

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 1405 (Wicks)
Version: July 1, 2021
Hearing Date: July 13, 2021
Fiscal: No
Urgency: No
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SUBJECT

Debt settlement practices

DIGEST

This bill establishes the Fair Debt Settlement Practices Act, regulating debt settlement providers and payment processors, as defined.

EXECUTIVE SUMMARY

Consumers facing the burden of overwhelming, unsecured debt, such as credit card debt, often turn to debt settlement companies. These, generally for-profit, companies offer services with the goal of negotiating on behalf of the consumer with creditors to reach a settlement of outstanding debts. This usually involves settling the debt for a reduced overall amount and paying it off in agreed-upon monthly payments. In exchange, the consumer pays the debt settlement provider certain fees.

However, while some tout the services as a lifeline to struggling consumers, there have been widespread instances of deceptive practices in the industry that make big promises and leave consumers worse off than when they started.

This bill establishes the Fair Debt Settlement Practices Act in order to regulate debt settlement providers and payment processors. The bill prohibits harmful and deceptive practices and requires specific contractual provisions that enhance transparency and consumer protections. The bill also requires certain monthly reporting and authorizes consumers to cancel at any time without penalty. The bill also establishes an enforcement mechanism to ensure consumers can enforce their own rights.

This bill is sponsored by the California Low-income Consumer Coalition. It is supported by a coalition of groups, including the East Bay Community Law Center and the Public Law Center. The bill is opposed by RESOURCE. The bill passed out of the Senate Banking and Financial Institutions Committee on a 7 to 0 vote.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Provides the Check Sellers, Bill Payers, and Proraters Law (Proraters Law), administered by the Department of Financial Protection and Innovation (DFPI), which requires a prorater to be licensed by DFPI. (Fin. Code § 12000 et seq.)
- 2) Defines “prorater” as a person who, for compensation, is engaged in the business of receiving money and distributing it among creditors in payment of a debtor’s obligations. (Fin. Code § 12002.1.)
- 3) Establishes the California Consumer Financial Protection Law (CCFPL). (Fin. Code § 90000 et seq.)
- 4) Defines “financial product or service,” under the CCFPL, to include a service to assist a consumer with debt management or debt settlement, or modifying the terms of any extension of credit. (Fin. Code § 90005 (k)(8)(B).)
- 5) Defines “covered person,” under the CCFPL, as a person that engages in offering or providing a consumer financial product or service to a resident of this state and affiliates or service providers, as specified. (Financial Code Section 90005 (f).)
- 6) Authorizes DFPI to require covered persons engaged in the business of offering or providing a consumer financial product or service to register with the Department. (Fin. Code § 90009 (a).)
- 7) Establishes, in federal law, the Telemarketing Sales Rule, which regulates debt relief services by phone. The law prohibits the collection of fees or other consideration before the underlying debt is settle or reduced and requires debt relief service providers to truthfully disclose material terms of their services, including the amount of time necessary to achieve the represented results, in addition to other requirements and disclosures. (16 C.F.R. § 310.1 et seq.)

This bill:

- 1) Provides the following definitions:
 - a) “debt settlement provider” means a person who, for compensation, provides debt settlement services;
 - b) “debt settlement services” means any of the following:
 - i. providing advice, or offering to act or acting as an intermediary, including, but not limited to, offering debt negotiation, debt reduction, or debt relief services between a consumer and one or more of the consumer’s creditors, if the primary purpose of that

- advice or action is to obtain a settlement for less than the full amount of the debt; or
 - ii. advising, encouraging, or counseling a consumer to accumulate funds in an account for future payment of a reduced amount of debt to one or more of the consumer's creditors; and
 - c) "payment processor" means a person who provides payment processing services.
- 2) Prohibits a debt settlement provider from engaging in false, deceptive, or misleading acts or practices when providing debt settlement services. Without limiting the general application of the foregoing, an act or practice is false, deceptive, or misleading, in connection with providing debt settlement services, if the act or practice consists of any of the following:
- a) making or permitting another entity to publicly make on behalf of the debt settlement provider, a statement or representation that is false, deceptive, or misleading;
 - b) posting directly, or indirectly causing to be posted, an online review or ranking on an internet website if the debt settlement provider, or its agent, provided anything of value in exchange for favorable treatment in that review or ranking; or
 - c) omitting any material information.
- 3) Requires a debt settlement provider to provide consumers with specified disclosures along with an unsigned copy of the written contract proposed to be entered into between the parties no less than three calendar days prior to the execution of that contract by the consumer. A fully executed copy of the contract shall be delivered to the consumer by the debt settlement provider immediately after the debt settlement provider receives the contract. These disclosures include information about potential outcomes, the consumer's rights, and detailed information about the debts covered, the expected timeline, and methods to contact the debt settlement provider.
- 4) Prohibits a debt settlement provider and a payment processor from engaging in unfair, abusive, or deceptive acts or practices when providing debt settlement services or payment processing services. An act or practice is unfair, abusive, or deceptive if the act or practice consists of certain conduct carried out by a debt settlement provider or payment processor, including:
- a) offering to lend money or extend credit to the consumer, or purchase an enrolled debt; and
 - b) accepting any cash, fee, gift, bonus, premium, reward, or other compensation from any person other than the consumer in connection with debt settlement services.

