation or home-equity loans."[24]

In 2002, Assembly Member Liu authored AB 2293, a bill that substantially amended the licensing exemption from the CSBPPL to address many of the abuses in the industry. Prior to

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[22] In addition to the report's criticisms of consumer credit counseling organizations, it also states that such agencies have been operating in "a near-total absence of government oversight[…]."

[23] Stephen Gardner, Consumer Credit Counseling Services: the Need for Reform and Some Proposals for Change, Volume 13 Numbers 1 & 2 Fall 2001/Winter 2002, Advancing the Consumer Interest.

[24] Christopher H. Schmitt, Heather Timmons and John Cady, A Debt Trap for the Unwary, October 29, 2001, BusinessWeek Online.

AB 2293, the licensing exemption was virtually the same as it had existed in 1968 when only 8 entities relied upon it. Prior to AB 2293 the exemption was narrowly tailored to apply to:

- Nonprofit entities subject to California's Nonprofit Public Benefit Corporation Law or Nonprofit Mutual Benefit Corporation Law, whose membership consisted exclusively of retailers, lenders in the consumer credit field, educators, attorneys, social service organizations, employers or employees organizations, and related groups where the principal functions of the organizations were:

    1. Consumer credit education;
    2. Counseling on consumer credit problems and family budgets; and
    3. Arranging, and in some cases administering, debt settlement plans, for which a charge for administrative services only may be made in the amount of 6.5 percent of the money disbursed monthly, or twenty dollars per month, whichever is less, to offset expenses.

The exemption set forth additional requirements for an organization to qualify for the exemption, including the requirements:

- That records be kept in accordance with sound accounting practices;
- That consumer funds be banked in a trust account;
- That appropriate fidelity bond and insurance be maintained;
- That reports be made to debtors;
- That independent audits be made; and
- That the exemption apply only to prorater activities (and not the other licensed activities under the CSBPPL).

The exemption was intended to recognize organizations with a public or charitable purpose that had emerged in California in order to assist debtors with credit problems. Prior to 1968, the exemption was unnecessary because the services of these organizations were entirely free to the consumer, thereby not placing the organization within the definition of "prorater." However, the 1968 legislation allowed these organizations to charge minimal fees solely to offset the expenses of providing services, where the cost of providing services wasn't entirely funded through other means. The regulatory requirements in the exemption were provided to ensure the protection of debtors in dealing with these organizations.

AB 2293 revised the exemption. Effective January 1, 2003, the exemption:

1. Requires the organization to have as its principal functions consumer credit education, counseling on consumer credit problems and family budgets, and arranging or administering debt management or settlement plans;

2. Requires the organization to limit fees received from a debtor to no more than the following:

    a) For education and counseling combined, $50;
    b) For debt management plans, a sum not to exceed 6.5 percent of the money disbursed monthly, or twenty dollars ($20) per month (whichever is less); and

c) For debt settlement plans, a sum not to exceed 15 percent of the amount of the debt forgiven.

3. Prohibits the organization from requiring up-front payments or deposits;

4. Prohibits the organization from requiring the payment of fees until the debt is successfully settled;

5. Requires the organization to maintain and keep current and accurate books, records, and accounts;

6. Requires the organization to provide to the Commissioner, prior to engaging in business, information on where the trust account holding debtors' funds is maintained, and consent for the Commissioner to take possession of the account, if necessary for the protection of debtors;

7. Requires the organization to maintain a $25,000 surety bond;

8. Requires the organization to report account information to a debtor at least once every three months, or upon the debtor's request;

9. Requires the organization to submit to the Commissioner an audit report containing audited financial statements;

10. Requires the organization to maintain accreditation by an independent accrediting organization, including either the Council on Accreditation or the International Standards Organization;

11. Prohibits the organization from engaging in any unfair or deceptive acts or practices;

12. Requires the organization to adopt and implement best practices designed to prevent improper debt management or settlement practices and prevent theft and misappropriation of funds;

13. Requires the organization to resolve complaints from debtors in a prompt and reasonable manner; and

14. Requires the organization to provide written notice to the Commissioner within 30 days of dissolution or termination of engaging in the activities of a prorater.

AB 2293 also added new enforcement authority to the CSBPPL to allow the Commissioner to more effectively bring actions for violations of the law. Upon enactment, AB 2293 did not have any formal opposition, and the enhanced regulatory requirements were supported by the Coalition for Quality Credit Counseling, industry participants who actively assisted in forming the legislation.

F. The Study Requirement in AB 2293

In addition to the above new regulatory requirements, AB 2293 requires the Department to conduct a study and make recommendations to the legislature regarding the establishment of fees for debt management and debt settlement plans.

In particular, Section 11 of AB 2293 provides as follows:

> The Department of Corporations shall conduct a study of the consumer credit counseling industry in California and make recommendations to the Legislature on or before March 1, 2003, regarding the establishment of fees for debt management plans and debt settlement plans. This study shall be conducted in consultation with the consumer credit counseling industry and consumer organizations.

During the enactment of AB 2293, the consumer credit counseling industry raised the concern that the fee cap under the existing licensing exemption had not been increased in twenty years, and in recent years creditors have reduced the amount of fair share contributions they are contributing to consumer credit counseling organizations. To address this concern, AB 2293 directed the Department to study the issue and make recommendations to the Legislature.

THE STUDY

A. Initial Solicitation

In late October, the Department sent a letter to a variety of local and national consumer and industry groups requesting assistance with the study.[25] The letters described the study required of the Department and the fee caps in the law prior to, and subsequent to, the effective date of AB 2293. The letters further requested the following:

1. Ideas on how the Department may obtain the information necessary for the Department to make recommendations to the Legislature regarding debt management and settlement fees;
2. Ideas on questions for industry participants in a survey that may elicit information that will be useful to the Department in formulating recommendations for the Legislature;
3. Information regarding potential survey respondents, including information on consumer groups representing debtors; and
4. Information on industry groups that may have records of nonprofit entities engaging in business in the consumer credit counseling industry.

The Department received four responses to its letters.[26] The responses came from Shelley Curran, Policy Analyst for the Consumers Union;[27] Richard Elbrecht, Supervising Attorney in the Legal Services Unit of the Legal Affairs Division of the California Department of Consumer

[25] The letter and list of recipients are provided in Exhibit 2.
[26] The responses are provided in Exhibit 3.
[27] According to Consumers Union, the publisher of Consumer Reports, it is an independent, nonprofit testing and information organization that only serves consumers.

Affairs; William Powers, Legislative Director of the Congress of California Seniors;[28] and Peter Lake, Chair of the Coalition for Quality Credit Counseling.[29] In addition to providing a response to the Department's October 24, 2002 solicitation, the Coalition for Quality Credit Counseling ("CQCC") also provided the Department assistance by forwarding industry group membership lists, cost-of-living/inflation calculators, and information on other states' fee limits. The CQCC also was available to answer the Department's questions related to the industry.

While not directly related to the Department's survey, the American Association of Debt Management Organizations arranged a workshop for its membership to assist its members in becoming familiar with the new requirements of AB 2293. The workshop and accompanying question-and-answer session provided the Department the opportunity to hear from industry participants. The workshop also provided the Department the opportunity to request contact information from industry participants for purposes of the study.

I. Consumers Union

Consumers Union provided the Department with background information on consumer debt. According to Consumers Union, consumer revolving debt has increased by ten times in the past twenty years and is now at a level of $680 billion. The increase in household debt and the general rise in the availability of credit have resulted in increased demand for credit counseling and an explosion in the debt industry. In the year 2000, three million consumers sought help from credit counselors.

According to Consumers Union, throughout the 1990s the debt industry boomed. Over the course of the past ten years, competition grew between traditional credit counseling services, which are affiliated with the NFCC and provide education, budgeting services and debt management plans, and smaller and more business-like nonprofit credit counselors. The smaller groups now comprise nearly forty-five percent of the industry.

Consumers Union recommended that the Department focus its study not only on questions regarding the need for a change in the fees charged for services, but also on the impact of such fees on consumers who use these services. It further suggested the Department use this opportunity to ask additional questions to better understand the industry and its practices.

Consumers Union provided the Department with suggested questions for the Department to include in its survey of credit counselors, including questions surrounding the funding and availability of credit counseling, the background of the credit counselors, and information on the customers of credit counselors. The Department incorporated many of these suggestions into its survey.

II. Congress of California Seniors

The Congress of California Seniors indicated that it wanted to associate itself with Consumers Union's comments. It further urged the study to attempt to determine who uses the credit

[28] According to the Congress of California Seniors, it is a statewide advocacy organization with a combined membership of over 600,000 dedicated to improving the quality of life for seniors and their families.
[29] According to the Coalition for Quality Credit Counseling, it is comprised of members from the two largest and oldest industry groups in the credit counseling industry: the National Foundation for Credit Counseling (NFCC) and the Association of Independent Consumer Credit Counseling Agencies (AICCCA). Together, these two trade organizations provide credit counseling to over 2 million individuals and families nationally each year and are managing over 1 million individuals in debt management programs.

counseling service by age and ethnicity, whether there is a relationship between credit counseling and bankruptcy, and what the standard is for successful credit counseling, if any. In creating the survey, the Department made the decision to limit the inquiry to the fee issue due to limited resources and severe time constraints. Therefore, the Department did not include the broad inquiries suggested. Nevertheless, the Department believes that the answers to these questions will provide beneficial information to those responsible for creating policy in this area.

