



Point of view

Analyzing Strategic Regulatory Policy Shifts

Americas FS Regulatory Center of Excellence

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Debt Collection Reform

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1. Executive summary

Recent actions by multiple regulatory authorities at both the federal and state levels reaffirm that debt collection practices remain a key regulatory and compliance focal area. Examples of such actions include:

- The release of the Federal Reserve Bank of New York's Quarterly Report on Household Debt and Credit for the first quarter of 2017, highlighting an upward trend in delinquencies for auto and credit card debt along with continuing and "stubbornly high" student loan delinquency flows. The report also shows that auto and student loans comprise an increasing share of total household debt.¹
- A Consumer Financial Protection Bureau (CFPB or Bureau) report on student loan defaults.²
- A ruling by the U.S. Supreme Court finding that a creditor may file an obviously time-barred debt as part of a Chapter 13 bankruptcy filing without violating the Fair Debt Collection Practices Act (FDCPA).³
- A year-long initiative, "Operation Collection Protection," undertaken by the Federal Trade Commission (FTC) and the CFPB in partnership with multiple federal, state, and local law enforcement entities. Collectively, they filed more than 165

enforcement actions throughout 2016 to address illegal debt collection practices.

- FTC and CFPB reports highlighting debt collection-related complaints as the most common type of consumer complaint received.

KPMG LLP's (KPMG) Financial Services Regulatory Risk practice has prepared this Point of View paper to look at areas where creditors and debt collectors can begin to review and strengthen their own practices in light of the heightened federal- and state-level regulatory attention directed toward debt collections activity.

The paper expands on a KPMG Client Alert released last year analyzing the impact of possible CFPB proposals to reform the FDCPA for third-party debt collectors (the Outline). The Outline, which was released in July 2016, addresses debt collection practices commonly identified in collections-related complaints and lawsuits and details enhanced consumer protections the Bureau believes will help mitigate the root causes of consumer frustration and the potential for consumer harm. It is not a proposed rule but does serve as an indicator of the areas of concern to federal and state regulators as well as to the types of requirements the Bureau might build into future regulations.

2. Compliance management challenges and expectations

The Bureau conducted a self-assessment and determined that the impact and effect of the proposals under consideration would not exceed "moderate" costs and effort, anticipating that the majority of costs and effort would be up front at the initial implementation.

However, the true cost of the proposals under consideration is not known and industry participants should be aware that system upgrades and process enhancements that will be necessitated by

¹ Released May 17, 2017 and available at

<https://www.newyorkfed.org/microeconomics/hhdc.html>

² Update from Student Loan Ombudsman on Redefaults, released May 16, 2017 and available at <https://www.consumerfinance.gov/about->

[us/newsroom/cfpb-report-finds-9-10-highest-risk-student-loan-borrowers-were-not-enrolled-affordable-repayment-plans/](https://www.consumerfinance.gov/about-us/newsroom/cfpb-report-finds-9-10-highest-risk-student-loan-borrowers-were-not-enrolled-affordable-repayment-plans/)

³ See *Midland Funding, LLC v. Johnson*, Case No. 16-348, 581 U.S. ____ (2017) available at https://www.supremecourt.gov/opinions/16pdf/16-348_h315.pdf

the proposals contained in the Outline will likely require substantial effort to update and could be very costly.

2.1 System Upgrades

Enhanced Reporting Requirements: The Bureau expects a robust reporting and data analytics practice to collect information on pools of debt and disputes in order to detect warning signs and identify trends. This requires the development and establishment of a reporting system and the appropriate staffing to determine and subsequently analyze the information that signals potential bad debt. Most debt collectors, especially smaller entities, may not have the resources available to design and implement such practices.

Information Transfers: Transfers of account information (e.g., between sellers and buyers, and servicer transfers) often encounter difficulty when information is transitioned between different debt collection platforms or physical loan files exchange hands. To ensure complete information transfers and the security of customer information requires significant intermediary work. Placing tougher standards on information transfers will increase the cost and effort to synchronize disparate platforms and mediums.

