

Client Update

Consumer Financial Protection Bureau Outlines Plan for Comprehensive Reform of Debt Collection Industry

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On July 28, in conjunction with a field hearing on debt collection, the Consumer Financial Protection Bureau (“CFPB” or the “Bureau”) released an outline of proposals under consideration to regulate the debt collection industry (the “Outline”).¹ Released as part of the required consultation with a cross section of small entities likely to be affected by the regulation pursuant to the Small Business Regulatory Enforcement Fairness Act (the “SBREFA”), the Outline contains broad proposals to cover the debt collection activities of third-party collection agencies, debt buyers, collection law firms and loan servicers. The CFPB has indicated that it will convene a second consultation process to address proposals aimed at first-party creditors (i.e., creditors collecting on their own debts).² The Bureau’s release of the Outline is an important step in the Bureau’s progress towards a final rule, which could, in the words of Bureau Director Richard Cordray, “drastically overhaul the debt collection market.”³

In this client update, we provide an overview of the Bureau’s debt collection activities to date and the three main categories of requirements in the Outline—

¹ CFPB, Small Business Review Panel for Debt Collector and Debt Buyer Rulemaking, Outline of Proposals Under Consideration and Alternatives Considered (July 28, 2016), available at http://www.consumerfinance.gov/f/documents/20160727_cfpb_Outline_of_proposals.pdf [hereinafter, “Outline”].

² CFPB Director Richard Cordray, Prepared Remarks on Field Hearing on Debt Collection, Sacramento, CA (July 28, 2016) available at <http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-field-hearing-debt-collection/>.

³ Director Cordray, Prepared Remarks, *supra*.

information integrity and substantiation of consumer debts, litigation and time-barred debt practices and collection communication practices. We also discuss key takeaways, including with respect to changes in compliance obligations, and provide an outline of the next steps in the rulemaking process.

BACKGROUND

The long anticipated Outline follows the Bureau's November 2013 Advanced Notice of Proposed Rulemaking ("ANPR") which put the debt collection industry on notice that the CFPB intended to closely monitor industry practices to determine whether additional regulation was warranted. In the ANPR, the CFPB requested information on a wide range of debt collection activities to assist it in considering which practices would be ripe for further regulation.⁴ The Bureau indicated that it was considering using its authority under both the Fair Debt Collection Practices Act ("FDCPA") and the Dodd-Frank Act to promulgate rules that would cover not only activity by third-party collectors, but also conduct falling under the Bureau's authority to prohibit unfair, deceptive and abusive acts and practices ("UDAAPs"), as well as activity by first-party creditors.

Since the release of the ANPR, the Bureau has received and studied thousands of consumer complaints and began field hearings to consider industry views of the market. The CFPB also conducted a broad industry survey on practices of debt collectors of different sizes for the purpose of better understanding the operational costs of debt collection firms and the potential burdens of implementing any new rules. In connection with the Outline, the CFPB released its report on the nature of the debt collection business, describing the technological and operational systems by which debt collection firms operate today.⁵ In addition, the Bureau has brought over 25 debt collection enforcement actions since its establishment, many of which have addressed the same issues the Bureau raises in its Outline.

⁴ CFPB, Debt Collection Advance Notice of Proposed Rulemaking (Nov. 6, 2013) available at http://files.consumerfinance.gov/f/201311_cfpb_anpr_debtcollection.pdf; see also Debevoise & Plimpton LLP, Client Alert, CFPB Begins Comprehensive Rulemaking Process on Debt Collection (Nov. 2013) available at http://www.debevoise.com/~media/files/insights/publications/2013/11/cfpb%20begins%20comprehensive%20rulemaking%20process%20on%20_/files/view%20client%20update/fileattachment/cfpb%20begins%20comprehensive%20rulemaking%20process%20on%20_.pdf.

⁵ CFPB, Study of Third Party Debt Collection Options (July 28, 2016) available at http://files.consumerfinance.gov/f/documents/20160727_cfpb_Third_Party_Debt_Collection_Operations_Study.pdf.

