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REGULATORY POLICY

Debt Collectors, Meet the New Cop on the Beat: Implications of CFPB's Supervision of Debt Collection Market



By NATHAN W. CATCHPOLE AND HEATHER S. KLEIN

Tomorrow inaugurates a new level of scrutiny of the consumer debt collection industry. The Consumer Financial Protection Bureau (CFPB) as of Jan. 2 will have the authority to do comprehensive examinations of the largest debt collectors in the country. Of course, until now the industry has faced its share of *enforcement* actions by state and federal law enforcement agencies, such as attorneys general and the Federal Trade Commission (FTC) — but the CFPB is the first federal agency capable of *supervising* debt collectors, which gives it a new tool to gather information about how the debt collection industry operates.

This article discusses which debt collectors are covered by the CFPB's supervisory authority and what the CFPB will review during its examinations. And, because the effects of the CFPB's examinations will reach beyond individual companies and will be felt throughout

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the consumer credit market, we end by describing how the CFPB's debt collection examination authority will usher in broader changes in the ways that companies sell consumer debt and interact with consumer debtors.

Collectors Now Subject to CFPB Supervision

The Dodd-Frank Act gave the CFPB authority to define by rule certain nonbank "larger participants" of markets for consumer financial products and services. After the CFPB defines "larger participants," it can supervise them — in addition to the CFPB's statutory authority to supervise payday lenders, residential mortgage companies, private student lenders, large banks, and their service providers.

Following on its earlier work defining nonbank "larger participants" in the consumer reporting market, the CFPB, on Oct. 23, 2012, issued a final rule defining nonbank "larger participants" in the consumer debt collection market (the "Consumer Debt Collection Rule" or the "Rule"). See 77 Fed. Reg. 65775 (Oct. 31, 2012) (to be codified at 12 C.F.R. Part 1090). That Consumer Debt Collection Rule takes effect Jan. 2.

The Consumer Debt Collection Rule defines "larger participants" of the consumer debt collection market as nonbank entities, including third-party debt collectors, debt buyers, and debt collection law firms, whose annual receipts resulting from consumer debt collection, on average over the last three fiscal years, exceed \$10 million.¹ Debt collectors and law firms who do debt col-

¹ If an entity's life is shorter than three fiscal years, the CFPB will look at the annual receipts for the life of the entity.

"Consumer debt collection" is defined as "a 'debt collector' . . . collect[ing] debt incurred by a consumer for personal, family, or household purposes, and related to a consumer financial product or service." 77 Fed. Reg. 65781. The definition of "debt collector" largely tracks the Fair Debt Collection Practices Act ("FDCPA") definition, covering "persons whose principal business activity is debt collection or that 'regularly' engage in debt collection." 77 Fed. Reg. 65785; cf. 15 U.S.C. § 1692a(6). The Consumer Debt Collection Rule recognizes five exceptions to its definition of "debt collector": a person

lection work for large banks, payday lenders, residential mortgage companies, private student lenders, and “larger participants” are subject to supervision as “service providers,” even if they themselves are not “larger participants.”

In calculating whether an entity’s receipts exceed the \$10 million threshold, the amounts that count are those collected on personal, family, or household debts in relation to consumer financial products or services.² Included among those are amounts collected in relation to student loans, and commissions and fees earned by third-party debt collectors and debt collection law firms.³ Certain other amounts do not count towards the \$10 million threshold, including net capital gains or losses, taxes collected for and remitted to a taxing authority if included in total income, amounts collected for another, and amounts collected on debts that were originally owed to a medical provider.

The largest debt collection companies are clear targets for supervision, having annual receipts much in excess of the \$10 million threshold. However, the calculation is less clear for many more companies. The Consumer Debt Collection Rule enables the CFPB to request information from an entity to assess whether that entity is a “larger participant.” Once qualified as a “larger participant,” an entity will retain that status for at least two years. The Rule provides a procedure by which an entity may challenge its designation as a “larger participant,” but there is nothing to suggest that the CFPB would not initiate, or would halt, any *enforcement* activities during the pendency of such a challenge to its supervisory authority.

What the Debt Collection Rule Portends

What can entities subject to the Rule expect? In a word, examinations. In two words, extensive examinations — estimated to last weeks or months and, for the largest in the industry, estimated to occur every other year. What’s more, the examinations will not be limited to the activities that generated the receipts that led to the entity’s designation as a “larger participant.”

The examinations will delve into far more than the Fair Debt Collection Practices Act (FDCPA), which for years has been the central compliance focus of the debt collection industry. The CFPB also will examine an entity’s compliance with all other federal consumer financial laws, primarily the Fair Credit Reporting Act (FCRA), the Gramm-Leach-Bliley Act (GLBA), the Elec-

collecting debts only for another person to whom he or she is related or affiliated and if the principal business of such other person is not debt collection; a nonprofit organization engaged in consumer credit counseling; a person collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity concerns a debt originated by such person; a person collecting or attempting to collect a debt owed or due or asserted to be owed and due another to the extent such debt was not in default at the time it was obtained by such person (i.e., the loan servicing exception); and a person engaged solely in enforcing a security interest. *See* 77 Fed. Reg. 65782-85.

² A debt related to a “consumer financial product or service” is one that was originally created through an extension of credit or deferment of an obligation to pay. 77 Fed. Reg. 65780 (incorporating 12 U.S.C. § 5481).

³ The Rule does not allow debt buyers to deduct the acquisition price of the debt from their receipts. 77 Fed. Reg. 65787 & n.93.

tronic Funds Transfer Act (EFTA), and the Equal Credit Opportunity Act (ECOA).