- 5) Provides further that for a debt settlement provider it is an unfair, abusive, or deceptive act to request or receive payment of any fee or consideration for debt settlement services, unless and until certain conduct has occurred, including the provider settling or reducing the debt; and to fail to distribute a statement of accounting to a consumer at least once a month while the contract for debt settlement services is in effect, and as otherwise provided.
- 6) Provides further that for a payment processor it is an unfair, abusive, or deceptive act to facilitate the distribution of payment of any fee or consideration for debt settlement services before the requirements referenced in the above paragraph have been met. It is also an unfair, abusive, or deceptive act to fail to distribute a statement of accounting to a consumer at least once a month while the consumer is engaged with the payment processor, as well as on or before the fifth business day after a consumer requests a statement of accounting.
- 7) Authorizes a consumer to terminate a contract for debt settlement services at any time without a fee or penalty of any sort by notifying the debt settlement provider in writing, electronically, or orally. The debt settlement provider must then immediately cancel the contract, notify the payment processor, and provide a detailed accounting of amounts received and any documentation the provider has received from creditors.
- 8) Requires a debt settlement provider to immediately forward any notice of a lawsuit on an enrolled debt and any settlement agreement that a debt settlement provider has negotiated on the consumer's behalf.
- 9) Exempts specified persons and entities from the bill's application, including certain nonprofit business organizations and attorneys and law firms, as provided.
- 10) Authorizes a consumer to bring a cause of action against a debt settlement provider and a payment processor for violation in order to recover or obtain any of the following:
 - a) statutory damages in an amount to be determined by the court of no less than \$1,000 and no more than \$5,000 per violation of this title;
 - b) actual damages sustained by the consumer as a result of the violation;
 - c) injunctive relief;
 - d) costs and reasonable attorneys' fees; and
 - e) any other relief that the court deems proper
- 11) Establishes the statute of limitations for such actions as four years from the later of the last payment by or on behalf of the consumer or the date on which the consumer discovered or reasonably should have discovered the facts giving rise to the consumer's claim.

- 12) Provides for reasonable attorney's fees to be awarded to a prevailing debt settlement provider and a prevailing payment processor upon a finding by the court that the consumer's prosecution of the cause of action was not in good faith.
- 13) Immunizes a debt settlement provider or a prevailing payment processor from civil liability for damages under the bill if the debt settlement provider or a prevailing payment processor shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error, and occurred notwithstanding the maintenance of procedures reasonably adopted to avoid any error.
- 14) Provides a severability clause and deems waiver of these provisions as void and unenforceable.

COMMENTS

1. Stated intent of the bill

According to the author:

With many Californians struggling financially from the COVID-19 pandemic, it is important to ensure that consumers who are facing economic challenges are protected from predatory practices that may worsen their financial situations. Debt settlement companies have been loosely regulated, and current law has not reflected the changing practices of this industry, which has made enforcement more difficult. AB 1405 will provide oversight and regulation on bad actors in the debt settlement industry by updating current law to provide essential guardrails and basic consumer protections for Californians in order to prevent vulnerable consumers from predatory business practices.

2. Debt settlement industry

According to the Federal Trade Commission:

Debt settlement programs typically are offered by for-profit companies, and involve the company negotiating with your creditors to allow you to pay a "settlement" to resolve your debt. The settlement is another word for a lump sum that's less than the full amount you owe. To make that lump sum payment, the program asks that you set aside a specific amount of money every month in savings. Debt settlement companies usually ask that you transfer this amount every month into an escrow-like account to accumulate enough savings to pay off a settlement that is reached eventually. Further, these programs often

encourage or instruct their clients to stop making any monthly payments to their creditors.¹

The American Fair Credit Council (AFCC), an association representing the debt settlement industry, extolls its virtues:

AFCC members work diligently on behalf of financially challenged consumers to negotiate reductions of the balances owed on unsecured debts. Our members negotiate affordable repayment plans with their clients' creditors, thereby helping clients return to financial independence. In 2020 alone, AFCC member companies helped approximately 220,000 Californians settle more than \$453 million in unsecured debt.