Automating and Digitizing Labor: Compliance leaders should look for opportunities to digitize and automate processes as much as possible. Robotic Process Automation (RPA), machine learning, cognitive computing and advanced analytics can automate a majority of compliance requirements. For example, the Bureau will be releasing a new interface for its Complaint Portal in the first half of 2017. The new interface is intended to improve the user experience. It will also allow registered users to directly access and manipulate data, and automate the download of critical information. Understanding what information to dissect and analyze may allow for insight into industry trends and assessment

of how an entity's current compliance measures meet regulatory standards.

2.2 Process Enhancements

Bad Debt: An inability to substantiate debt would require additional steps before the debt collector could support and make lawful claims of indebtedness. The Outline does not provide an objective threshold of what constitutes bad debt. This may, according to the Outline, preclude collection on entire portfolios until substantiation. Certain classes of debt portfolios, as a key characteristic, require extensive skip tracing to identify consumers. From the Outline, it is unclear how the CFPB would propose to handle such scenarios, and whether such pools could ever be substantiated to the extent needed to satisfy the Bureau.

Validation Disputes: A proposal in the Outline would allow consumers to dispute a debt by returning a tear-off section included in validation notices. The Outline's suggested template provides broad dispute categories that may not help consumers with legitimate concerns. A check-box may not present a clear picture of an actual problem, making it more difficult for a consumer to dispute complex problems (e.g., ID Theft or Fraud) and inhibiting a debt collector's ability to legitimately resolve harm.

Communication Limitations: Successful debt collection is reliant on the amount and accuracy of account data. This often requires persistence and creativity to establish confirmed consumer contact. The Outline seeks to create uniform requirements that would restrict and cap communication efforts in contrast to industry experience. As such, the proposed limits appear to underestimate the potential impact that restricting communications will have on debt collectors. Infrequent and less meaningful communication may result in an inability to collect on legitimate amounts due.

3. New provisions and amendments

The Outline focuses on improving three distinct practices and activities: 1. **Information Integrity**; 2. **Understanding Initiatives**; and 3. **Communication Practices**. The Bureau asserts establishing standards and enhancements in these areas will address common complaints received, including:

- Continued attempts to collect on debt from the wrong consumer or in the wrong amount. This is the most common debt collection complaint and the Bureau believes this issue arises from 1) the quality or quantity of information debt collectors receive at placement or sale and 2) the lack of

critical information in the initial collection notices provided to consumers to assist in identifying the debt as theirs.

- Debt collectors' communication practices. This is the second most common complaint and encompasses the frequency of communication attempts and information/disclosures provided to consumers by debt collectors.
- Educating and informing consumers of certain debt characteristics that may materially impact consumers, but are not readily understood.

The Outline reflects the Bureau's current expectation regarding the practices and activities third-party debt collectors will need to implement to comply with future FDCPA regulations. The following provides the key features of the Outline and potential requirements under consideration (refer to the Appendix for additional details of the Outline proposals).

3.1 Information Integrity

The Bureau believes that substantial deficiencies in account information and a lack of critical elements in initial communication notices result in downstream problems that may lead to an increase in complaints, lack of consumer response and an overall inefficient and frustrating process. The Outline identifies three enhancements to ensure information integrity:

- **Substantiate the Debt:** For all claims, debt collectors must have a reasonable basis that a particular consumer owes a particular debt. The Outline provides three elements (see appendix) that objectively establish a reasonable basis to collect on a debt.
- **Transfer of Information:** The owner or prior debt collector must transfer any information received from the consumer in the course of collection activity to the next collector.

- **Validation Notices:** Debt collectors are generally required to send consumers a written notice containing information about the debt and consumer's rights. The Outline proposes certain enhancements to this written notice.

3.2 Understanding Initiatives

The Outline seeks to address characteristics of debt and the debt collection process that consumers may not be aware of or may not understand by requiring debt collectors to disclose key pieces of information, including a **Litigation disclosure** and **Time Barred and Obsolete Debt**.

3.3 Communication Practices

The Outline seeks to address significant problems identified in communication practices by empowering consumers with greater control during the debt collection life cycle, which include:

- Limited Contact Frequency
- Limited Content Messages
- General Time Place Manner Restrictions
- Decedent Debt
- Consumer Consent.

4. Regulatory environment

In the past several years, debt collection has generated more consumer complaints to the Bureau and the FTC than any other financial product or service. In response, both the Bureau and the FTC have individually and collectively taken action to address this regulatory issue.