III. Department of Consumer Affairs

The Department of Consumer Affairs ("DCA") provided the Department with several documents in addition to its letter, including information on the law regarding unlawful advertising, unlawful trade practices, fiduciary duties, and fair debt collection. DCA also provided several articles on credit counseling and debt management.

DCA discussed concerns with the falloff of financial support from creditors, and the increase in the need for credit counseling in light of the increase in consumer debt. DCA indicated that the complaints it receives indicate that a problem area in the industry is the failure of the credit counseling organizations to achieve the promised debt reductions for the debtors. DCA speculated that this might be attributable to organizations entering the market seeking to respond to the increased demand for services by offering services in exchange for creditor-unsubsidized prices. Credit counselors may be exaggerating results in order to induce debtors to pay higher fees for services. Credit counselors also may be "overselling" – enrolling debtors in debt management programs in instances where such a plan is not appropriate for the debtor, thereby causing a debtor to incur a monthly fee for a plan that does not result in overall savings for the debtor or the elimination of the debt.

With respect to the current statutory fee structure, DCA made the following observation:

> "The current statutory fee structure naturally encourages overselling by linking the amount of the authorized fees to the amounts paid under the plan, a certain way to [motivate] debt management firms to enroll people in debt management programs when it is not in their best interests to do so. This motivation is likely to be especially powerful if the fees that can be charged for counseling, education and other services are limited to low amounts, as they presently are. The reason that overselling can easily occur is that most people who have become accustomed to the use and repayment of credit are genuinely capable of carrying out a debt management program on their own (but, of course, not one that achieves the extraordinary results promised by some debt management firms but rarely if ever achievable). The enclosed materials indicate that credit counselors typically enroll a very low percentage of their clients in formal debt management programs. One source indicates that only about 30% are so enrolled. Another source that [DCA has] consulted indicates that the percentage so enrolled may be as low as 15%. In contrast, debt management firms typically enroll all or most of their clients, [DCA is] informed. (An apt analogy would be a physician who had his patient visit him daily to administer an aspirin tablet.)"

DCA recommended the Department consult an economist for the purpose of validating whether the current fee structure encourages overselling, and to facilitate the design of a fee structure that would encourage desirable behavior by credit counselors, creditors, and debtors. Unfortunately, the Department does not have the resources necessary to implement this recommendation. Nevertheless, the Department agrees with DCA that an economist would be best suited to study the effect of the fees on the behaviors of the entities involved.

DCA further suggested that the Department remember, in structuring its survey of credit counselors, that the organizations responding to the survey have an interest in merchandising formal debt management programs that cost debtors far more than the present law permits. DCA noted that if debtors need protection by government, overextended debtors need a great deal more. The Department attempted to follow this advice in structuring its survey by probing into the costs of providing services to debtors, rather than merely requesting recommendations on fee increases.

DCA counseled the Department to be skeptical of recommendations for large increases in fees, or the elimination of fee caps, based on the reasoning that this will allow credit counseling to be more widely available, and the market will naturally set a competitive fee structure. DCA compared the impact of this reasoning to the deregulation of interest rate ceilings in consumer credit transactions in the late 1970s and 1980s, and the resulting large proliferation of debt. Finally, DCA suggested that, to the extent overextended consumers have resources that they may use to pay for credit counseling and debt management, only a very small portion should be used for that purpose, and the rest should go to the consumer's creditors to reduce debt.

IV. Coalition for Quality Credit Counseling

The CQCC indicated that as AB 2293 was moving through the Legislature, the only area of disagreement between legislators and the industry revolved around the fees that are permitted to nonprofit agencies under the licensing exemption. This fee study is the compromise on that issue. The CQCC indicated that the combination of escalating consumer prices since 1983 (the last time the statute was revised), the reduction in support from creditors for credit counseling, and higher overall operating costs that were not present in 1983 all contribute to make the current fee unrealistic.

The CQCC provided the Department with specific recommendations on how the Department may obtain information necessary to make recommendations to the Legislature concerning debt management and debt settlement fees.

- Other States

  The CQCC recommended the Department look to fee structures used in other states and supported by the NFCC and AICCCA for the best indication of fees that should be permissible in California. The CQCC provided an appendix to their letter with a summary of the fees permitted by other states that regulate credit counseling operations. The CQCC indicates that the states identified have direct licensing of credit counseling organizations and have first-hand knowledge of the types of fees that are necessary to provide quality credit counseling.

- Industry Standards

  The CQCC indicated that, as a condition of membership, AICCCA limits the fees that may be charged by its members to a maximum of $75 for a start-up fee and a maximum monthly maintenance fee of $50. The CQCC indicates that these fees have stood the test of time, and are designed to provide a fee structure that supports the industry, provides good value to consumers and permits ethical counseling agencies to continue to provide other valuable services, such as housing-related and educational services, to consumers.

- Cost-of-Living Index

  The CQCC suggested the Department use a cost-of-living index in determining an appropriate fee. According to the CQCC, using the cost-of-living index as applied to Social Security payments, a $20 fee in 1983 would be $35.81 in 2001. The CQCC indicates that the cost of providing services has increased (above inflation) since 1983, because agency accreditation and counselor certification did not exist in 1983, creditor requirements have increased, and creditor support has decreased since that time.

The CQCC specifically recommended the following fees:

- A fee of $75 to start a program;
- A monthly fee of $50 for administering a debt management plan;
- An increase in the percentage of the monthly payment that may be paid in fees to 12%;
- No cap on fees that may be charged of clients using other services, such as counseling on credit reports or housing related matters;
- A 15% limit on debt settlement negotiation fees, chargeable once actual savings to the consumer are accomplished; and
- A permissible minimum fee of $350 for debt settlement services, where the $350 may be charged if debt settlement services are cancelled after 5 days.

In response to the Department's inquiry regarding questions to ask industry participants, the CQCC suggested the Department ask questions related to the costs of doing business in California under California's regulatory structure. The CQCC further suggested questions on fees in other states and accreditation and counselor certification. The Department incorporated some of the questions into its survey. However, where the answers to the questions would be outside the scope of the Department's recommendations to the Legislature, the Department decided not to include the questions, in light of time and resource limitations. Finally, the CQCC provided the Department with the names and addresses of AICCCA members and other organizations providing credit counseling services that may be operating in California. The CQCC further provided the Department with copies of the California SBC and Verizon Yellow pages for Credit and Debt Counseling Services.

B. Review of Other States

The Department researched the laws in other states to determine how other states regulate fees in the consumer credit counseling industry. The CQCC provided the Department with information on the fees allowed in other states, and Kathleen Stutts, President and CEO of the

Consumer Credit Counseling Service of the Sacramento Valley, surveyed NFCC members and provided their responses to the Department.

The Department found a wide range of regulatory structures.[30] For a few states, the Department was unable to find any regulatory requirements at all.[31] Many states prohibit the business of "debt adjusting" or "debt pooling," but exempt nonprofit corporations, as specified, among other common exemptions, such as attorneys and creditors.[32] A few states expressly limit the exemption to services provided without cost to the debtor.[33] Other states expressly limit the fees charged to debtors (or received for services, which may also include contributions from creditors) to the actual cost of providing the service, or provide that the fees must be nominal.[34] Some states require licensing or registration. Of these states, several limit licensing to nonprofit organizations.[35]

The Department prepared the following chart of information on the states that have fee limitations. The chart sets forth the limitations on initial, monthly, and termination fees that may be charged by the organization, and relevant conditions on the fees. Note that many states limit fees to 15% of the money deposited by a debtor monthly. A survey of these states appears to indicate that most states permit the credit counselor to charge a debtor 15% of money deposited monthly, in addition to the percentage of contributions received from creditors. Indiana's statute expressly provides that the combined total fee for creditor contributions and debtor fees may be no more than 20% monthly.

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[30] In researching the laws of other states, the Department has attempted to be as thorough and accurate as possible. However, an organization should seek private counsel to determine its obligations when engaging in business in any state, and should consult with the proper authorities to ensure that the Department's interpretation of any state's law is accurate.
[31] For example, Alaska.
[32] For example, Kentucky prohibits debt adjusting, except for tax-exempt charitable organizations under Section 501(c)(3) of the Internal Revenue Code. Louisiana exempts nonprofit corporations from its prohibition of debt adjusting. Massachusetts law provides that the furnishing of services for a debtor in connection with a debt pooling plan constitutes the practice of law, except in the case of a nonprofit credit counseling corporation. In South Carolina the practice constitutes the practice of law, and no exemption appears to exist for nonprofit corporations. Oklahoma prohibits "debt pooling," except for a nonprofit association formed for the purpose of collecting accounts and exchanging credit information. Texas prohibits "debt pooling," but exempts a nonprofit organization providing debt-counseling services to residents of that state. Wyoming prohibits "debt adjusting," except by a tax-exempt nonprofit consumer credit counseling service. South Dakota prohibits "debt adjusting," but exempts nonprofit corporations, and also exempts any person filing a $50,000 bond with the attorney general of that state.
[33] For example, in Georgia it is unlawful to engage in the business of debt adjusting, but presumably offering free services is lawful. Maryland also prohibits debt adjusting, but exempts nonprofit, religious, fraternal, or cooperative organizations that offer debt management service exclusively for members, if a charge is not made and a fee is not imposed. Mississippi prohibits debt adjusting, except for nonprofit corporations whose consideration comes exclusively from creditors, and who register with the state. Missouri, North Carolina and New Mexico prohibit debt adjusting, except for an agent of creditors of a debtor, whose services in adjusting the debtor's debts are rendered without cost to the debtor. However, New Mexico also excepts nonprofit corporations organized as a community effort to assist debtors (with no fee limit), and Missouri indicates that credit service organizations may charge a nominal fee for processing, etc. Pennsylvania prohibits debt pooling, except by better business bureaus, legal aid societies, or welfare agencies acting without compensation or profit on behalf of debtors as debt adjusters or debt poolers.
[34] For example, Arkansas prohibits the activity, except for nonprofit organizations giving debt management service "without fee or charge or with fee if such fee is in an amount not to exceed the amount of actual expenses incurred in offering such service." Delaware, Hawaii, and the District of Colombia prohibit "debt adjusting," except by a nonprofit or charitable corporation or association, even though the nonprofit corporation may charge and collect nominal sums as reimbursement for expenses in connection with such services.
[35] For example, Connecticut and Rhode Island limit licensing to bona fide nonprofit organizations. Both states define a "bona fide nonprofit organization" to require that no person profit financially, other than receiving a reasonable salary, and that "debt adjustment services" be provided at no cost or at a cost not to exceed that required to defray necessary, reasonable and bona fide expenses to provide such services. Maine has a licensing act for nonprofit corporations. New York licenses nonprofit organizations only, and requires the fees to be charged to be submitted to the state (however, the statute does not limit the fees).