However, on the same internet page cited above, the FTC immediately follows with warnings about debt settlement risks. It highlights that these programs often require deposits, that creditors have no obligations to agree to negotiate, and that they may even have a negative impact on your credit. Additionally, the site goes on to warn of debt-settlement scams where companies "engage in deception and fail to deliver on the promises they make." The FTC specifically advises to avoid doing business with a debt settlement company if it:

- charges any fees before it settles your debts
- touts a "new government program" to bail out personal credit card debt
- guarantees it can make your unsecured debt go away
- tells you to stop communicating with your creditors, but doesn't explain the serious consequences
- tells you it can stop all debt collection calls and lawsuits
- guarantees that your unsecured debts can be paid off for pennies on the dollar

The Consumer Financial Protection Bureau (CFPB) also expressly warns about the dangers of soliciting debt settlement services:

Warning: Debt settlement may well leave you deeper in debt than you were when you started. Most debt settlement companies will ask you to stop paying your debts in order to get creditors to negotiate and to collect the funds required for a settlement. This can have a negative effect on your credit score and may result in the creditor or debt collector filing a lawsuit while you are collecting settlement funds. And if you stop making payments on a credit card, late fees and interest will be added to the debt

¹ *Settling Credit Card Debt* (November 2012) Federal Trade Commission, <https://www.consumer.ftc.gov/articles/0145-settling-credit-card-debt>.

each month. If you exceed your credit limit, additional fees and charges may apply. This can cause your original debt to increase.²

At the federal level, the FTC'S Telemarketing Sales Rule regulates many debt settlement companies and specifically prohibits many of these practices, as provided. And in response to widespread deceptive practices, the FTC has used its enforcement authority to attempt to root out such schemes:

The FTC has brought scores of law enforcement actions against these bogus credit-related services, and the agency has partnered with the states to bring hundreds of additional lawsuits. Further, in 2010, the FTC amended its Telemarketing Sales Rule to protect consumers seeking debt relief services, like debt settlement or credit counseling. The Rule prohibits for-profit companies that sell these services over the telephone from charging a fee before they actually settle or reduce a consumer's debt. It also prohibits debt relief providers from making misrepresentations and requires that they disclose key information that consumers need in evaluating these services.³

The National Consumer Law Center describes the state of the industry in California and the need for stronger regulation of it:

As Californians continue to struggle with the financial impacts of the COVID-19 pandemic, it is clear that many are falling behind on bills. When seeking help with their debt, consumers should not also have to face the threat of being defrauded by those to whom they turn for assistance. Consumers in California all too frequently fall victim to the unrealistic and impossible promises offered in the online, direct mail, and radio advertisements of unscrupulous debt settlement companies that target people at their most vulnerable. Additionally, those who sign up for debt settlement agreements frequently discover that they were not presented with clear disclosures of the full impact the agreement will have upon their credit. As these consumers look to the unlicensed debt settlement companies for help in getting out of debt, they find themselves in more trouble, with a damaged credit score and facing lawsuits filed by the very creditors they thought they were paying off.

² *What are debt settlement/debt relief services and should I use them?* (February 15, 2017) Consumer Financial Protection Bureau, <https://www.consumerfinance.gov/ask-cfpb/what-are-debt-settlementdebt-relief-services-and-should-i-use-them-en-1457/#:~:text=Warning%3A%20Debt%20settlement%20may%20well,you%20were%20when%20you%20s tarted.&text=And%20if%20you%20stop%20making,your%20original%20debt%20to%20increase.>

³ *Debt Relief and Credit Repair Scams*, FTC, [https://www.ftc.gov/news-events/media-resources/consumer-finance/debt-relief-credit-repair-scams.](https://www.ftc.gov/news-events/media-resources/consumer-finance/debt-relief-credit-repair-scams)

Last year, the Legislature passed and the Governor signed AB 1864 (Limón, Ch. 157, Stats. 2020) which enacts the California Consumer Financial Protection Law (CCFPL). CCFPL provides the Department of Financial Protection and Innovation (DFPI) with broad authority to regulate providers of consumer financial products and services. However, given the infancy of the law, this bill steps in to provide baseline protections in the debt settlement industry to protect consumers from the worst practices connected with these services.