The future of a CFPB debt collection rulemaking, however, is uncertain at best. The Trump Administration and the Congressional Republicans are seeking to implement regulatory reforms that will broadly scale back the number and burden of regulations, especially in the financial services industry. They have specifically called out reforms for the Dodd-Frank Wall Street Reform and Consumer Protection Act and the governance and authorities of the CFPB. Potential changes have sought to limit the Bureau's authority to publish its Complaints Database as well as its rulemaking and enforcement authorities related to the unfair,

deceptive, or abusive acts or practices provisions. However, its rulemaking authority for the federal consumer protection laws has not yet been challenged.

Importantly, multiple agencies have authority to enforce the consumer protection laws that touch debt collection activities, including the FDCPA, the Fair Credit Reporting Act, and the Telephone Consumer Protection Act, assuring that debt collection issues will remain top of mind in the industry.

5. Considerations and conclusions

Covered debt collection participants should begin to prepare for expanded Bureau supervision and examination regarding debt collections. An early start allows for flexibility to address changes resulting from heightened scrutiny and potentially new rule requirements and compliance standards. The issues identified in the Outline give sufficient notice of the areas that may be subject to change and an idea of the direction of change through rulemaking. With regard to the expanded Bureau supervision and examination for debt collection, compliance leaders could immediately begin to take the following actions:

5.1 Preventive Elements

Assessment of Current State: Review and assess compliance management systems to determine if they include sufficient written policies and procedures, risk assessments, proper communication channels, and training to meet the Bureau's expectations prior to implementation. Evaluate gaps between current operations and a target operating landscape, including necessary next steps to meet the desired future state.

Staffing and Training: Align appropriate staffing expertise and resources to properly implement and administer a compliance program dedicated to the FDCPA and other consumer protection regulations. Develop a comprehensive training program and track appropriate role-specific training on applicable laws, rules, and regulations for first-line units and compliance risk management, and establish standards for the frequency and method (e.g., formal, on-the-job, external) of training to be conducted for both the first line units and compliance risk management.

Accountability: Ensure that the Board of Directors, or similar invested stakeholders, maintain transparent oversight the compliance risk management plan and the enterprise-wide compliance risk management program. Communication channels between senior management and staff should be transparent and formalized to create a free flow of information and dedicated escalation protocols.

5.2 Detective Elements

Reporting and Data Analytics: Consider establishing and implementing a comprehensive enterprise-wide state of compliance reporting to different levels of stakeholders on a recurring basis and establish centralized management information systems, which may include: (i) thematic analysis of compliance concerns; (ii) risk metrics, limits, and limit breach reporting that reflects the level of compliance, adherence to policy, monitoring and testing results, and potential areas of concern; (iii)

identification of significant and unresolved deficiencies; and (iv) a summary of monitoring and testing results.

Complaint and Dispute Management: Develop and establish a complaint case management system to enable the identification of warning signs and trends. Debt collectors should be aware that complaints and disputes relating to debt may appear in various forms. The Fair Credit Reporting Act (FCRA), for example, places an affirmative duty on furnishers to correct inaccurate or incomplete credit information and allow for direct consumer disputes. An increase in direct credit disputes, or pools with a relatively high percentage of direct credit disputes, may be symptomatic of underlying bad debt and require further substantiation due diligence. Participants should identify trends (e.g., volume or nature of disputes) and accordingly enhance processes based on the impact on the first-line units as well as compliance to address any identified deficiencies.

Call Management and Monitoring: Understand the location, timing and frequency of calls to consumers to avoid exceeding communication caps, as proposed in the Outline, and regularly review consumer communications to verify service agents speak with consumers appropriately. Also, vet and identify the source of telephone numbers. A recent declaratory ruling interpreting the Telephone Consumer Protection Act (TCPA), an act intended to protect consumers from unwanted calls to cellular phones that prohibits the use of automatic telephone dialing systems (ATDS) to do so, may have significant impact on debt collectors. Equipment that has the capacity to store, produce, or dial random sequence of numbers, regardless of its actual use, is defined as an ATDS. As a result, some collection entities are resorting to manual dialing rather than face the potential for legal damages. Other debt collectors are electing to invest in updated consumer data and reduce the number of calls to those more likely to yield positive consumer contact.