During this time, a number of states have also issued comprehensive debt collection rules, which it appears the Bureau has reviewed in the course of outlining its own proposals. For example, in December 2014, the New York Department of Financial Services (“NYDFS”) issued final regulations that bear similarities to the Outline.⁶ Like the NYDFS regulations, the CFPB’s Outline imposes a number of debt substantiation requirements, including requiring that collectors inform consumers who are orally disputing the debt that they may make a written request for substantiation of the debt.

THE OUTLINE

The CFPB’s Outline covers three main areas of debt collection: (1) information integrity and substantiation of debts; (2) litigation and time-barred debt practices; and (3) collection communication practices. It also considers limitations on transfer of debt to certain entities and record retention requirements.

Information Integrity and Substantiation of Consumer Debts

The CFPB consistently has expressed concern that debt collectors often seek to collect debts from the wrong consumer, for the wrong amount, or that are not legally enforceable, and that, under pressure from collectors, consumers may resolve debts that they are not obligated to pay. In addition, the Bureau has questioned whether the information that consumers currently receive in notices required under the FDCPA is sufficient to permit consumers to easily determine whether the debt claimed is in fact theirs or whether there is some error.

To address these concerns, the CFPB is considering requirements that it believes would reduce the likelihood that a consumer will be pursued for inaccurate debt or debt not owed. The Bureau proposes new requirements in three main categories: (1) substantiation of debt prior to collection; (2) transfer of certain information provided by consumers to subsequent collectors; and (3) the FDCPA-mandated validation notice and a Statement of Rights.

Substantiation of Debt. In order to combat data integrity concerns and ensure the validity and accuracy of a consumer’s debt, the Bureau is considering several options, including:

⁶ Debevoise & Plimpton LLP, Client Update: New York’s New Debt Collection Rules Extend Well Beyond the FDCPA and May Influence CFPB’s Rulemaking (Dec. 10, 2014) available at <http://www.debevoise.com/~media/files/insights/publications/2014/12/client%20update%20%20nydfs%20regulations%20on%20debt%20collections.pdf>.

- Specifying what would constitute a reasonable basis for making initial collection attempts, including the particular information a debt collector can obtain and review that would establish support for a claim of indebtedness;⁷
- In order to prevent debt owners from disclaiming responsibility for accurate information, allowing collectors to establish reasonable support for a claim of indebtedness, at least in part, by a representation from the creditor or debt buyer regarding the establishment of reasonable policies and procedures to ensure accuracy and validity of the transferred information;
- Specifying the requirement to review “warning signs” that the debt is inaccurate—*e.g.*, missing data, implausible debt, consumer disputes or the inability to obtain underlying documents. If a collector finds warning signs, it might be required to obtain additional support for the debt prior to any further collection efforts;⁸
- Mandating that for transferred debts that are in dispute, the subsequent collector cannot make collection attempts until the dispute is resolved;
- Clarifying the information required to satisfy the FDCPA’s verification requirement for consumer disputes, as well as procedures for duplicative disputes and oral disputes; and
- Requiring that collectors obtain and review certain documentation prior to filing suit against a consumer.

Transfer of Information to Subsequent Collectors. The accuracy of data transferred to downstream collectors has long been a point of concern to regulators, including both the Federal Trade Commission and the Bureau. In order to address these concerns, the Bureau is considering:

- Requiring downstream collectors to obtain and review certain information related to prior collection activity, including where collectors return a debt to a debt owner or when selling a debt downstream; and

⁷ This information likely would be more extensive than that provided under many debt collectors’ current practices. The Bureau’s Outline includes an appendix detailing this information, which includes full name; last known address; last known telephone number; account number; date of default; amount owed at default; charges for interest or fees imposed after default and the authority for such interest or fees; and the date and amount of any payment or credit applied after default.

⁸ The Bureau’s Outline includes an appendix specifying documentation that it may require to be reviewed to support a claim of indebtedness prior to further collection efforts, including information similar to that required to support an initial claim, as well as other documents such as charge-off statements, billing statements, contracts, notes or service agreements.