3. Strengthening the laws around debt settlement to protect consumers

This bill seeks to address the deceptive practices in the industry and to protect consumers that turn to these companies in their time of need. The bill borrows from a host of other regulatory structures to build a comprehensive consumer protection model, establishing the Fair Debt Settlement Practices Act.

a. Prohibiting deceptive practices

The bill starts by specifically identifying and prohibiting false, deceptive, or misleading acts in the industry. It expressly provides a nonexclusive list of the most problematic practices activities that are deemed to be prohibited, including:

- making or permitting another entity to publicly make on behalf of the debt settlement provider, a statement or representation that is false, deceptive, or misleading;
- posting directly, or indirectly causing to be posted, an online review or ranking on an internet website if the debt settlement provider, or its agent, provided anything of value in exchange for favorable treatment in that review or ranking; or
- omitting any material information.

The bill also regulates the conduct of “payment processors,” which are defined as persons who accept, maintain, hold, or distribute funds, or facilitate the acceptance, maintenance, holding, or distribution of funds, on behalf of a consumer for the purpose of facilitating debt settlement services.

The bill also prohibits “unfair, abusive, or deceptive acts or practices when providing debt settlement services or payment processing services.” This includes:

- offering to lend money or extend credit to the consumer, or purchase an enrolled debt; and
- accepting any cash, fee, gift, bonus, premium, reward, or other compensation from any person other than the consumer in connection with debt settlement services.

It also prohibits a debt settlement provider from requesting or receiving fees or other consideration for their debt settlement services, unless and until all of the following occur:

- the debt settlement provider has renegotiated, settled, reduced, or otherwise altered the terms of at least one debt pursuant to a settlement agreement approved and executed by the consumer;
- the consumer has made at least one payment pursuant to that settlement agreement between the consumer and the creditor; and
- the fee is set at an appropriate percentage of the amount saved, as provided.

b. Contractual requirements and mandated disclosures

Debt settlement providers are also required to make a number of disclosures. This ensures that consumers are aware of what they are getting into and their rights. This includes many of the same warnings made by the FTC and CFPB above, such as disclosing that:

- there is no guarantee that any particular debt or all of the consumer's enrolled debts will be reduced, eliminated, or otherwise settled;
- the deposits made pursuant to the contract will not be distributed to the creditor until a settlement is obtained. This may take months to achieve;
- if the consumer stops paying any creditor, the creditors may still try to collect or sue the consumer;
- failing to pay debts on time may adversely affect the consumer's credit rating or credit scores;
- specific results cannot be predicted or guaranteed, and the debt settlement provider cannot require a creditor to negotiate or settle a debt;
- whether the debt settlement provider pays or receives referral fees; and
- all conditions that the consumer must satisfy before the debt settlement provider will make a settlement offer to a creditor.

The bill also requires these contracts to make consumers aware that debt settlement services may not be suitable for all individuals and that there are other alternatives, such as bankruptcy. The contracts must also itemize and detail each debt to be serviced, provide the relevant estimated timelines, and provide adequate contact information for the provider. While the services are being provided, providers and payment processors must provide monthly statements to keep consumers informed. To provide consumers time to consider the decision, the provider cannot communicate with any creditors until five days after full execution of the contract. The bill also empowers consumers to cancel the contract at any time, and requires providers to inform them of this right.

c. Enforcement

To ensure these rights are meaningful, the bill provides consumers a cause of action against debt settlement providers or payment processors in violation of the bill's provisions. Consumers can seek statutory damages set by the court in addition to any actual damages. Prevailing consumers are entitled to costs and reasonable attorney's fees.

The bill also places some protections against frivolous actions, in addition to those already existing, and establishes a safe harbor for good faith providers and payment processors. It authorizes an award of reasonable attorney's fees to a prevailing defendant where it is found that the plaintiff's prosecution of the cause of action was not in good faith. It also insulates a provider and processor from any civil liability if they can establish by a preponderance of the evidence that the violation was unintentional and resulted from a bona fide error, and occurred notwithstanding the maintenance of procedures reasonably adopted to avoid any error. The bill establishes a four-year statute of limitations, as provided.