5.3 Responsive Elements

Addressing the changes to potential regulatory obligations: Update policies, procedures, templates, and call scripts to ensure they are consistent with the regulatory expectations (e.g., obtaining and tracking additional information, assessing and responding to warning signs, providing validation notices and statements of rights, meeting limits on contact frequency, and collection restrictions on time-barred debt).

Compliance leaders can take several actions immediately to enhance their compliance effectiveness and efficiency while

simultaneously increasing their organizational agility. KPMG's Compliance Transformation framework, which consists of eight program elements, provides relevant components that will

configure and facilitate a tailored, proactive debt collection compliance program architecture that can respond flexibly to the evolving regulatory expectations discussed in this Point of View.

Appendix

Key Features of the CFPB's Outline

The Outline focuses on improving three distinct practices and activities: 1. Information Integrity; 2. Understanding Initiatives; and 3. Communication Practices.

Information Integrity:

The Bureau believes that substantial deficiencies in account information and a lack of critical elements in initial communication notices result in downstream problems. The Outline identifies enhancements to ensure information integrity:

- **Substantiate the Debt:** Debt collectors must substantiate, or possess a reasonable basis for, claims that a particular consumer owes a particular debt. The Outline provides three elements that objectively establish a reasonable basis to collect on a debt with flexibility to accommodate alternative approaches to debt substantiation. As such, the elements are not requirements and a deficiency in one element is not dispositive of bad debt so long as a debt collector can support any action taken as being reasonable, based on their due diligence of the debt.
- **Fundamental Information⁴:** The Bureau believes that the identification of certain fundamental information would establish a reasonable basis for a claim of indebtedness. The list of fundamental information would provide core information debt collectors can obtain and review about the consumer, the character of the debt, and the chain of title that provides the collector's right to collection. Each specific item is not needed to establish the claim, but the debt collector would bear the burden of justifying an alternative solution.
- **Creditor Representation of Accuracy:** The Bureau believes that a debt owner's or creditor's representation of accuracy would help form a reasonable basis. Such written representation would need to indicate the adoption and implementation of reasonable, formal policies and procedures that ensure the information transferred to debt collectors is complete and accurate.
- **Warning Signs:** Debt collectors would also need to review information for warning signs to establish a reasonable basis. This would require due diligence on the adequacy and accuracy of information that is greater than a mere cursory review. The discovery of warning signs does not invalidate the right to collect, but would trigger the need to take steps to substantiate the debt. Warning signs would need to be reviewed at different phases during the debt collection life cycle, including prior to initiating an attempt to collect the debt,⁵ during the course of collection activities,⁶ and after the receipt of a dispute of indebtedness.
- **Transfer of Information:** The Bureau is concerned that the subsequent placement or sale of debt to a new debt collector may not be accompanied by information previously provided to a prior collector, exacerbating problems caused by inaccurate or incomplete information. Without the transfer of complete information, consumers are often required to resubmit information already provided. Proposals in the Outline would obligate the owner or prior debt collector to transfer any information received from the consumer in the course of collection activity to the next collector. Specifically, the Outline is concerned with

⁴ Fundamental Information includes: (1) consumer's full name, last known address, and last known telephone number; (2) consumer's account number with the debt owner at the time the account went into default; (3) date of default, amount owed at default, and date and amount of any payment or credit applied after default; (4) each charge or interest or fees imposed after default and the contractual or statutory source of such interest or fees; and (5) the complete chain of title from the debt owner at the time of default to the collector.

⁵ Warning signs at initial review may include: (1) information for an individual debt is not in a clearly understandable form; (2) information for any individual debt is facially implausible or contradictory; (3) a significant percentage of debt in the portfolio has missing or implausible information either in absolute terms or relative to portfolios with comparable types of accounts; or (4) a significant percentage of debt in the portfolio has unresolved disputes, either in absolute terms or relative to portfolios with comparable types of accounts.