STATE	INITIAL FEE	FEE LIMITATION	CANCELLATION FEE
Arizona (A.R.S. §6-709)	Retainer fee of $39.	¾ of 1% of total indebtedness or $50 monthly, whichever is less. • A licensee is not entitled to any fee until notice of the debt management contract has been given to all creditors listed in the application form. • Unusual and necessary "out of pocket" expenses may be charged by the licensee if there is advance written approval of debtor and Arizona Superintendent of Banks. • Total debt is calculated not less often than annually and the charges are adjusted on the new total debt. • Any fees charged may not be based on a total debt which includes a mortgage on the residence or a rent payment as a liability or a debt. • If a compromise of a debt is arranged by the licensee with any of the creditors, the debtor is allowed the full benefit of that compromise.	If the termination is by the debtor, the licensee may keep the retainer fee.
Georgia (O.C.G.A. § 18-5-2)		Prohibits fees.	
Idaho (Idaho Code § 26-2229) (Requires a permit under Idaho Collection Agency Act.)		Prohibits a permit holder from taking or receiving for services performed more than 15% of the amount received by it at any one time for payment or prorating to creditors and provides that no other charges may be made or received for any such service.	
Illinois (205 ILCS 665/12)	Initial counseling fee not to exceed $50 per debtor counseled, provided the average initial fee for all debtors counseled does not exceed $30 per debtor.	Not to exceed $50 per month, provided the average monthly fee does not exceed $30 per debtor for all debtors counseled.	
Indiana (Burns Ind. Code Ann. §28-1-29-8)	Maximum initial payment of $50 which must be deducted from the total contract fees and charges in order to determine the monthly amortizable amount for subsequent fees.	Not to exceed 15% of the amount the debtor agrees to pay through the licensee, divided into equal monthly payments over the term of the contract. The total monthly amount of fees paid by the debtor to the licensee plus the fair share fees paid by the debtor's creditors to the licensee may not exceed 20% of the monthly amount the debtor agrees to pay through the licensee. • Any fees charged by the licensee for services rendered, other than for cancellation, are not considered a debt owed by the debtor to the licensee. • Unless approved, a licensee may not retain in the debtor's trust account, for charges, an amount more than one month's fee plus the close-out fee. • A licensee may not enter into a contract with a debtor for a period longer than 24 months.	Upon cancellation of the contract or termination of payments by the debtor, no more than $100 may be withheld as a closeout fee. • The licensee may not charge more than one set up fee or cancellation fee, or both unless the debtor leaves the services of the licensee for more than six months.

STATE	INITIAL FEE	FEE LIMITATION	CANCELLATION FEE
Iowa (Iowa Code §533A.9)		Not to exceed 15% of any payment made by the debtor pursuant to the contract.	If there is a total payment of the contract before the contract period has expired, the licensee may receive no more than 3% of such final payment.
Maryland (Md. COMMERCIAL LAW Code Ann. § 14-1316)		Prohibits fees.	
Michigan (MCLS §451.428)	Initial payment of not more than $25, which is part of the fees and charges of the licensee and may be deducted from the amount of a subsequent fee that is amortized.	Not to exceed 15% of the amount of the debt to be liquidated during the express term of the contract.	In the event of cancellation or default, the licensee may collect $25, in addition to the fees already received, which is not subject to the 15% limitation. This provision does not apply to cancellations made by the debtor which were done by midnight of the third business day after the first day the contract was in effect.
Minnesota (Minn. Stat. §332.23) (Minnesota's licensing law provides that the licensing law is not applicable to nonprofit corporations, organized under Minnesota law, giving debt prorating service, provided no fee is charged for such service.)	Origination fee of not more than $25 and the actual cost of a credit background report from a credit reporting agency (if affiliated with the licensee, the total cost of the report may not exceed $8). The cost of only one credit report may be collected in any 12-month period.	Not to exceed 15% of funds deposited with licensee by debtor for distribution. • No fees or charges for any handling of recurrent payments, including current rent, house, utility, telephone, maintenance, child support, insurance premium and such other payments as may be prescribed by the Minnesota Commissioner of Commerce. The total fees in the contract may be exceeded in relation to creditors under open-end agreements if agreed to in the contract and the additional debts to be prorated do not exceed 10% of the original debts in contract or written revisions to the contract (Minn. Stat. §332.21).	
Mississippi (Miss. Code Ann. § 85-9-5)		Prohibits fees.	
Montana (Mont. Code Anno. §31-3-203) (Montana only permits nonprofit or charitable corporations or associations to engage in this activity.)	Processing and documentation fee of $75.	15% of the total amounts that are owed by the debtor and reduced to equal monthly portions over the life of the contract.	

STATE	INITIAL FEE	FEE LIMITATION	CANCELLATION FEE
Nebraska (R.R.S. Neb. §69-1212)	Initial payment that is not to exceed $25 and which is credited to the total fee to be charged.	Not to exceed 15% of the amortized amount agreed to be paid through the licensee. • A licensee is not entitled to any fee or charge until the debt management program is arranged and approved by the debtor.	Not to exceed 25% of the remaining unamortized fee agreed upon in the contract.
Nevada (NRS §676.250) (Nevada's licensing law is not applicable to nonprofit corporations organized to render financial planning service to the public.)	Initial retainer fee of $50 (need not be amortized).	Not to exceed 15% of the listed terminal indebtedness (does not include indebtedness on a residence or other expenses normally incurred in maintaining a residence), exclusive of the retainer fee. The service fee must be amortized equally, each month, over the length of the contract. • A licensee may charge a fee of $3 per check issued in payment of all nonterminal indebtedness. • A licensee may not receive a fee, other than the initial retainer fee, until the licensee has secured the consent of more than 50% of the total number of creditors listed in the contract and holding more than 50% of the total indebtedness listed in the contract.	If the debtor satisfies the total indebtedness listed in the contract before its expiration, the licensee is allowed to charge a fee of not more than 7% of the then-remaining balance of indebtedness listed in the contract.
New Hampshire (RSA 399-D:11)	The licensee may request a deposit of $10 upon the signing of the contract, which is to be held in escrow by the licensee. If the debtor fulfills the conditions of the contract, the deposit will be returned. If the debtor fails to make payment in accordance with the contract for a period in excess of 60 days, the deposit will be forfeited.	The fee amount varies according to the plan of payment and is to be amortized equally at 30-day intervals. The permitted fee is as follows: (a) not more than 10% of the amount required to pay indebtedness when the plan is for a period of 10 months or less; (b) not more than 12 ½ % when the plan is for a period of more than 10 months but less than 18 months; (c) not more than 15% when the plan is for a period of 18 months or more. • A licensee is not entitled to a fee until the debt adjustment program is arranged and approved by the debtor. • A licensee may not receive any fee without the written consent of creditors who hold obligations representing 25% of the total amount of indebtedness and 25% of the total number of creditors listed in the contract, or unless a like number of creditors accept a distribution of payment. • A licensee is not entitled to a fee until the contract has been in full force and effect for 30 days. A contract shall not be effective until a debtor has made a payment for distribution to his creditors. • If the licensee arranges a compromise with any one or more creditors, the debtor shall have the full benefit of the compromise.	In the event of prepayment or cancellation by the debtor with 30 days' written notice to the licensee, or cancellation by the licensee after willful default for more than 30 days by the debtor, and if the licensee has performed all of the services required by the statutory code and the terms of the contract, the licensee is entitled to a cancellation charge of 5% of the agreed service charge which is due and unpaid for the unexpired term of the contract, but in no event more than $50.
New Jersey (N.J. Stat. §17:16G-6) (Only New Jersey nonprofit corporations may obtain licenses. An agent of creditors of the debtor, whose services in adjusting the debtor's debts are rendered without cost to the debtor, need not be licensed.)		Permits a fee to cover the cost of providing debt adjustment and credit counseling (each defined separately). Fee for debt adjustment may not exceed 1% of the gross monthly income of the debtor, but in no case more than $25 in any one month. Fee for credit counseling services may not exceed $60 in any one month. • The fee may be waived in the discretion of the licensee.	