4. Stakeholder positions

The California Low-Income Consumer Coalition, the sponsor of the bill, makes the case:

The bill provides consumers with significantly more protection than they receive under current federal law while requiring modest but essential additional measures by debt settlement companies. The result is robust consumer protections against bad actors in the debt settlement industry with little change to the practice of those companies already acting in compliance with existing law.

The East Bay Community Law Center (EBCLC) explains the need for the bill and its support:

Over the last few years, EBCLC has seen a noticeable increase in consumer lawsuits initiated by collectors and creditors over debts that are enrolled in debt settlement plans. From 2019-2020, more than half of debt collection lawsuits by original creditors stemmed from participation in a debt settlement program. Throughout the pandemic, the burden on women, especially women of color, to maintain their household and a position in the workforce has been particularly unbearable. Mounting debt is an emotional, mental, and physical strain. Desperate consumers, many of whom are overwhelmed by debt for the first time, search for ways to manage their debt and ultimately find debt settlement programs. On its face, the basic practice of debt settlement is harmful to a consumer for a multitude of reasons. Firstly, the consumer can do the same practice

themselves for free. Secondly, the practice shows irresponsible behavior on the consumer's credit report which will impact the consumer's ability to qualify for safe housing, and high paying employment. And thirdly, debt settlement plans are the beginning of a financial death spiral that will take years to overcome -- if it is even possible. Aside from these harms, the most concerning harm is the number of people who report that they did not know what they were signing up for. This is seen far too often when the practice of debt settlement is described to consumers who contact our clinics, after they have been sued. . . . AB 1405 would make greater strides towards restoring the balance of the state financial ecosystem amongst consumers and creditors.

The California Association of Collectors writes in support:

AB 1405 would update current law to provide essential guardrails for an industry too often characterized by promises of relief that actually put already-struggling Californians at risk of further financial harm. Millions of Californians have been forced by the pandemic to take on debt. This bill would help prevent them from falling victim to companies that would take advantage of their economic vulnerability. The bill provides clear guidelines to protect consumers - and honest competitors - from companies engaged in harmful business practices.

An individual law firm writes in opposition to the bill. There are various exemptions from the bill, including for nonprofits and attorneys and law firms. The firm takes issue with the exemption as written for attorneys and requests a broader carve out.

RESOURCE also writes in opposition:

Legislative threats to the debt settlement industry, most notably AB 1405 in the California State Assembly, effectively kneecap embattled California business owners who are fighting to stay alive during the pandemic. Our communities need these businesses, and their services and goods and jobs, to survive.

SUPPORT

California Low-income Consumer Coalition (sponsor)

AARP California

Bet Tzedek

California Asset Building Coalition

California Association for Micro Enterprise Opportunity

California Association of Collectors

Consumer Federation of California

East Bay Community Law Center

Financial Counseling Association of America
Freefrom
Hope for All: Helping Others Prosper Economically
Legal Aid of Marin
National Consumer Law Center
New Economics for Women
OneMain Financial
Public Counsel
Public Law Center
University of California Irvine, Consumer Law Clinic

OPPOSITION

RESOURCE

Thurman Legal

RELATED LEGISLATION

Pending Legislation:

SB 531 (Wieckowski, 2021) requires certain notices to be provided to debtors in connection with the sale or assignment of delinquent consumer debt. It also establishes certain documentation requirements for debt collectors and a right to request certain information from those collecting on sold or assigned delinquent debt. This bill is on the Assembly Floor.

AB 424 (Stone, 2021) establishes protections for borrowers with private student loan debt, including requirements for creditors to have certain documentation before collection and before initiating civil actions to collect on such debt. This bill is currently in the Senate Appropriations Committee.

AB 1020 (Friedman, 2021) applies certain requirements from the FDBPA to the Hospital Fair Pricing Act, including communications requirements and pleading and evidentiary standards. AB 1020 is currently in this Committee and being heard on the same day as this bill.

Prior Legislation:

AB 1864 (Limón, Ch. 157, Stats. 2020) *See* Comment 2.

AB 2524 (Wicks, Ch. 159, Stats. 2020) deletes provisions of the Check Sellers, Bill Payers and Proraters Law that require licensees under that law to be organized under California law and that prohibit those licensees from engaging in business outside California, as specified.

PRIOR VOTES:

Senate Banking and Financial Institutions Committee (Ayes 7, Noes 0)

Assembly Floor (Ayes 54, Noes 16)

Assembly Appropriations Committee (Ayes 12, Noes 4)

Assembly Judiciary Committee (Ayes 8, Noes 2)

Assembly Banking and Finance Committee (Ayes 9, Noes 3)
