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# 2011 Legal and Regulatory Outlook for Credit Counseling Agencies


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As 2011 begins, it seems that, now more than ever before, legal and regulatory issues will figure prominently on the agendas of credit counseling agencies ("CCAs"). The growing number of consumers in economic distress and the government response to the economic downturn are just some of the reasons for this prominence, as CCAs are at the center of the nonprofit response to help consumers through education and counseling. At the same time, many in the industry are working closer than ever with government agencies to ensure that their services are supported and meet the needs of consumers.

On top of all of that, many in the industry are preparing for new challenges and opportunities, including potentially cumbersome regulation. With developments such as the commencement and operation of a new federal regulator, the Bureau of Consumer Financial Protection ("CFPB" or the "Bureau"), the wake of new regulations for the for-profit debt relief industry, changes expected to traditional and reverse mortgage regulation, and new state laws and regulations targeted at CCAs, the time is ripe to assess the legal and regulatory direction of the industry.

Here are a few of the key legal and regulatory issues to consider as you plan for the new year:

***CROA and Other Sources of Private Litigation***

One of the top legal issues that continues to confront the credit counseling world is increasingly aggressive class action lawyers, some of whom are on the record as investigating numerous CCAs for alleged violations of the federal Credit Repair Organizations Act ("CROA"). In recent years, a number of CCAs have been caught up in a wave of actual and threatened lawsuits – most of them class actions – alleging violations of CROA.

Consumers, assisted by class action attorneys, argue that these agencies failed to comply with mandatory disclosures, the advance fee ban, and other requirements under CROA. Many counseling agencies, in turn, rightly should be able to turn to the exemption under CROA for nonprofit, tax-exempt 501(c)(3) organizations. To overcome the exemption, the class action lawyers often allege that the CCAs are "sham" nonprofits. Proving that a CCA is not a "sham" nonprofit can be a lengthy, costly exercise – even if ultimately successful in the end. Moreover, a loss in court can have significant adverse consequences because CROA allows plaintiffs that prevail to recover the greater of the total amounts paid to the CCA or actual damages, punitive damages, costs, and attorney's fees.

Although under CROA, plaintiffs' efforts at recovery should be stymied to the extent that the credit counseling agency has tax-exempt status recognized by the Internal Revenue Service ("IRS") under Section 501(c)(3) of the Internal Revenue Code (the "Code"), given the state of the caselaw, at least some courts are likely to disregard the exemption and question whether a credit counseling agency's activities, in fact, constitute "credit repair." This issue was the subject of an important 2010 federal Court of Appeals (1st Circuit) decision. In a case involving a nonprofit, tax-exempt credit counseling agency that offered debt management plans, the appellate court ruled that "credit counseling aimed at improving future creditworthy behavior is the quintessential credit repair service." As a result, the debt management plan ("DMP") activity of the CCA was considered to trigger CROA. This decision may unleash a new wave of lawsuits and, with it, high legal costs that cut into funds available to provide services to the public. As a result, a strong CROA compliance program, sufficiently-broad insurance coverage, an absence of negative factors in the "bona fide nonprofit" analysis, and a record of exemplary service remain critical to minimizing the risks of a private lawsuit.

In addition, the types of claims for which consumers may bring lawsuits against CCAs, particularly on the state level, continue to change and multiply – with many states enacting statutes covering specific lines of service, such as mortgage foreclosure assistance, in addition to general state unfair and deceptive trade practice statutes and credit service organization laws. While these consumer

protection laws differ in how they apply and are intended to curtail the practices of unscrupulous actors, consumer protection advocates suggest to enterprising plaintiffs' lawyers that these laws can be used to target to CCAs. Moreover, many state debt adjusting laws include private rights of action. For example, the Uniform Debt-Management Services Act, which includes a private right of action, is now effective in six states and one U.S. territory.