STATE	INITIAL FEE	FEE LIMITATION	CANCELLATION FEE
North Carolina (N.C. Gen. Stat. § 14-426)		Prohibits fees.	
North Dakota (N.D. Cent. Code §13-07-06) (North Dakota prohibits "debt adjusting" except for nonprofit or charitable corporations.)	Origination fee of up to $50, which may be subtracted from the initial amount paid by the debtor to the counseling service.	Up to 15% of any sum deposited by the debtor for distribution may be withdrawn and retained as partial payment of the consumer credit counseling service's fee. • An agreement with a debtor may not be entered into unless a thorough written budget analysis indicates the debtor can reasonably meet the requirements of the plan and that the debtor will be benefited by the plan.	
Oregon (ORS §697-692)	Initial set-up fee of not more than $25.	Not more than 15% of the amount actually received by the debt consolidating agency on behalf of a debtor for payment to creditors. • A debt consolidating agency may charge a fee to cover the expenses for education classes if certain conditions apply, and the fee has been approved by the Director of the Department of Consumer and Business Services. • With the exception of the education classes, an agency shall not charge a person for any discussion that may or may not result in an agreement for services of the agency.	Prohibits the making of a contract or agreement with a client that provides for later charges or reserves for liquidated damages.
Pennsylvania (18 Pa.C.S. § 7312)		Prohibits fees.	
Tennessee (Tenn. Code Ann. § 39-14-142)		Prohibits "debt adjusting," except nonprofit organizations rendering debt management services for fees or charges not to exceed $20 per month per debtor.	
Vermont (8 V.S.A. § 4872)		Provides that the fee retained may in no case exceed 10% of any payment received by the licensee for the purpose of distribution to creditors, except that the Commissioner may by regulation allow the accumulation of a reserve fund which may not exceed $ 50 and may allow the licensee a reasonable service charge, not to exceed $ 25 in the event of the prepayment, cancellation or default of the contract.	
Virginia (Va. Code Ann. §6.1-363.1) (Note that Virginia's law is applicable only to nonprofit agencies – otherwise, the activity constitutes the practice of law.)		A monthly fee not to exceed $20. The licensee may with the debtor's advance permission after disclosure of applicable fees, be reimbursed by the debtor for (i) the actual cost of obtaining one credit report and related information from credit reporting agencies and (ii) the actual bank charges for automatic account debiting for debt repayment. Prior to entering into an agreement with a debtor for the provision of debt pooling or distribution services, a licensee is to provide separate written notice informing the debtor that the provision of services may have a derogatory effect upon the debtor's credit report and credit scores.	

STATE	INITIAL FEE	FEE LIMITATION	CANCELLATION FEE
Washington (Rev. Code Wash. (ARCW) §18.28.080) (Washington's licensing provisions are not applicable to a nonprofit organization engaged in debt adjusting if it does not assess against the debtor a service charge in excess of $15 per month.)	Initial charge of up to $25 which is considered part of the total fee. (If there is an initial charge, no additional fee may be retained which would bring the total fee retained more than 15% of the total payments up to that date.)	Not to exceed 15% of the total debt listed by the debtor on the contract. The fee for any one payment retained by the adjuster may not exceed 15% of the payment. • No fee shall be applied to rent and utility payments for housing. • A debt adjuster is not entitled to retain any fee until notifying all creditors listed by the debtor that the debtor has engaged the adjuster in a program of debt adjusting. • Washington prohibits a debt adjuster from receiving any cash, fee, gift, bonus, premium, reward, or other compensation from any person other than the debtor or a person in the debtor's behalf in connection with his or her activities as a debt adjuster.	In the event of cancellation or default by the debtor, the debt adjuster may collect 6% of the remaining indebtedness listed on the contract, but not to exceed $25.
West Virginia (W. Va. Code §61-10-23) (West Virginia prohibits the solicitation of this activity.)		Allows a fee equal to 2% of the total amount of money deposited by a debtor for the purpose of distributing to creditors. A nonprofit firm, corporation or voluntary association may make an additional charge not to exceed 5% of the total amount of money actually deposited pursuant to a debt pooling to defray the costs of counseling services furnished for the benefit of debtors.	
Wisconsin (Wis. Adm. Code DFI-Bkg 73.01)	A budget set up charge of $50 is permitted; however, if the debtor engaged in a "debt adjustment plan," the permitted fee is $25.	The maximum monthly fee charged the debtor may not exceed 10% of the amount of money paid to the licensee to be distributed to a creditor or creditors or $ 120 in any one calendar month, whichever is less. The agency may accept voluntary fees or contributions from the creditors in an amount not to exceed 15% of the funds disbursed to the creditors. • No fee may be charged on any money advanced or returned to the debtor.	

C. Survey of Consumer Credit Counseling Organizations

As part of the Department's study, the Department sent a survey to all of the consumer credit counseling organizations that the Department was able to locate. The survey, including the Department's letter of explanation, is attached to this report as Exhibit 4. The list of consumer credit counseling organizations (or possible consumer credit counseling organizations) to which the Department sent the survey is attached to this report as Exhibit 5.[36] In preparing the questionnaire, the Department considered a simple survey asking consumer credit counseling organizations what they believe the fee should be, and why. However, the Department determined that without inquiring into the specifics of the costs of providing services, the sources of income, and the organizations' financial information, the Department would not be able to make informed recommendations related to fees. Therefore, the Department opted for a longer survey intended to elicit details regarding the income and expenses of the

[36] The Department had many mailings returned by the Postmaster. Also, several organizations to which the Department sent surveys called to inform the Department that they were not engaged in the business of credit counseling or prorating in California.

organizations. The Department received over 35 responses to the survey.[37] These responses are included as Exhibit 6.[38]

I. Responses to Survey Regarding Sources of Funding and AB 2293

AICCCA members were very diligent in responding to the Department's survey. AICCCA responded to the survey on behalf of its members, and the individual members provided the Department with additional facts and opinions in their responses that were specific to their individual operations. The size of organizations responding to the request ranged from consumer credit counseling organizations with nearly $300,000 in annual revenue to consumer credit counseling organizations with over $25,000,000 in annual revenue.

In reviewing the responses, the Department found the following common responses:

a) Dramatic decline in creditor fair-share contribution in the past few years.

Consumer credit counseling organizations universally responded that the money received from creditors and the capped fees from debtors do not cover the cost of operations. The consumer credit counseling organizations identified a drastic decline in creditor contributions in recent years.[39] Partners in Vision International, Inc. indicates:

> "As recently as a few years ago, voluntary creditor contributions (fair share), were a larger source of revenue for the CCC/DMP agency. In fact, this agency never asked its clients for a monthly contribution until July, 2002. Recently, creditors' philosophy has changed. Fair share contribution has dropped off significantly, being cut almost in half on average. In the past, an average client's mix of creditors provided concessions such as reducing the clients' interest rates, and waiving their late fees and over-limit fees – this in addition to paying the agencies higher fair share. Our agency believes, the recent reduction in fair share is based on the creditors' need to control costs – creditors can't control their costs by offering both top concessions and top fair share."

The Department received many comments indicating that creditors should be required to make fair share contributions. CCCS of Alabama, Inc. suggested "[s]upport should be required by creditors and interest rates capped for prorated accounts much like the law in Canada."

In addition to survey respondents attributing the decrease in creditor contributions to the creditors controlling costs, some consumer credit counseling agencies attributed the decrease in creditor contributions to the large increase of agencies operating as "debt management providers."[40] The proliferation of debt management organizations, disparagingly referred to as "dmp mills" by traditional consumer credit counseling agencies, has resulted in creditors

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[37] Responses continue to arrive.
[38] The Department has not included the organizations' financial records in the report.
[39] See, for example, Kathleen Day, Credit Counseling Agencies Dealt Setback; Banks Reduce Funding as Bankruptcies Rise; Consumer Groups Hit Move, July 16, 1999, The Washington Post, describing the cutback in funding by banks. This article is attached as Exhibit 7.
[40] The distinction between "debt management providers" and "consumer credit counselors" appears to be that a debt management organization's core function is enrolling clients in debt management plans and frequently they operate solely over the telephone. These organizations do not spend a measurable amount of time on education and counseling for any particular community, and through maximizing enrollments in debt management plans are able to repay a lot of consumer debt to creditors, and thereby receive a lot of funding through fair share contributions. See, for example, Springboard Non-Profit Consumer Credit Management, A White Paper on Debt Management Industry Counseling Methods, attached as Exhibit 8.

responding to the marketplace by substantially decreasing fair share contributions and implementing various performance requirements for the receipt of the voluntary funds.[41]

The reduction in contributions by creditors may have been inevitable, given the ability of debt management organizations to operate cheaply (by phone or through the Internet) and enroll a large number of individuals in debt management plans. However, the traditional community-based credit counselors that provide person-to-person counseling are disproportionately impacted by the reduction in fair share contributions by creditors. By and large, the survey respondents indicated that fair share contributions have declined from 12% to 15% a few years ago, to an average of 7% or less currently (of the amount of funds paid to the creditor). Only the largest creditors pay a fair share contribution. Thus, while consumer credit counseling organizations facilitate debt payments to numerous creditors (some may have thousands of creditors to whom they facilitate payments to), the number of creditors making a fair share contribution to these agencies appears to be around 100 (or fewer). However, these creditors are also often receiving the most money from the consumer credit counseling organizations.

