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COMMENTARY

The CFPB's Debt Collection Proposals: What You Need To Know

On July 28, 2016, as a precursor to eventual notice-and-comment rulemaking, the Consumer Financial Protection Bureau ("CFPB" or "Bureau") released an outline of proposals under consideration for regulating the debt collection market.[1] These proposals have been anxiously awaited by both first-party and third-party debt collectors, as well as service providers to the debt collection industry, since the Bureau first issued its Advanced Notice of Proposed Rulemaking in late 2013.[2] The proposals in the Bureau's outline are wide-ranging, covering everything from the information provided by original creditors and the content of validation notices to the collection of time-barred debts and the frequency of consumer contact. There is no practice that the outline does not touch, befitting a rule that has already taken close to three years to draft.

At first blush, it is plain that the proposals would significantly increase costs in the collections industry and decrease the number of debts collected. Many smaller entities will likely be forced to close, while other, unscrupulous ones may choose to operate in violation of the law. Understanding the content of and reasons for the Bureau's proposals and the impact they will have on the debt collection industry today will allow the industry both to begin to prepare its response to a future rulemaking and to identify current practices that may draw the Bureau's supervisory or enforcement attention even during the pendency of the rulemaking process. What follows are some key takeaways from the Bureau's current proposals.

The Bureau's Goals and Their Significance

The Bureau premises its debt collection proposals on its consumer-protection mandate but also notes that the collections industry is in need of new guidance, given the passage of time and the advance of new technology since collection rules were first put in place. In this case, the Bureau is relying on the authority granted under the Dodd-Frank Act to update existing Fair Debt Collections Practices Act ("FDCPA") rules as well as its authority to regulate unfair, deceptive, and abusive acts and practices ("UDAAP") to achieve those goals.[3]

The Bureau has long expressed concerns about debt collection practices, the largest source of complaints received by the Bureau and the Federal Trade Commission in recent years. The Bureau has been studying the debt collection industry nearly since its inception through formal studies, reviews of consumer complaints, supervisory examinations, and enforcement investigations. From this vantage point, the Bureau has developed a two-pronged theory for what it sees as the primary problems in the industry:

a lack of understanding by consumers of the law and their legal rights, combined with poor information practices within the debt collection industry.

According to the Bureau, consumers operate at a disadvantage to debt collectors, repeat players who are frequently entities the consumer has never heard of or had any contact with before. Consumers do not understand how to challenge a debt that they do not believe they owe (for instance, where the amount is wrong) or what protections they may have under law (for instance, where a debt is no longer collectable because the statute of limitations has run). Consumers also complain of collection tactics they perceive as harassing, as well as of false or misleading statements made by collectors during the collections process. What results, according to the Bureau, are consumers who repay debts they do not owe or could avoid paying simply to end the collections process, or who spend significant time and effort challenging a debt where a more straightforward option may be available. These are the touchstone issues that motivate the Bureau's debt collection efforts.

As for the industry side of the equation, the Bureau believes that collectors, both collections agencies and debt buyers, are too often in possession of limited and inaccurate information about consumer debt and that they do not share what they do know with consumers. Some of these problems arise due to particularities of the industry, where a debt may be sold downstream multiple times, with different entities attempting collection over many years and with consumer-friendly information left out of the transfer process. Left unsaid, but doubtlessly a factor in the Bureau's evaluation, the industry's structure also provides opportunities for less-than-scrupulous players with little incentive to comply with the law to purchase debtor information on the cheap.

These motivations are not merely of academic interest. As the Bureau notes in its outline, over the last five years it has brought 25 debt collection enforcement actions, the Federal Trade Commission has brought another 40, and the Bureau has identified issues during supervisory exams as well. In taking these actions, the Bureau has relied on the same UDAAP authority that it is invoking to justify the proposals under consideration. For example, the Bureau has found originators of debt liable for unfair practices or for providing "substantial assistance" to a collector's deceptive practices where the originator sold debts it knew contained inaccurate or inadequate information or were unenforceable.[4]

In a very real sense, these proposals merely set down on paper many activities the Bureau believes are already illegal under its existing authority and about which it will not hesitate to take action. Accordingly, the Bureau's expressed concerns, both generally and in the form of specific proposals, should serve as a reference point and alert the industry to the perspectives it should be adopting even today, well before these proposals become formal rules.[5]

First-Party Debt Collectors

Somewhat surprisingly, the Bureau's proposals apply only to third-party debt collectors (both agencies and buyers) and not to creditors collecting their own debt. While this limitation is part of the FDCPA, as noted above, the CFPB has long taken the position that its UDAAP authority allows it to regulate any entities within the collections process.

The proposals suggest a market-driven reason for this distinction.[7] While consumers choose the companies with whom they do business and from whom they incur debt, they do not choose collection agencies and debt buyers. Accordingly, a consumer may elect not to do business with a company that engages in aggressive collection practices. Although not specified by the Bureau, consumers may also file complaints (with the Bureau, the Better Business Bureau, or through myriad other channels) about those companies. As such, these providers of financial services have strong financial and reputational incentives to engage in consumer-friendly practices. Moreover, these entities do not suffer from the information challenges that a downstream debt collector faces, since they presumably possess full information about their customers, and the debts they collect tend to be fairly recent, eliminating the source of many of the problems the Bureau seeks to address.