***Stepped-Up Enforcement by the FTC and State Attorneys General***

A second issue, albeit also a potential benefit to many CCAs, is an increasingly aggressive Federal Trade Commission ("FTC") that is on record as vowing to continue its stepped-up enforcement in the debt relief services and other "poverty"-related verticals. During the summer of 2010, the FTC, with the support of many state Attorneys General, issued a final rule amending the Telemarketing Sales Rule ("TSR") to address the telemarketing of debt relief services offered to consumers. The "Debt Relief Services Amendments" impose new standards for substantiating debt relief service advertising claims, require specified disclosures, and prohibit providers from collecting fees in advance of providing services. Further, the FTC issued its Mortgage Assistance Relief Services ("MARS") Rule to regulate the practices of for-profit entities providing assistance to consumers in modifying mortgage loans or avoiding foreclosure. Importantly, in addition to the FTC, the new "Debt Relief Services Amendments" to the TSR and the MARS Rule also will be enforceable by the new Bureau.

While the MARS Rule is limited to for-profit actors due to its own set of internal definitions, the TSR does not appear to be limited in the same manner, although it is the FTC's position that nonprofit entities are beyond the scope of TSR. That being said, the FTC has not been restrained when insisting that nonprofit organizations prove their *bona fide* nonprofit status, rather than accept, at face value, their state incorporation status and federal tax-exempt status (if applicable). As a result, the FTC has been aggressive in its pursuit of "sham" nonprofits.

There also likely will be a continued focus on the credit counseling industry by the state Attorneys General, especially in the area of advertising and marketing, even in instances where the state banking department is already regulating the organization. Enforcement actions taken at the state level can be costly to defend. For this reason, simply being licensed as a debt adjuster in a state is often not enough. Rather, CCAs need to be aware of and in compliance with all applicable requirements under state law as well as rules and policies of their self-regulatory accreditation bodies.

***Consumer Financial Protection Bureau***

By now, nearly everyone is familiar with the planned rollout and startup of the federal CFPB that will have oversight and rulemaking power over virtually all financial product and service providers, including CCAs. The Bureau has general authority to issue integrated disclosure standards, identify deceptive industry practices, and promulgate regulations for CCAs, as well as the ability to enforce the Debt Relief Services Amendments to the TSR and the MARS Rule (as referenced above). This new regulator will bring both new challenges and opportunities as the Bureau takes shape.

Momentum is gaining as the Bureau picks up staff – including several key staffers with experience relevant to CCAs. Heading up the CFPB enforcement division will be the departing Attorney General of Ohio, Richard Cordray. During his tenure as Ohio Attorney General, Cordray became well known for bringing cases against loan modification companies and, recently, for advocating close scrutiny of "robo-signers." Also, several former staff attorneys from the FTC and state regulatory agencies that have some specific familiarity with the credit counseling industry are part of the Bureau implementation team and will be involved in writing rules and making enforcement decisions.

Further, the underpinnings of the new federal Consumer Financial Protection Act (enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act)) are increased disclosure and ensuring that financial products and services deliver on what they promise and are appropriate for the consumers to whom they are offered. All of these basic tenets are widely supported by the nonprofit credit counseling industry, but may result in new restrictions and obligations. Without ongoing engagement with the new Bureau, there may be unintended limitations imposed on being able to offer certain products and services. At the same time, there may be opportunities to influence policies with regard to lending practices and credit counseling industry relations with creditors, as well as to develop new ways to reach out to consumers in economic distress.

The impending changes in Washington as a result of the Dodd-Frank Act also will usher in a number of new potential regulatory opportunities for CCAs. Under the law, Congress created new opportunities for pre-purchase and other housing counseling services, and a number of financial literacy and

education initiatives with or by the Bureau. It also may be possible to advocate for a loosening of restrictions on creditors that presently make it difficult for CCAs to be able to provide less-than-full balance debt management plans (with reductions of principal, not just interest).

***Other Federal Rulemakings***

While the bulk of the upcoming relevant federal regulatory developments will occur as a result of the Dodd-Frank Act and at the Bureau, there will be other government agencies with rulemakings that will impact the industry. A sampling of these rulemakings – based on a review of each agency's recently released semi-annual regulatory agenda – include:

**Federal Trade Commission:**

- **Mortgage Acts and Practices ("MAP") Rules** - The FTC issued a notice of proposed rulemaking ("NPRM") for MAP-Advertising on September 30, 2010 and the comment period closed on November 15, 2010. The FTC anticipates issuing an NPRM for MAP-Servicing during early 2011. HUD's rulemaking authority in this area will be transferred on July 21, 2011 to the CFPB under the provisions of the Consumer Financial Protection Act.