Consumer credit counseling organizations indicate that while the fair share contribution averages around 7%, the range is 0% (or no contribution) to 10%. Further, creditors are implementing "pay for performance" programs that affect the fair share contribution. The Department requested the standard reimbursement terms of creditors in its survey, but generally did not receive specific terms from respondents. However, the Department did receive MBNA's terms, which require (1) tax-exempt status under IRC § 501(c)(3), (2) maximum fees of $100 for start-up, $50 monthly, (3) RPS payments,[42] (4) accreditation, (5) a minimum of 90% of total budget proposals to be RPS full budget proposals,[43] and (6) a decline rate of less than 15%. Consumer credit counseling organizations with a decline rate of 0% to 5% receive a fair share contribution of 10%, a decline rate of 6% to 10% receive a contribution of 8%, and a decline rate of 10% to 15% receive a contribution of 6%.[44] Consumer credit counseling organizations expressed that concern that creditors continue to decrease fair share contributions, and therefore this funding source may continue to decline.

b) Education and counseling generally provided free - supported by debt management plan fees and creditor fair share contributions.

Survey question number 15 asked consumer credit counseling organizations whether they charge a fee for counseling services, and nearly every respondent answered "no." In response

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[41] According to David A. Lander in Recent Developments in Consumer Debt Counseling Agencies: The Need for Reform, February 2002, ABI Journal, "Toward the end of the 90s, consumer retail lending profits leveled off. Consumers began paying their bills in ways that generated fewer late charges and less interest; limits had been reached on the extension of credit and on the benefits of consolidation and technology. As profits leveled off or dropped, creditors began looking more closely at the debt-counseling industry they had created. Creditors realized that fair share was a significant expense item to them that was allowing some agencies to accumulate a surplus, and was encouraging new entries into the industry. The debt-counseling industry had been created in a way that encouraged agencies to put people into debt-management plans since such plans generated maximum revenue to the agency. In 1999 and 2000, a number of major creditors that had been supportive of the debt-counseling industry reduced or eliminated fair share contributions, and some that had provided concessions to participants in the debt-management plans reduced or eliminated those benefits. This has significantly reduced revenue at debt counseling agencies."

[42] "RPS" means "remittance processing service," and requires payments be made electronically.

[43] See, for example, Mastercard's description of its services of providing budget proposals electronically to creditors from credit counselors, in Exhibit 9.

[44] The "decline rate" appears to be MBNA's rate of declining debt management plans proposed by the consumer credit counseling organizations. According to David A. Lander in Recent Developments in Consumer Debt Counseling Agencies: The Need for Reform (February 2002, ABI Journal), "Recently, two creditors, First USA and MBNA, developed and implemented proprietary evaluation mechanisms according to which the creditor pays debt counseling agencies on a sliding scale that rewards agencies that bring value to the creditor."

to the question regarding the percentage of the credit counselor's budget that is derived from counseling or education services, the most common answer was none. Many consumer credit counseling organizations offer education such as the course "Credit When Credit is Due," and charge $50 (on average) for the course. Thus, some consumer credit counseling organizations receive some income from debtor education. However, the income is nominal, and amounts to no more than 1% to 7% of a consumer credit counseling organization's budget, according to the survey.

Some consumer credit counseling organizations provide a wide variety of education opportunities or credit-related services. The education offered includes such topics as purchasing a home, budgeting, interest rates, purchasing an automobile, checkbook balancing, frugal vacations, and identity theft. Some consumer credit counseling organizations also provide programs for IRS tax settlement assistance, student loan assistance and consolidation, down payment assistance programs, foreclosure intervention, and credit report education. Some charge nominal fees for services (frequently $25 - $50). The responses indicate that consumer credit counseling organizations generally do not mandate that clients engage in any particular education program for which a fee is charged, but many indicated that a client's success in a debt management program is improved if education is also a component of the program.

The survey did not define "counseling" and therefore responses to the survey varied accordingly. Some organizations consider every contact with the organization "counseling," given that the contact would involve the inquiry into details about the consumer's income and debt, and result in at least an assessment of whether the consumer is a candidate for a debt management program. Partners in Vision indicated that "[c]lients are required to complete a household budget to track money management and identify overspending and identify potential financial resources. Counseling includes additional education and action steps and recommendations."

Regardless of the extent of counseling provided to each client, counseling and education was nearly universally funded through the income received from clients in debt management plans, including creditor fair share contributions. As indicated by CCCS of Alabama, Inc., "nobody wants to pay for education." The number of clients in debt management plans as a fraction of total clients counseled varied among consumer credit counseling organizations, but the most frequent percentage was between 20% and 35%. A few consumer credit counseling organizations operating nationally indicated that about 10% of those contacting the agencies are enrolled in debt management plans. Consumer credit counseling organizations generally indicated that from 25% to 50% of their budgets were funded by clients enrolled in debt management plans, with about 50% to 70% of their budgets funded through creditor fair share contributions. In comparing the numbers, it appears that overall fees charged of clients enrolled in debt management plans are somewhat aligned with the fraction of total services received by this group. However, it may alternatively be reasoned that this group is not receiving any benefit from the fair share contributions related to their repayment of debt, since funding is used by consumer credit counseling organizations to provide counseling to clients not enrolled in a debt management plan for free.

c) No measurable funding received from other sources.

While a few consumer credit counseling organizations identified small grants (all less than $100,000) from sources such as HUD or local municipalities, most consumer credit counseling organizations indicated that they did not receive any funding from grants or fundraising. All revenue was generally received from creditor fair share contributions and debt management fees, with some revenue from education.[45]

d) Requirements of AB 2293 do not create need for additional funding.

While consumer credit counseling organizations pointed to some provisions in AB 2293 that may increase costs, in general the requirements of the bill were not identified as the cause of consumer credit counseling organizations' concerns with operating under the current fee restrictions. Many consumer credit counseling organizations identified the fee restrictions in AB 2293 as causing financial difficulties; however, these comments generally reflect a lack of prior compliance with existing fee restrictions, since AB 2293 did not amend the amount that may be charged a debtor monthly to administer a debt management plan. Some consumer credit counseling organizations identified the bonding and audit requirements as additional burdens. However, the law prior to AB 2293 required a bond and an independent audit.[46] Consumer credit counseling organizations also pointed to the cost of revising client agreements, and the cost of providing certified counselors.

Some consumer credit counseling organizations cited long distance charges as an increase in costs. It is unclear how AB 2293 increases long distance charges. Consolidated Credit Counseling Services, Inc. identified the following costs as a result of AB 2293:

> "Bank charges related to California client transactions. Previously, bank charges were offset to some degree by interest earned on the funds. AB 2293 requires the trust account to be non-interest bearing. This is unfair to our organization and an absolute gift to banks. Mailing costs for quarterly reports to all CA clients, estimated at approximately $1 per client per quarter. Previously, reports were sent to clients upon request."

A few respondents indicated that "changes in California regulatory interface" increases costs. As a result of AB 2293, consumer credit counseling organizations must now file audited financial statements annually with the Department. Professional Credit Counselors suggested that AB 2293 prohibits some reputable companies from doing business in California, indicating that the existing fee limits presume that monthly maintenance fees are the only way of charging fees for services and prohibit other methods that may benefit debtors.[47]

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[45] A credit counselor's Annual Information Return (IRS Form 990) may indicate additional revenue from interest or investments, however these amounts were not significant.

[46] The provision in AB 2293 regarding bonding is much more specific, and thus compliance would impose a new cost on credit counselors. Respondents frequently indicated the cost of the bond was $250 to $500 a year.

[47] According to Deborah McNaughton of Professional Credit Counselors, "With the way this California Legislature and study for AB 2293 is designed there are many companies that will not be able to offer their services to the residents of California. I understand putting some restrictions and caps on fees must be implemented to protect consumers, however: it should not be one sided where only the NFCC and AICCCA benefit by driving other companies out of business in the state of California. Funding from grants and large corporations such as the United Way with donations in excess of millions of dollars to the NFCC helps keep their business operating. In addition to the 'fair share' collected from the creditors, a monthly service fee, and set up fee the NFCC can charge a lesser fee than other companies who don't depend on donations. In comparison, other companies who are highly reputable may charge a set up fee. The Debt Relief Clearinghouse companies do this, however; in comparison with the NFCC and AICCCA, the consumer with the Debt Relief Clearinghouse is actually paying less or equal to the NFCC or AICCCA. This is a result of the money from the 'Good Payer Program' being rebated back to the client. [The 'Good Payer Program' is an account set up for the consumer where 50 percent of the 'fair share' paid to the company is saved and given to the client. Every six months if the payments have been paid on time upon the request of the client, the company will give the client the money.] I know of no other company offering this incentive to their clients."

II. Responses to Survey Regarding Costs and Need For Fee Increases

a) Cost to Initiate and Administer Debt Management Plans

The Department's survey asked consumer credit counseling organizations about the cost to initiate and administer a debt management plan, and what these costs were based on. The figures provided by respondents varied widely. Consumer credit counseling organizations also provided the Department with figures on the numbers of clients enrolled in debt management plans. In some instances, the figures provided to the Department as the cost of a debt management program are higher than the total expenses the credit counselor claimed on its Annual Information Return divided by the number of clients it indicated are enrolled in debt management plans.