- Requiring collectors to forward certain information (e.g., identity theft, bankruptcy discharge) received from consumers after the debt has been returned to the debt owner or sold.

Validation Notices and Statement of Rights. The Bureau suggests that a more detailed validation notice will assist consumers in confirming whether they owe debts alleged. Specifically, it is considering:

- Requiring validation notices to include additional information and a “tear-off” to assist consumers in exercising their rights to dispute a debt and to obtain additional information;
- Requiring that a Statement of Rights be included with the validation notice;
- Requiring the Statement of Rights to conform to language preferences other than English; and
- Prohibiting collectors from furnishing information to credit reporting agencies unless they have communicated directly with a consumer.

These requirements would go well beyond current practice. For example, the FDCPA requires a validation notice containing only the amount of the debt; the name of the current owner of the debt; and statements that include an explanation of consumers’ rights to dispute debts and to request the name and address of the original creditor, if different from the creditor that owns the debt. Further, while the FDCPA requires verification of the debt if a consumer submits a written dispute, it does not provide clear guidance on the substantiation of debt prior to collection attempts. The Outline suggests that the Bureau is considering adding significant and detailed requirements to the current collection process.⁹

In addition to the requirements imposed on collectors, the outlined proposals likely would have significant impact “upstream”—for creditors and debt buyers. For instance, the ability of collectors to rely upon representations from debt owners may impose additional legal and compliance risks upon creditors or debt buyers. As a whole, although the requirements in the Outline would provide clarity and uniform standards, they would dramatically increase compliance costs across the industry.

⁹ Notably, however, the Bureau stepped back from a requirement that collectors review and obtain copies of original account-level documentation. Rather, the CFPB found that imposing such a requirement would be unduly burdensome and unnecessary, so long as creditors and debt buyers attest to the accuracy of the information they are providing.

Litigation and Time-Barred Debt Practices

Issues related to debt collector litigation and time-barred debt recovery have been a prevailing concern for the CFPB. To mitigate consumer harm—particularly where collectors attempt to collect on debt for which the statute of limitations has expired, *i.e.*, time-barred debt or where revival statutes may come into play—the Outline would require additional consumer disclosures, which, in some ways, resemble disclosures prescribed by the NYDFS and other state regulators.

While a few states prohibit debt collectors from collecting on time-barred debt, most states permit collection but allow a consumer to invoke the statute of limitations as an affirmative defense in a collection suit. In the Outline, the CFPB expresses concern that consumers, when faced with litigation or a threat of litigation, may not be fully aware of the nature of time-barred debt and their right to invoke the statute of limitations as a defense. Tied into this concern are situations in which the consumers, unaware of the implications of jurisdictional requirements regarding the statute of limitations, revive a debt by making a payment in response to a collector's demand, which resets the statute of limitations and the ability to sue.

In order to increase consumer understanding of litigation, time-barred debt and revival statutes, while also reducing the harm these issues may cause to consumers, the Bureau has outlined several measures that would impose restrictions on debt collection firms' activities in these areas:

- Requiring a "litigation disclosure" in all consumer communications where a debt collector intends to sue to collect on the debt;
- Potentially prohibiting the filing of suits or threatening suits on time-barred debt, even where the debt is revived by the consumer;
- Providing a disclosure to consumers, where a debt collector seeks to collect on time-barred debt, that the age of the debt restricts the debt collector from suing to collect on the debt (including potentially on each communication in which the collector seeks payment);
- Prohibiting a subsequent collector from suing where a prior firm provided a time-barred debt notice and had already brought suit;
- Disclosing whether the debt is obsolete or can appear on the consumer's credit report; and
- Providing a disclosure that consumers may revive time-barred debt if they make a repayment on that debt.

While the Bureau, as an alternative, considered banning the sale of time-barred debt or the collection of time-barred debt entirely, it determined that the proposed regulations might adequately address consumer issues. Regardless, taken together, these proposals indicate the Bureau's position that current time-barred debt practices and litigation pose substantial harm to consumers. Although the Outline would not ban such practices outright, in imposing these requirements, substantial changes are likely to occur both in consumer understanding and collection firms' decisions to sue to collect payment.