⁶ Warning signs during collection activity may include: (1) a consumer dispute with respect to an individual debt; (2) the inability to obtain underlying documents in response to a dispute; or (3) receipt of disputes from a significant percentage of debt in the portfolio, either in absolute terms or relative to portfolios with comparable types of accounts

transferring information that would indicate that all or part of the debt may be uncollectible or likely to lack sufficient informational support.⁷

- **Validation Notices:** At the onset of collection efforts, debt collectors are generally required to send consumers a written notice containing information about the debt and consumer's rights. The Bureau's data suggests that the current version of the validation notice does not prevent attempts to collect debt from the wrong consumers and in the wrong amounts. Sparse information contained in current versions of the validation notice may lead to consumer confusion and misinformation, increasing the likelihood of future interactions and frustration.⁸
 - An actionable **"tear-off"** will accompany revised validation notices to facilitate the exercise of disputes and present original-creditor-information rights. This will provide consumers with an easier and clearer way to dispute incorrect indebtedness.
 - A separate, one-page **Statement of Rights** document that would accompany the validation notice and describe what a consumer can do (e.g., stop communications, dispute the validity of the debt, etc.) and what a debt collector cannot do (e.g., communicate at inappropriate hours, etc.).
 - The Outline discusses the benefit of requiring alternative or translated validation notices and Statement of Rights documents to address a growing **limited-English proficiency (LEP)** population and implementation options, including publishing LEP versions in the Federal Register.

Understanding Initiatives

The Outline seeks to address characteristics of debt and the debt collection process that consumers may not be aware of or may not understand by requiring debt collectors to disclose key pieces of information:

- **Litigation Disclosure:** Proposals under consideration include the affirmative duty to provide a brief "litigation disclosure" in all written and oral communications to the consumer in which they represent, expressly or by implication, an intent to sue. The disclosure would include a statement of the debt collector's intent to sue; potential for negative ruling against the consumer if he or she fails to defend a lawsuit; and additional information about debt collection litigation, including contact information for legal services programs available on the Bureau's Web site and through the Bureau's toll-free telephone number.
- **Time Barred and Obsolete Debt:** The Outline would require the inclusion of a brief, plain-language statement in the validation notice and initial communication, informing the consumer that, because of the age of the debt, the debt collector cannot sue to recover it. A similar disclosure regarding the ability to sue on the debt may be required at additional intervals and, possibly, during each communication in which a debt collector attempts to collect payment. An accompanying disclosure informing the consumer as to whether a time-barred debt generally can or cannot appear on a credit report is also under consideration by the Bureau.

Communication Practices

The CFPB seeks to address the significant problems identified in communication practices by empowering consumers with greater control during the debt collection life cycle.

- **Contact Frequency:** The proposals in the Outline would create uniform requirements that would restrict and cap communication efforts.
- **Limited Content Messages:** The Outline seeks to address the perceived inability to leave messages for a consumer when direct contact cannot be made. Leaving consumer messages would be permissible (including voicemails, with a third party in a live conversation, or through another method such as email) if the message only conveys: (1) the individual debt collector's name; (2) the consumer's name; and (3) toll-free method for the consumer to reply to the debt collector's message.
- **General Time Place Manner Restrictions:** The Bureau is also considering expansive time, place, and manner restrictions, allowing consumers greater say and control over a debt collector's contact attempts. The Outline would prohibit communication

⁷ Information that may support an ability to collect include: (1) payments submitted by the consumer; (2) bankruptcy discharge notices; (3) identity theft reports; (4) disputes; and (5) any assertion or implication by the consumer that his or her income and assets are exempt under federal or state laws from a judgment creditor seeking garnishment.

⁸ See 15 U.S.C. 1692g; validation notices must include: (1) amount of the debt; (2) name of the creditor to whom the debt is owed; (3) description of the consumer's right to dispute the debt and obtain the name and address of the original creditor; and (4) statement that the collector will assume the debt to be valid unless disputed by consumer

at locations that the Bureau has identified as presumptively inconvenient for consumers if the debt collector knows or should know that the consumer is at such a location.

- **Decedent Debt:** The Outline proposes to establish a waiting period (30 to 60 days) before debt collectors would be permitted to attempt communications with a decedent consumer's surviving spouse or family members. Communication would be effectively banned during the waiting period unless the surviving individual initiates communication to consent to waiving protections.
- **Consumer Consent:** Consumers would be permitted to waive communication restrictions. Such consent would need to come directly from the consumer and be refreshed at the sale or transfer of the debt to allow a consumer to reassess and reset communication parameters with a new debt collector. Consent would need to be accompanied by a clear and prominent disclosure—oral or written—informing the consumer what exactly they are consenting to (e.g., allowing communications at a specific date and time).

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