However, as the consumer credit counseling organizations indicate, the number of clients in debt management plans continually fluctuates, as some complete their plans, some drop out and some enroll. Therefore, the numbers requested by the Department are moving targets and not easily estimated, according to the consumer credit counseling organizations. Also, as the consumer credit counseling organizations indicate, the costs vary widely. Some debtor accounts are easily maintained whereas others require more interactions and thus are more costly.

Consumer credit counseling organizations provided the Department the following information on the costs for debt management plans. At Consumer Credit Counseling Service of Mid-Counties, the initial counseling session with a client lasts from 90 to 120 minutes. It indicates the cost of counseling is $75 per hour, based on the average counselor salary, benefits, training and overhead. Thus, the cost to initiate a plan averages around $150 per client, including another half-hour to set-up the plan. Credit Counseling Centers of America indicates that the average cost can be as high as $400 to initiate a plan, with an average monthly cost from $15 to $35, "depending on each client and considering the following factors: the number of creditors enrolled into the DMP, whether the creditor accepts electronic or manual proposals, the mix of creditors, whether the creditor acknowledges the acceptance of the DMP to the agency or to the client, and the manual follow-up that is required with the creditor to obtain a debt management plan status for the client, etc."

Pioneer Credit and Debt Consolidation Services indicates the initial cost ranges from a low of $40 to a high of $350, "depending on client, amount of debt, length of counseling session, educational level of client. Cost is actual labor costs for counseling session and the negotiation process with the individual creditors along with the educational materials. Cost does not include advertising." It indicates the cost of administering a plan ranges from a low of $5 to high of $75 per month.

b) Benefits to Debtors

The consumer credit counseling organizations indicate that clients in debt management plans receive such benefits as reduced monthly payments,[48] reductions in interest rates and potential elimination of interest charges, re-aging of delinquent accounts, cessation of over-the-limit fees, changing of due dates, elimination of late fees, and elimination of maintenance fees. The

[48] Though usually not reductions in debt.

Consumer Credit Counseling Service of Virginia and Southeast Maryland, Inc. indicates that it conducted a customer value assessment and found that an average client would obtain $2,500 in debt management plan reductions in interest, late fees, and over-the-limit fee waivers. It suggests that this client benefit more than compensates for the client fees needed to offset decreasing creditor service contributions.

c) Variances in Profitability

The Department's survey and a review of the consumer credit counseling organizations' Annual Information Returns reveal a dichotomy on profitability. A few agencies are operating at a loss, or close to a loss, on a shoestring budget. These agencies are unanimously community-based NFCC members that provide in-person counseling to the community. The survey responses of these agencies tend to show that they are providing a lot of counseling services to lower income persons and the under-served communities.

At the other end of the spectrum, some of the largest agencies responding to the survey show sound financial health. These agencies are frequently national, and appear to be providing services by telephone. Almost unanimously in all agencies' Annual Information Returns (except those showing a loss), the excess of revenue less expenses is very small relative to the revenue of the agency. However, a review of the details of the returns shows that large amounts are frequently spent on items such as marketing, advertising, or public awareness. In a few instances, a third to a half of the total expenses is attributable to these expenses. In some instances, a large amount of the expenses is attributable to a service that is provided by a separate, affiliated organization related to the agency through common membership, governing bodies, trustees, or officers. A few returns show handsome salaries to officers and directors.

Every respondent indicates that it does not request fees in circumstances where the debtor is unable to afford the fees. However, many organizations indicated that the criteria for a debtor to enter a debt management plan includes the debtor being more than 30 days behind in payments and income insufficient to meet monthly expenses without creditor concessions. Thus, the ability to "afford" the fees is a relative term. Some agencies indicated that fees are requested of debtors on a scale, based upon their ability to pay. Other agencies appear to have fixed fees.

d) Shift Cost to Creditors

Related to the discussion on the decrease in fair share contributions by creditors, many respondents suggest that creditors should be held accountable and required to make a greater fair share contribution. According to CCCS of Alabama, Inc., " Creditors give credit at high rates to people who clearly cannot afford it. Creditors share much of the responsibility in creating the problems and should financially support the solution [by being required to make a fair share contribution]. Creditors have cut costs and improved their bottom line by shifting the cost of debt management plans to consumers. If creditors are not required to support plans, they will continue to use donations to put pressure on agencies to act in the creditor's best interest and not the consumer's."

e) Pleas for Fee Relief

In response to the Department's questions regarding whether there should be fee caps, some agencies supported the free-market approach to setting fees.[49] However, many agencies recommended fee caps equivalent to the caps required by a major creditor ($100 initiation and $50 monthly maintenance) and the AICCCA ($75 initiation/set-up and $50 monthly maintenance). According to the AICCCA:

> "AICCCA's fee caps of $75 for enrollment and $50 monthly for maintenance are based on the realities of the industry. These limitations have been carefully considered based upon the experience of years of industry involvement. These are maximums and many of our members make them entirely voluntary. Also, it is common for consumers who need the services of our members but are in serious financial trouble, to receive our services for little or no fee. Any agency recommending lower fee caps should be free to operate at those lower fees if they are able to deliver quality service under them. AICCCA's fee caps are well below those allowed by many other states. Limiting fees to a percentage of outstanding debt has little to do with agency costs. Each month, the consumer's payment must be processed, their bills paid, and statements sent. Educational materials are made available to all consumers equally without regard for their level of debt. AICCCA agencies do not charge those who cannot afford to pay."

In addition to these benchmarks, many agencies indicated that fee caps should be based on cost-of-living increases since 1983 (the effective date of the last statutory fee increase) and some suggested additional growing room. A sampling of the recommendations and comments regarding the requested increases is included in Exhibit 10.[50]

While a few agencies recommended small increases, such as increasing the cap from $20/month to $25 or $30/month, one agency suggested that a fee increase is unnecessary. According to Christian Credit Counselors, Inc., "we do not feel that the current fee cap should be lifted. We operate at an average far less than the cap and we are able to maintain a substantial surplus in our contributions received. Consumers are already burdened with their debts. Based on our operations, agencies should be able to provide excellent services at the current fee cap allowed."[51]

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49 See, for example, Consolidated Credit Counseling Services, Inc., which indicated "California clients will receive a lesser benefit than clients in other states that do not mandate such lower fees. Benefits include educational materials free of charge, personalized financial counseling and a higher level of customer service. The aim of our organization is to provide a valuable and much needed service to the consumer at a reasonable and justifiable cost and with the best level of consumer support. Limiting fees results in the lack of ability to provide the best service to the consumer as the organization is unable to attract experienced and knowledgeable staff and acquire the technology to efficiently and effectively run the organization. In addition, the size of the debt and the number of creditors have a direct impact on the cost of processing the client's transactions. A fee cap does not take this into account. Consumers in the industry are financially strapped and most will shop around for the best deal based on cost. So whether an organization is for profit or nonprofit, they both target the same consumer and pricing will be a major concern for the consumer. However, if consumers believe that nonprofits cannot provide as good a service as for profit organizations due to lack of resources, this will severely effect the ability of nonprofit organizations to compete in the market. Debtors can be protected from excessive fees by ensuring that the agreement clearly stipulates all fees and that there are no hidden charges. We believe that most consumers do shop around and are aware of the fee levels. However, to protect those uninformed consumers, there could be a cap of say 15% of the average amount of the monthly payment. This has been used by other states and would prevent those unscrupulous organizations that charge large up-front fees."

50 Also included is a summary of fees or requested contributions for consumer credit counseling organizations providing this information.

51 According to this agency, "We suggest a voluntary contribution of up to $20 per month. We average approx. $13 per month per client. We do not charge any one time or start-up fees. We have maintained a large surplus in our receipts over the years. We provide excellent service to our clients. We do not feel that the fee caps currently in place should be increased as

In requesting fee relief, traditional consumer credit counseling agencies expressed the necessity to maintain the community-based counseling structure. According to Consumer Credit Counseling Service of Mid-Counties, “Without fee relief, the only business model that is left is to more closely resemble the national telephone-only servicing centers, not offering comprehensive counseling in areas of housing and education.”

The AICCCA indicated that monthly fees were not a source of problems in the industry that necessitated regulation. According to the AICCCA:

> “The major problem in the credit counseling industry does not lie with fees that fall in the range of ‘reasonable’ or with the agencies that charge such reasonable fees. By and large, most nonprofit credit counseling agencies are consumer advocates and strive to provide a valuable counseling service. Consumers nationwide have fallen victim to agencies that have charged excessive fees such as the entire first month’s payment as a fee, sometimes without the consumer’s full knowledge. These agencies often operate their nonprofit entities for personal gain rather than in the best interests of consumers. Those agencies should be the prime targets for the controls that California seeks to enforce.”

According to Consumer Credit Counseling Service of Twin Cities, “The client who comes for our services should be paying for the value of counseling by certified counselors as mandated by NFCC. The cost of health care, workers compensation liability and any professional services are on a high increase as our income decreases therefore we need to have a fee increase in order to keep services available for consumers.”

f) Debt Settlement Plans

Most survey respondents indicated that they do not perform debt settlement plans (the negotiating and settling of all of a debtor’s debts in a lump-sum payment). CCCS of Alabama, Inc. stated “Debt settlement Plans that have the agency hold money and consumers ‘save up’ for the settlement should be banned! It is bad for the consumer because if a settlement agreement cannot be reached, when the consumer saves enough to pay the settlement, the consumer will be so far behind they will have no choice but to file bankruptcy. Consumers in debt management plans, however, will sometime have lump sums from tax returns or other sources and want help from agencies with settlement negotiations. This involves a great deal of agency staff time and compensation should be allowed, but certainly no more than 15% of the amount owed.”