That said, their exclusion from this rule remains puzzling. Since its inception, the Bureau has promoted the idea that it aims to create a level playing field for all market participants, focusing on the consumer experience and treating those who provide that experience alike, whether they are banks or non-banks, first-party providers or third-party providers. And yet in this case, the Bureau is inexplicably creating an uneven playing field for market participants and different consumer experiences when it comes to many of the proposals under consideration. For instance, the proposals place significant restrictions around the frequency of customer contact and there is no readily discernible reason why there should be a distinction between first-party and third-party collectors about such a basic aspect of consumer protection. It appears that even two-and-a-half years after starting this process, the Bureau remains unsure of what it thinks about first-party collectors and how to apply its rules, even where that creates distinct consumer experiences.[8]

The Challenge of Information Sharing

However, these proposals do not ignore the original creditors entirely. The Bureau focuses significant attention on the accuracy of information available to collectors. Remedying the perceived lack of effective information transfer—between creditors and collectors, during transfers between collectors, and ultimately between collectors and consumers—is a key aspect of the Bureau's proposals.[7] The Bureau's concern stems from the fact that the quality and quantity of information shared in the collections process varies substantially, often consisting of little more than basic information regarding the debt and the debtor. And even that information degrades as the debt is transferred downstream, with information that benefits the consumer (such as payments made or disputes filed) often lost as the debt transfers between collectors. Accordingly, the Bureau seeks to ensure that debt information can be substantiated and that the information remains intact as the debt is transferred.

The cornerstone of these proposals is the new "reasonable basis" standard, which prohibits collectors from initiating any collection activity unless the collector has a reasonable basis to believe the debt is accurate and legally collectable. And, to accomplish the goal, the Bureau proposes what amounts to a safe harbor. Specifically, a collector will be found to have a reasonable basis for collection if the collector can get certain detailed information about the debt (more extensive than what is often provided today), receives certification from the prior owner of the debt that the information transferred is identical to the information in the prior owner's records, and investigates any "warning signs" that a particular debt or a portfolio of debt may not be accurate or collectable, which will likely require the collector to obtain additional documentation relating to the original debt. Moreover, collectors are expected to stay attuned to and investigate additional warning signs that may come up during the collections process and substantiate indebtedness in response to consumer disputes, which again will often require supplemental information about the original debt.

Although the Bureau says that there would be flexibility in what constitutes a reasonable basis and what documentation may constitute an effective investigation of a consumer dispute, collections firms will likely flock toward the safe harbor and the Bureau's suggested documentation, unwilling to risk a dispute with the Bureau over compliance. This, in turn, will mean that creditors will have to provide more up-front information, and will remain involved long after the debts have been sold, as collectors return to seek documents or other information to resolve a warning sign or a disputed debt. In other words, the parties to a transfer of debt will likely remain linked long after the transaction has seemingly closed.

What this means practically is that creditors who want to continue selling debt should maintain records more carefully and for longer periods of time, and they should also have staff who can respond to collector inquiries. Creditors may also bear liability risk for longer, be it through the certifications they provide or through the data provided at sale and later documentation. Further, pricing of debt sales will become more difficult, and "put back" features may become more common, to protect the buyers of debt who may discover only after the sale is completed that certain warning signs make an attractive portfolio essentially uncollectable. The result is a more complex, risky, and costly process that links the downstream parties together for as long as the debt remains outstanding.

Conclusion

Although we touch on only a few of the key features of the Bureau's debt collection outline, both the extent to which these proposals will change the industry for creditors and collectors, and how the industry needs to be preparing today, are evident. While the details of the rules will emerge over the coming months, understanding the meaning and impact of these proposals will prepare for the very different future that is coming to the world of debt collection.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

C. Hunter Wiggins
Chicago / Washington
+1.312.269.1554 / +1.202.879.7656
hwiggins@jonesday.com

Christian G. Vergonis
Washington
+1.202.879.3914
cvergonis@jonesday.com

Lisa M. Ledbetter
Washington
+1.202.879.3933
lledbetter@jonesday.com

Albert J. Rota
Dallas
+1.214.969.3698
ajrota@jonesday.com

Gregory R. Hanthorn
Atlanta
+1.404.581.8425
ghanthorn@jonesday.com

Ethan (Eitan) Levisohn
Washington
+1.202.879.3881
elevisohn@jonesday.com

Endnotes

1 Small Business Review Panel for Debt Collector and Debt Buyer Rulemaking: Outline of Proposals Under Consideration and Alternatives Considered. This outline of proposals was published in conjunction with the Small Business Regulatory Enforcement Fairness Act consultation process and, as such, is not subject to broad public comment at this stage.

2 As the Bureau does in its outline, for the purposes of this *Commentary* we refer to collection agencies and debt buyers as "debt collectors."

3 As the Bureau alludes to in its proposal, the definition of "debt collectors" for the purposes of the Bureau's future rule is likely to be broader than the FDCPA's definition.

4 *See In re Chase Bank, USA N.A.*, 2015-CFPB-0013 (July 8, 2015); *In re Citibank, N.A.*, 2016-CFPB-0003 (Feb. 23, 2016).

5 Once the rules do become final, it would be unsurprising to see another burst of enforcement activity around them.

6 Dodd-Frank does limit the Bureau's authority over merchants of nonfinancial goods and services who extend credit solely for the purchase of those goods and services. 12 U.S.C. § 5517(a).

7 Notably, the Bureau's outline does specifically say that the practices of first-party collectors will be dealt with on a separate track. Compliance with the obligations discussed here may limit the necessity and breadth of future rules, as the Bureau may be waiting to determine whether additional regulation is necessary or whether these rules sufficiently nudge the first-party collectors to where the Bureau wants them to go, both in terms of their own collections practices and their relationships with agencies and debt buyers.

8 Although the Bureau argues that these issues also result in frustration and increased costs for the collections industry, it does not contend that the proposals would be a net benefit for the collections industry.