CFPB staff will probe all aspects of an entity’s compliance management system, including how the entity: trains, compensates, and monitors collectors; engages and manages service providers; scopes and responds to audits; receives and resolves consumer and third-party complaints; and communicates and escalates compliance issues to management and the Board of Directors.

What kind of legal issues are fair game for CFPB examinations? The list is lengthy, and is previewed by the CFPB’s Debt Collection Examination Procedures and its general Supervision and Examination Manual. For instance, examiners will review account files to see: when the account was charged-off; whether overshadowing collection efforts occurred after the initial demand letter was sent; which telephone numbers were called and how frequently; how interest, if any, accrued on the account; what payment arrangement the consumer was provided and why; and, if litigation was initiated, whether it was timely and proper. Examiners will review the company’s systems to see how it: processes payments; stores nonpublic consumer information; furnishes information to consumer reporting agencies; identifies accounts that should not be collected on and segregates those accounts from the collection queue; and exchanges account data with debt buyers, sellers, servicers, and other third parties. CFPB examiners will also look at how the company receives and responds to complaints and disputes from consumers (or filed on behalf of consumers), such as complaints that the collector has the wrong person, the consumer owes a lesser amount, the consumer paid off the debt, the debt resulted from identity theft, or the consumer was mistreated by a collector.

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While some of the areas listed above could perhaps have been expected, the CFPB’s examinations will touch on other areas that some industry players may have previously overlooked. For example, examiners will review collection practices to determine whether those practices discriminate on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance income, or the exercise of certain federal rights. The CFPB will further examine compliance management systems to see whether those systems address ECOA and fair lending risks and will assess the fair lending training offered to individual collectors. And for collectors that also qualify as creditors for ECOA purposes, the CFPB will look closely at how those collectors exercise discretion in extending credit and how they control and monitor their credit-extension activities.

At a minimum, examinations will result in a confidential report and a consumer compliance rating from one to five, with five reserved for entities demonstrating re-

peated non-compliance with consumer law and an unwillingness or inability to comply with the law. The CFPB will also use examination results to issue industry-wide supervisory guidance. Further, as the CFPB learns more about debt collection practices, it positions itself to issue or amend rules that implement the federal consumer financial laws. For example, the CFPB is the first agency with authority to issue rules under the FDCPA, and there is speculation that the agency will eventually do so. Examinations will also evolve into enforcement actions for some companies, resulting in consent orders and potentially heavy civil money penalties.

How Debt Collection Could Change

Already, the industry is incurring large compliance costs to prepare for CFPB oversight. Companies are creating new or additional staff positions dedicated to the compliance function. They are also reviewing and updating policies and procedures, collection scripts and letters, training programs, third-party contracts and oversight materials, and compensation policies, among other documents, with a focus on ensuring that the materials reflect company practices. In conjunction with those efforts, they are undertaking mock CFPB exams with outside counsel to identify and correct problematic practices and to patch gaps in their compliance management systems. Even institutions that may collect their own debts, which would exempt the institution from supervision as a “larger participant” under the Consumer Debt Collection Rule, can expect that the procedures described in the Rule will be applied to their servicing and collections operations.

Beyond compliance, the business of debt collection will evolve. CFPB exams, and the enforcement actions they will generate, will force the industry to change the way it sells consumer accounts and interacts with consumers. Again, these issues will not just be faced by nonbank debt collectors potentially subject to the CFPB’s examination authority — all other financial institutions will also be affected, whether they sell charged-off accounts, collect debts in-house, or outsource their collections.

One aspect of the debt collection business likely to change is the amount of account-level documentation that a debt owner (and even the debt collector, where different from the company that owns the debt), possesses or can readily access. Often, debt is re-sold without or with limited access to documentation, making it difficult for subsequent holders to identify and correct account inaccuracies. The CFPB has already shown an

inclination to regulate this area. In October, it issued Consent Orders to American Express that, among other things, required certain AmEx subsidiaries to “maintain accurate and complete information on each consumer debt that the [company] collects or attempts to collect,” including consumer agreements and documents evidencing the debt and activity on the debt, and to make that information or documentation available to the consumer upon request.

This signals that the CFPB may generally require debt owners and debt collectors to possess or have access to certain account documents before collecting a debt. The CFPB may even identify certain documents that must be provided to a consumer when the consumer disputes or requests validation of his or her debt. Such changes would restructure the debt buying industry. Rather than sellers separately charging buyers for document requests, or only providing documents to buyers if available, debt sellers and debt buyers would need to provide access to account documentation through the debt sale contract.

A second aspect of the debt collection business likely to change under the CFPB’s watch is the treatment of time-barred debt, which is debt that falls outside a state’s statute of limitations and therefore cannot be sued on. In the FTC’s Consent Decree with debt buyer Asset Acceptance in January 2012, the FTC required Asset to disclose, in an initial communication with a consumer regarding a time-barred debt and at certain times thereafter, that, because of the debt’s age, Asset would not sue the consumer for it. Several jurisdictions, such as New Mexico and New York City, require collectors to make similar disclosures. The CFPB may find that failing to make such a disclosure is an unfair, deceptive, or abusive act or practice (UDAAP). It may also prohibit as a UDAAP selling, transferring, or assigning the right to initiate arbitration or legal action to recover on a debt, which the FTC also prohibited Asset from doing.

Conclusion

With the commencement of CFPB supervision of larger participants of the consumer debt collection market, the CFPB arms itself with another tool to learn about and address violations in consumer financial services. Become prepared now, or be prepared to suffer later.

The rule defining larger participants of the Consumer Debt Collection Market can be viewed at http://files.consumerfinance.gov/f/201210_cfpb_debt-collection-final-rule.pdf.