Consumer Debt Counselors, Inc. indicates that “typically, we will only suggest settlements to clients whose debt obligation has been sold to a third party collector at a discount to the actual indebtedness.” According to Springboard Nonprofit Consumer Credit Management:

> “Due to the intrinsic nature of the product, there is a lot of work involved upfront in negotiating a settlement. In fact, all the hard work is at the beginning – that of

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it would be an additional burden on already stressed consumers. We feel that any agency that places the clients needs as a priority should be willing to provide debt management services as a priority not based on the profitability of the organization.” A review of this agency’s Annual Information Return indicates that it does indeed have a substantial surplus, and keeps operating expenses at a minimum.

contacting the creditor and making a deal. It's sort of like a catch 22: the creditor tends to be more agreeable to a YES if we can prove the client has the money to settle; we can prove this more easily if the client already has funds on deposit with us – the best indication of good faith on their part. The agency deserves some sort of set up fee for this initial work as we take on too much risk without knowing how serious the consumer is. The consumer needs to have some 'skin in the game' so to speak. [We] would suggest a 'setup' fee cap of $300.00. [We] know as a matter of fact that our agency's pricing model - from which AB2293 got the '15% of savings' idea - is the cheapest to be found anywhere. We do not earn interest on client funds. Not being able to collect anything upfront has greatly hurt our ability to do these."

g) Biannual Survey

In addition to fee increases, AICCCA members suggested the Department conduct a survey every couple of years to ensure that the fee cap is keeping pace with market changes.

D. Survey of Debtors

In conducting its study, the Department also surveyed debtors. The survey is attached as Exhibit 11. Given that the Department does not have direct access to debtors, the Department received many more responses from debtors than it anticipated. The Department is grateful to the consumer credit counseling organizations that ensured the survey was distributed to their clients, despite the fact that debtors interests in increasing fees would probably not be aligned with those of the consumer credit counseling organizations. Also, the Department notes that many debtor responses came from the U.S. Trustee. The Department had not thought to distribute the survey in this manner and it is appreciative of the consumer group or credit counselor that facilitated this distribution. The Department received close to 200 responses from debtors. The debtor survey was very simple. By and large, most respondents indicated that the $20 monthly fee cap was reasonable. A few respondents thought the fees were too high. Further, a few respondents suggested it is reasonable to raise the fee. The respondents' personal information has been redacted, and the survey responses are attached to this report as Exhibit 12. A chart summarizing the debtor comments with respect to the debt management plan cap is attached as Exhibit 13.

E. Survey of Consumer Groups

The Department surveyed consumer groups, and requested they answer specified questions on the debtor survey. The letter to consumer groups and a list of the groups receiving the survey are attached as Exhibit 14. Consumers Union responded to the Department's request,[52] and its response is included as Exhibit 15. The Department asked consumer groups to comment on what is a reasonable fee limit for the service of paying a debtor's bills under a debt management plan, and why.

Consumers Union provided the following response:

"Absent an increase in other allowable fees, it would be appropriate to grant an increase for credit counseling providers which reflects the Consumer Price Index (CPI). The CPI

[52] The Department also received responses from industry representative groups that the Department has included with the summary of survey responses for consumer credit counseling organizations.

measures price of a constant bundle of goods over a period of time and is frequently used to consider the present value of money from one period of time to the next. The CPI in 1982 for the Western Urban area was 97.4. In 2002 the number was 184.7. In short, the present value of $20 in 1982 was $37.93 at the end of 2002, a difference of $17.93.

But, credit counselors are now permitted under California statute to charge a one-time education and counseling fee of $50 from debtors that they were not explicitly permitted to charge before the enactment of this statute on January 1, 2003. Consumers Union recognizes that the $20 fee is an ongoing monthly fee. Even still, the increase in the education fee covers the difference between the present day value of the $20 fee nearly 3 times. Furthermore, charging consumers this education and counseling fee is not contingent upon a consumer entering a debt management or debt settlement plan. Arguably, consumers who do not enter debt management plans may now be charged the $50 counseling and education fee, providing credit counselors a new and expanded revenue stream.

Because this $50 is well over the present day value of $20 in 1982, Consumers Union sees no reason to increase the monthly fee for servicing a consumer's debt at this time. We urge the Department to recommend to the Legislature that this fee remain the same until the impact of the increased education and counseling fee is fully understood."

Consumers Union further cautioned the Department from considering fee increases for 15% limit on debt settlement plans, and indicated it does not think that the $50 education and counseling fee should be increased. Consumers Union indicated that both of these fees were just implemented with AB 2293, and therefore it is premature to make changes. Consumers Union further indicated that fee caps are both necessary and beneficial, and indicated that because of the way the law was drafted prior to AB 2293, some credit counselors charged excessive fees for their services. According to Consumers Union, because credit counselors are now permitted to charge fees to consumers well in excess of the present value of the previous fees permitted by statute, it does not think that there is any justification for additional fee increases at this time.

CONCLUSION

The Department's study of fees in the consumer credit counseling industry has highlighted the competing interests among creditors, traditional consumer credit counseling agencies, and emerging consumer credit counseling agencies.

A. <u>Creditors</u>

The Department's study indicates creditors are one of the primary beneficiaries of the efforts of the consumer credit counseling industry. Consumer credit counseling organizations educate debtors, keep debtors out of bankruptcy, and facilitate debt repayment to creditors. An alternative to increasing fees on distressed debtors could be to have creditors increase support of organizations providing these services. The Department was able review the Annual Information Returns of these organizations to determine the entities in need of greater support, and creditors should take an active role in doing the same. Further, creditors need to recognize that debt management plan contributions support debt counseling and education in many underserved communities, and thus creditor fair share contributions should not be solely linked to the amount of debt recovered through the consumer credit counseling organization. This means of funding disproportionately rewards debt management plan “mills,” punishes organizations with a counseling and education focus, punishes organizations focused on local, underserved communities, and shifts the industry from acting as a charity to acting as a collection agency.[53]

While the Department regulates some lenders at the state level, the majority of banks granting the unsecured credit are national banks regulated at the federal level. Therefore, the Department is unable to make any recommendations that would result in requiring creditors to take the burden off of debtors to support these organizations. Nevertheless, as Congress considers requiring credit counseling as a component of bankruptcy reform, the Legislature could urge Congress to consider a similar study of the consumer credit counseling industry and a determination of whether creditors should be mandated to support this industry. As the consumer credit counseling organizations indicate, the creditors are partially responsible for the situation of many of the distressed debtors by granting too much credit for the debtor’s income and resources, by charging oppressive rates of interest, late fees, and over-the-limit fees, and in some instances by engaging in predatory lending practices. California has actively attempted to put an end to predatory lending for the institutions under its jurisdiction, and the Legislature could urge Congress to do the same.[54]

B. Traditional Consumer Credit Counseling Organizations

The Department’s study indicates that traditional consumer credit counseling organizations, those community-based organizations with a physical presence in often moderate-to-lower-income neighborhoods offering face-to-face consulting and extensive credit education programs, are the organizations that are likely to be operating in the red, or on a shoestring budget. These organizations appear to be facing the greatest fiscal strain from the reduction in creditor support because of the high labor cost of the services provided by the agencies. These agencies may have limited resources, and some may have been slow to introduce new ways of engaging in business to provide the opportunity for a greater number of debtors to be serviced through debt management plans (and thereby increase revenue).

C. Emerging Consumer Credit Counseling Organizations

The Department’s study indicates that the emerging consumer credit counseling organizations, those organizations that have emerged in the last decade, are operating in a more business-like fashion and have driven the industry in efficiently providing services to clients. While these organizations may face financial pressures in the future as creditor support erodes, the Department’s study did not identify these organizations as operating on a shoestring budget or close to the red.

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[53] The following suggestion is set forth by David A Lander in Recent Developments in Consumer Debt Counseling Agencies: The Need for Reform (February 2002, ABI Journal) in an article discussing the transformation of the industry away from counseling and education: “The situation is on a very dangerous track. If the agencies providing effective counseling and education are to have any chance of continuing, progressive and sophisticated creditors must create a productive dialogue that must include consumer representatives, the dialogue should focus on quality, and major creditors must provide sufficient funding to those agencies that provide effective services. The dialogue should lead to a method of making certain that those agencies that provide productive services are paid for those services.”

[54] AB 489 (Migden, Chap. 732, Stats. 2001).

RECOMMENDATIONS

The Department has carefully considered the recommendations of debtors, consumer groups, and credit counseling organizations, and each group's reasons for its recommendations. The Department is proposing several recommendations for the Legislature to consider.

A. Monthly Maintenance Fees for Debt Management Plans

Existing law limits the monthly maintenance fee that may be charged a debtor to 6.5% of the money disbursed monthly or $20, whichever is less.

Recommendation 1: Increase $20 limit to $35 to incorporate a cost-of-living increase, if no counseling and education fee is imposed on debtors. The Department recommends a cost-of-living increase to the monthly maintenance fee that may be charged a debtor from a maximum of $20 to a maximum of $35 per month. However, the Department recommends that the increased monthly fee only be permitted for debtors that are not charged an education and counseling fee. In light of the fact that AB 2293 authorized a charge of up to $50 for education and counseling effective January 1, 2003, debtors already face an increase in the cost of obtaining debt management services from organizations charging the maximum fees allowed by law. While a cost-of-living increase to the monthly maintenance fee is reasonable in light of the length of time since the last increase, the new counseling and education fee defrays the need for a cost-of-living increase. Therefore, a cost-of-living increase of up to $35 per month in monthly maintenance fees is recommended only where consumer credit counseling organizations are not charging an education and counseling fee.