Collection Communication Practices

In the Outline, the CFPB notes that it has received numerous complaints about collection practices and is concerned that many consumers feel harassed or frustrated. The FDCPA forbids repetitious harassing phone calls, threatening violence, making misrepresentations about the debt, calling certain locations or at times that collectors know are inconvenient, or disclosing the existence of the debts to unauthorized third parties. However, the CFPB is considering expanding on these requirements because it believes that the FDCPA does not properly mitigate this form of consumer harm. As a result, the CFPB is considering a variety of regulations concerning debt collection practices, including:

- Limiting collectors to six communication attempts per week through any point of contact before they have reached the consumer or before right-party contact;
- Further limiting the period when debt collectors can attempt to contact borrowers; if a consumer objects to collection via a certain method or at a certain time (e.g., a particular phone line, during working hours), then the collector must abide by the consumer's wishes;
- Allowing collectors to leave voicemails for consumers, but limiting the voicemail's content to the individual debt collector's name, the consumer's name and a toll-free method by which the consumer can reply to the collection; and
- Creating a 30-day waiting period after the consumer has passed away during which collectors cannot communicate with the decedent's survivors.

The Outline would attempt to establish the first definitive list of debt collection practices that violate the FDCPA and to clarify certain legal requirements. For example, some collectors have expressed concern that they cannot leave any voicemails for consumers because of the risk that a third party might hear or see the message and thus learn of the debt. The CFPB is considering resolving this issue by allowing collectors to leave voicemails, but only permitting limited

disclosure in the voicemail. In addition, the FDCPA prohibits collectors from contacting debtors at a time or place that the collector knows or should know is inconvenient without consent; under the outlined proposals, if a debtor may be in multiple time zones, collectors must choose a time that would be convenient in all locations in which the debtor might be.

KEY INSIGHTS

The Outline is clearly designed to bring wide-ranging change to the debt collection industry, but a few aspects stand out:

- The Outline does not cover the activities of first-party collectors, perhaps reflecting industry concerns that many of the provisions in the FDCPA are not necessary to impose on first-party collectors. For example, in response to the ANPR, some financial institution trade groups specifically objected to validation requirements since such measures would be unnecessary for a first-party creditor that is already in communication with the consumer and subject to a host of other regulatory requirements regarding accuracy of account information and dispute rights. The CFPB may be attempting to narrowly tailor requirements for first-party collectors in light of such commentary.
- While it remains to be seen what the scope of the Bureau's proposals with respect to regulating first-party collectors will be, the Outline provides an important window into some of the changes on the horizon for first-party collectors. It is likely that the next rulemaking will seek to "level the playing field" between third-party debt collectors and first-party collectors with respect to prohibited practices. We may also see specific restrictions for first-party collectors, such as limits on accessing deposit accounts and limits on unsuccessful withdrawal attempts similar to the CFPB's proposed rule on payday loans.
- Irrespective of the promised rulemaking on first-party collectors, the proposals under consideration will impact such creditors given the emphasis on transfer of information and the requirements to update consumer information, which may require the implementation of additional policies and procedures to meet these new requirements for third-party collection activities. Given the possibility that the CFPB may move to extend some requirements to first-party collectors, entities should consider how to leverage these pre-existing procedures to some extent, which may mitigate some burdens of additional Bureau-imposed requirements.
- A debt collection rule may reduce the number of enforcement actions in the space, as such regulation will help clarify what the Bureau believes is a

UDAAP or other violation of law in this market. Some commentators have viewed the Bureau's enforcement actions as "regulation by enforcement," including with regard to UDAAPs.¹⁰ Having detailed regulations should assist industry participants in avoiding proscribed behavior. Nonetheless, even with a rule, the Bureau is likely to take the view that any practices described in the rule as UDAAPs are illustrative and not exhaustive. The CFPB will continue to monitor its consumer complaints database and its supervised entities for trends and the industry should expect that the Bureau will be apprised by consumer groups, State Attorneys General and other regulators of emerging issues.