**Federal Reserve Board:**

- **Regulation Z – Truth in Lending (Reverse Mortgages)** – In 2011, continued action is expected on the Federal Reserve Board's proposal to amend Regulation Z, and the staff commentary to the regulation, as part of a comprehensive review of the Truth in Lending Act's rules for home-secured credit. This proposal, among many things, would amend the disclosure rules for open- and closed-end reverse mortgages and prohibit certain unfair acts or practices for reverse mortgages. Under the proposed rule, a creditor would be prohibited from (1) conditioning a reverse mortgage on the consumer's purchase of another financial or insurance product such as an annuity; and (2) extending a reverse mortgage unless the consumer has obtained homeownership counseling. The proposed rule also would amend the rules for reverse mortgage advertising. The Federal Reserve's rulemaking authority in this area will be transferred on July 21, 2011 to the Bureau of Consumer Financial Protection under the provisions of the Consumer Financial Protection Act. Note that the Dodd-Frank Act directs the CFPB to conduct a study on reverse mortgage loans and grants the Bureau authority to issue integrated disclosure standards, identify deceptive industry practices, and promulgate regulations specific to reverse mortgages, including counseling requirements.

**U.S. Department of Justice ("DOJ") Executive Office for the United States Trustee** has, as it has for over two years now, two pending final rulemakings for bankruptcy pre-filing counseling and post-discharge debtor education. These two rulemakings were supposed to have been completed last year, but are now expected to be issued in 2011.

**U.S. Department of Housing and Urban Development ("HUD"):**

- **Secure and Fair Enforcement Mortgage Licensing Act of 2008 (the "SAFE Act"): Final Rule** – This pending final rule will provide the standards that HUD will utilize to determine whether a state's licensing system complies with the requirements of the SAFE Act, and it may include guidance to state regulators on the applicability of the SAFE Act to HUD-approved nonprofit housing counseling agencies. HUD's rulemaking authority in this area will be transferred on July 21, 2011 to the CFPB under the provisions of the Consumer Financial Protection Act.
- **Housing Counseling: New Program Requirements** – In March 2011, HUD is expected to announce proposed new housing counseling regulatory requirements that will implement changes by the Dodd-Frank Act, which include directing that HUD-approved housing counseling agencies provide counseling that addresses the entire process of homeownership and that HUD establish materials and forms to be used by HUD-approved housing counselors.

***Government Funding and Oversight***

Although funding for all services will remain a priority for CCAs, there has been an unprecedented wave of government funding aimed at housing counseling and related programs. A vast number of homeowners are being helped by HUD-approved housing counseling agencies that are relied upon by the government to provide free services to homeowners. As a result, nonprofit housing counseling providers are a part of an increasingly complex web of HUD housing counseling requirements, federal tax-exemption requirements, and public and private funding that obligate them to follow numerous requirements. CCAs that are recipients of such funding must be prepared to promote the benefits of their services to the public and demonstrate compliance with applicable rules and restrictions in light of the potential for increased scrutiny by Congress, state governments, and the IRS.

***Internal Revenue Service***

Last, but not least, while the IRS' credit counseling audit initiative has wrapped up for a number of CCAs, there are still some agencies under audit (or in the internal IRS appeals process) and the IRS' intense scrutiny of credit counseling agencies is expected to continue. In 2011, the success of many CCAs will continue to hinge on their tax-exempt status and ability to take advantage of government grant opportunities and programs (*e.g.*, HUD's housing counseling program). As a result, compliance with the Code prohibitions on impermissible private benefit, private inurement, and Code Section 501 (q), among other requirements, will be essential. There are many traps for the unwary in these areas, particularly as it relates to housing counseling and CCA relationships with mortgage servicers and investors.

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Even with changes on the horizon, the credit counseling industry proved it is well-positioned to help consumers in 2010. But pressure will increase on the industry from both federal regulators and state governments in the coming year. The legal and regulatory landscape is not as one dimensional nor as static as it has been in the past. With a new focus on consumer protection, the industry will face both challenges and opportunities in 2011.

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