Many consumer credit counseling organizations suggested that the monthly maintenance fee be increased to $50 per month, as recommended by AICCCA to its members and required by certain creditors. However, this suggestion represents a 150% increase in a fee imposed on distressed debtors. A substantial increase in fees charged to debtors may provide creditors with an incentive to decrease funding more, and thereby shift more of the cost onto debtors for a service that provides a substantial benefit to creditors. Many organizations are able to operate in California under a much lower fee cap, as evidenced by the growth of the industry in California throughout the years the cap has been in effect. These conditions do not support a large increase. Further, debtors have indicated that the $20 maximum monthly fee is reasonable, in light of their inability to meet their debt obligations. Many debtors indicate that the $20 is too high, and recommend a lower fee. Consumers Union recommends no increase at all. The Department's recommendation is a balance of all interested parties, and continues to protect debtors against unreasonably high fees.

Although the $20 fee limit in existing law has not been adjusted for inflation in 20 years, technology has also changed over this time. Electronic bill payment is now available and relatively inexpensive.[55] Nevertheless, an increase in fees appears necessary due to the increase in labor costs, rent, and other expenses. Therefore, this recommendation represents an increase in the maximum monthly fee that recognizes a cost-of-living increase over the years in question, while attempting not to shift the burden of funding these services from creditors, one of the beneficiaries of the services, to debtors, the least able to pay for the

[55] For example, the United States Postal Service has a bill payment service that allows consumers to pay up to 20 bills per month for $6.95 a month. Yahoo! offers a bill payment service for $4.95 a month for up to 12 bills.

services. Finally, note that while some states allow greater fees, other states prohibit fees entirely, and some states have fee caps lower than $35. Thus, a maximum monthly maintenance fee of $35 does not place a burden on consumer credit counseling organizations providing services in California that is disproportionate to that in other states.

Recommendation 2: Continue to maintain the 6.5% ceiling for fees on money disbursed monthly. After considering the comments and suggestions from all parties, and the reasons for the suggestions, an increase in this percentage does not appear to be necessary. Inflation has no bearing on this figure, and thus little reason supports increasing the percentage. Consumer credit counseling organizations suggest that the decrease in fair share contributions by creditors necessitates a need for increased fees from debtors. However, increasing the ceiling on this fee cap will shift the cost of supporting these organizations from creditors onto debtors by increasing fees on those debtors repaying the smallest amount of their debt monthly. As the debtor surveys indicate, if these individuals have more disposable income to pay in fees, they would be paying more of their debt. Therefore, no increase to the 6.5% ceiling for fees on money disbursed monthly is recommended.

B. Counseling and Education Fees

Existing law (post AB 2293) limits the fee that a debtor may be charged for education and counseling to a one-time sum of $50.

Recommendation 3: Maintain the current fee cap of $50. Consumer credit counseling organizations suggest that the fee cap for education and counseling related to a debt management plan be increased to $75 or $100. AICCCA suggests a maximum start-up fee of $75. In the Department's survey of debtors, they generally state that the $50 fee cap is reasonable, and Consumers Union suggests that it is premature to raise the fee. In light of the fact that this fee was just instituted last year in AB 2293 (effective for 2003), and recognizing that a significant number of other states have a limitation on initial fees at or less than $50, it is too soon to consider an increase in this fee. As noted by Consumers Union, this new fee provides an additional source of funding for consumer credit counseling organizations since many people use their services but do not enroll in a debt management plan. It is noteworthy that in the Department's survey of consumer credit counseling organizations, most indicated that they do not charge a fee for counseling.

C. Debt Settlement Fees

Existing law (post AB 2293) limits the fee that a debtor may be charged for a debt settlement plan to 15% of the amount of debt forgiven, and prohibits any up-front payments or deposits.

Recommendation 4: Maintain the current ceiling of 15% of the amount of debt forgiven, but allow an up-front fee of $300 or 5% of the total debt, whichever is less (included as part of the 15%, not in addition to the 15%). Consumer credit counseling organizations performing debt settlement services have indicated that these services require a substantial amount of work. These organizations indicate that requiring debtors to have a "stake in the game" ensures that the debtor will follow through with the debt settlement, and that the counselor's work in negotiating the settlement of the debt does not go to waste. It appears that allowing a small portion of the money up-front will not harm debtors, if certain protections are set forth in the law. The following protections are recommended:

- The debtor has a “cooling off” period to change his or her mind, such as the ability to cancel within 5 days;
- The credit counselor validates the debtor’s ability to raise the lump-sum payment before negotiating the settlement and retaining any fee;
- The credit counselor does not retain any part of the up-front fee if the debtor changes his or her mind before all of the debtor’s creditors have been contacted (even after the 5 day cooling-off period);
- If, upon settlement, any part of the up-front fee is more than 15% of the amount of debt forgiven, that amount is refunded to the debtor; and
- The credit counselor negotiates a settlement that reduces the debtor’s debt to an amount acceptable to the debtor, as set forth in the initial contract for services.

The above recommendations are fair to the industry and fair to debtors, and continue to protect debtors against the potential of overreaching by some in the industry.

D. Additional Options for the Legislature to Consider

In addition to the above recommendations, the Department sets forth the following options for the Legislature’s consideration. Option 1 is presented as a possible alternative to Recommendation 1. Option 2 is presented for consideration as way to assist organizations providing in-person counseling to a community. Option 3 is presented as a way to reduce the cost of doing business in California.

Option 1: Consider a mandated fee scale as an alternative to Recommendation 1. As an alternative to Recommendation 1, the Legislature may wish to consider a mandated fee scale based upon a debtor’s gross monthly income. This method of calculating fees would ensure that those debtors with the fewest resources pay the least for services. Further, it aligns the cost of services to a debtor’s income, rather than to his or her debt (see DCA’s comments regarding the problems with linking fees to the debt being repaid). For example, New Jersey limits the permissible fee to 1% of the debtor’s monthly gross income, not to exceed $25. New Jersey also permits a separate charge for counseling, not to exceed $60 in any one month. The separate charge for counseling allows an organization to recover the cost of providing the service to debtors. This formula appears to ensure the cost of services is not oppressive for those unable to pay, and shifts counseling costs onto those using the services.

However, there are negative aspects of this approach. The separate counseling fee discourages debtors from receiving counseling, and additionally, those in need of financial counseling may not have the resources to pay for it. As noted by the consumer credit counseling organizations, debtors do not want to pay for counseling and education, but the success rate for debtors in debt management plans is higher when counseling and education are a component. Note that it will be necessary to carefully define the activities that constitute “counseling” if a separate monthly fee is considered.

Option 2: Consider differing fees for organizations providing in-person services. The Legislature may wish to consider different fee caps for community-based organizations providing in-person counseling services. Arguably, these agencies provide more of a benefit to a community as a whole, over and above those agencies nationally serving debtors over the phone.[56] However, they also cost more to operate. (The Department notes that in its survey, these organizations appeared to be the most likely to have precarious financial conditions.) The Legislature may wish to consider a cap at one and a half times that of organizations not offering in-person counseling, while requiring the fee be limited to a percentage of the debtor's monthly income (1% or less), to ensure that fees are on a scale and not every debtor is charged the maximum fee. To define these organizations, the Legislature may wish to consider requiring that (1) the organization's contributions from creditors and debtors total less than $2 million annually; (2) the organization provides the option of in-person counseling; (3) no employee, officer, director or trustee receives more than $150,000 annually in salary and benefits; (4) marketing, advertising, and public awareness is no more than 10% of total expenses; and (5) the organization is not related through common membership, governing bodies, trustees, officers, etc. to any other exempt or nonexempt organization (line 80a of part VI of Form 990, the Annual Information Return under the Internal Revenue Code).

Option 3: Consider amending regulatory requirements to reduce operating expenses. The Legislature may wish to consider amending the regulatory requirements on consumer credit counseling agencies to assist in lowering the cost of doing business in California. Possible changes to consider include:

- Clarifying that mandating an education or counseling component to a debt management plan is not a prohibited "ancillary service" under AB 2293;
- Allowing organizations to retain interest earned on trust fund accounts;
- Clarifying that bank fees for insufficient funds may be charged to debtors and are not part of the monthly fee cap;
- Permitting organizations to file Form 990 (the Annual Information Return under the Internal Revenue Code) annually instead of audited financial statements; and
- Allowing trained counselors to meet with clients under the supervision of certified counselors, rather than requiring certification for every counselor.

These changes would not compromise the debtor protections in existing law, and may assist in lowering costs for consumer credit counseling organizations in California.

In formulating the above recommendations and additional options for consideration, an attempt was made to balance the interests of all affected parties.

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[56] See Kathleen Day, Credit Counseling Agencies Dealt Setback; Banks Reduce Funding as Bankruptcies Rise; Consumer Groups Hit Move, July 16, 1999, The Washington Post: "Household International sent a letter May 11 to counseling agencies that offer telephone counseling only, rather than face-to-face service, to announce rates would be cut to 6 percent June 1, down from 9.5 percent, 'in an effort to be consistent with our competitors. Face-to-face counseling is a more expensive service to provide and, we believe, more effective,' said Household spokesman Craig Stream."