- While the Outline could add further regulatory burden on the debt collection industry, standardizing debt collection practices may provide a more cohesive framework for an industry that operates in the face of disparate state laws. It remains to be seen whether a rulemaking by the Bureau would streamline compliance by pre-empting various state regulatory requirements or whether the Bureau's rules would add yet another layer of compliance complexity for industry participants. The Outline is notably circumspect on this front, suggesting that "[t]o the extent that some of these state laws are interpreted consistently with the FDCPA, it is possible that clarifying the FDCPA's application would provide greater guidance for collectors regarding some state laws as well."¹¹

PROJECTED TIMELINE

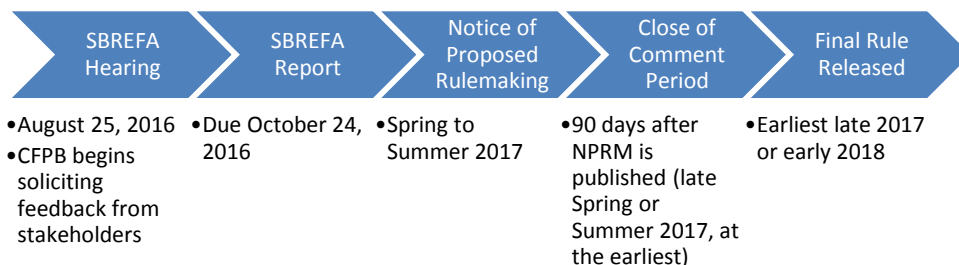
On August 25, 2016, the SBREFA Panel, which includes representatives from the CFPB, the U.S. Small Business Administration and the Office of Management and Budget, and a group of Small Entity Representatives ("SERs") will formally convene. After the convening, the Bureau will generally invite SERs to submit written comments. The Bureau will also meet with other stakeholders to discuss the Outline and the potential impact of the proposals under consideration, including hosting roundtables with trade associations and consumer groups. Sixty days after convening, the SBREFA Panel must complete a report on the input received, which the Bureau will consider as it drafts its Notice of Proposed Rulemaking ("NPRM").

¹⁰ See Prepared Remarks of CFPB Director Richard Cordray at the Consumer Bankers Association (Mar. 9, 2016), at <http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-consumer-bankers-association/>.

¹¹ Outline, at 1 n.2.

In the past, the Bureau’s NPRMs have not varied substantially from the initial Outline. Consequently, we expect the NPRM to be substantially similar to the proposals under consideration. We similarly expect the CFPB to set the comment period to run 90 days following the publication of the NPRM in the Federal Register. Because it appears that the CFPB will proceed with regulations applicable to first-party creditors separately, it is likely that the Bureau will release its NPRM relating to the current Outline first, followed later by an NPRM on first-party creditor collection after a separate SBREFA panel. Although it is possible that the Bureau could choose to include both sets of proposals in one NPRM, this seems unlikely given this would likely delay a rulemaking for third-party debt collection activity.

Based on past rulemakings, we would expect an NPRM on third-party debt collection to be released in second or third quarter 2017. Below is a projected timeline showing the progression to a final rule:



CONCLUSION

Any rulemaking on debt collection promises to bring significant change to the debt collection industry. Industry participants should keep in mind, however, that the Bureau has already been, and continues to be, aggressively bringing enforcement actions against debt collectors and against creditors, both for alleged violations of the FDCPA and for unfair, deceptive and abusive practices related to debt collection. These enforcement actions have provided guidance on the Bureau’s expectations with respect to debt collection, and thus industry participants should continue to monitor these actions and should not be surprised to see these principles reflected in the Bureau’s rulemaking. Industry participants will want to review their own internal practices and consider whether and how they might engage with the Bureau with respect to this rulemaking. In particular, organizations should consider the compliance costs associated with various proposals under consideration and consider whether alternative measures may be more cost effective.

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Please do not hesitate to contact us with any questions.