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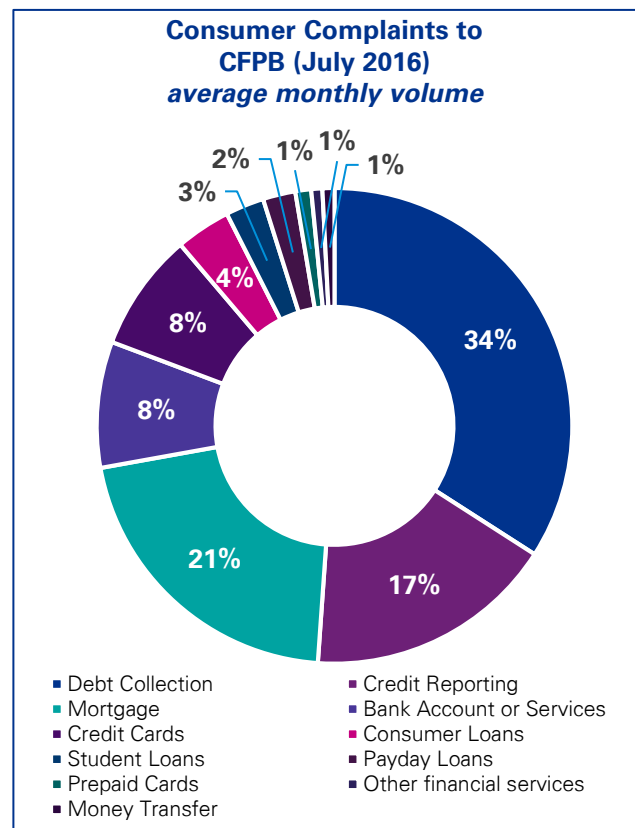
Debt Collection – CFPB Reveals Outline for Future Rulemaking

On July 28, 2016, the Consumer Financial Protection Bureau (CFPB or Bureau) released an outline of possible regulatory proposals¹ to address debt collection practices by third-party debt collectors under the Fair Debt Collection Practices Act (FDCPA).

The CFPB will address first-party debt collectors and creditors, which are not currently covered by the FDCPA, “on a separate track.”

The effort to increase consumer protection regarding debt collection standards is not occurring in a vacuum. The CFPB’s most recent Monthly Complaint report shows debt collection complaints by consumers continue to constitute the largest component of consumer complaints. In parallel, over the last year, regulators increased their scrutiny of information accuracy and integrity under the Fair Credit Reporting Act (FCRA) as well as contact frequency and consumer consent under the Telephone Consumer Protection Act (TCPA).

The CFPB’s initiative is raising some concerns with respect to how potentially more stringent debt collection standards may impact such areas as: banks’ ability to sell non-performing loans to debt collectors, assumptions regarding banks’ loss given default (LGD) rates as well as related write-offs, provisioning and capital allocations. They may also impact the ability of a range of debt buyers (including hedge funds) to acquire defaulted debt.



¹ See CFPB Small Business Review Panel for Debt Collector and Debt Buyer Rulemaking, Outline of Proposals Under Consideration and Alternatives Considered; see also Prepared Remarks of CFPB Director Richard Cordray on Field Hearing on Debt Collection, available at: <http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-field-hearing-debt-collection/>.

It will likely take more than six months before the CFPB issues final rules regarding debt collection. This provides lenders and their third party service providers with time to prepare for more stringent regulations. It also provides banks with opportunities to update scenario analysis regarding LGD rates in light of tightening debt collection standards, as appropriate.

Rulemaking Process and Background

The CFPB initiated the public policy process regarding debt collection in November 2013, through its Advanced Notice of Proposed Rulemaking (ANPR), seeking information on first- and third-party debt collection issues. The next step following the CFPB July 2016 outline is an impact assessment by a small business review panel.² The review panel is expected to convene in August 2016 and to issue a report within 60 days of the meeting. It is expected that the CFPB will use the review panel and the report to inform the formal notice of proposed rulemaking (NPR) regarding third party debt collection.

The CFPB may also convene a second review panel “in the next several months” to focus on first party debt collectors and creditors that may not meet the statutory definition of a “debt collector.” It is unclear whether the CFPB will issue a single NPR focused exclusively on third-party debt collection.

Outline Details

The Bureau’s outline focuses on developing policies covering three broad categories of issues: information integrity; consumer disclosures; and communication practices.

Information Integrity

The outline contemplates a range of changes regarding the acquisition and transfer of collection accounts, information collection, and complaint management processes:

- Debt Validation/Out of Statute: Substantiate a debt before initiating collections activity, based on a review of “fundamental information” and representations of accuracy from the creditor;
- Due Diligence: Obtain supplemental information if warning signs ; Transfer

information to successive collectors that obligates action (e.g., communications restrictions);

- Complaint Management: Provide verification of a debt in response to a consumer dispute;
- Validation: Provide a validation notice with enhanced information and disclosures along with a Statement of Rights in multiple languages.

Disclosures

The CFPB outline suggests that debt collectors should provide a brief “litigation disclosure” regarding their intent to sue in all written and oral communications. It also suggests new disclosures on when and how statutes of limitations can bar litigation. It also contemplates requiring debt collectors to waive the right to sue before collecting if payment on a time-barred debt would revive the statute of limitation.

Communication Practices

As detailed in the outline, the CFPB is exploring ways to increase consumer control over the communications they receive. Two specific sets of standards are under consideration. First, the CFPB is considering limits on the frequency and methods by which debt collectors can contact debtors (including deceased consumers and their survivors). Specific examples include:

- Quantitative limits on successful and attempted contacts;
- Geographic Prohibitions regarding “presumptively inconvenient” contact locations, including day care centers, places of worship, medical facilities, and places of bereavement; and
- Time Limits of 30 or 60 days on contact with the survivors of deceased consumers.

² The FDCPA was enacted in 1977 to “eliminate abusive debt collection practices by debt collectors.” It does not apply to first-party debt collectors. Section 1089 of the Dodd-Frank Wall Street Reform and Consumer Protection Act gave the CFPB authority to “prescribe rules with respect to the collection of debts by debt collectors.” It is the first federal agency to have statutory authority to write implementing regulations for the FDCPA. See Section 1089 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-213, July 21, 2010. The Dodd-Frank Act also gave the CFPB authority to issue regulations “identifying as unlawful unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.”

These to extend existing telemarketing contact limits under the TCPA to text and email messages associated with debt collection activities.

Second, the CFPB is exploring ways to require third party debt collectors to obtain affirmative consumer authorization, either orally or in writing, in order to waive the FDCPA's contact restrictions.

Implications

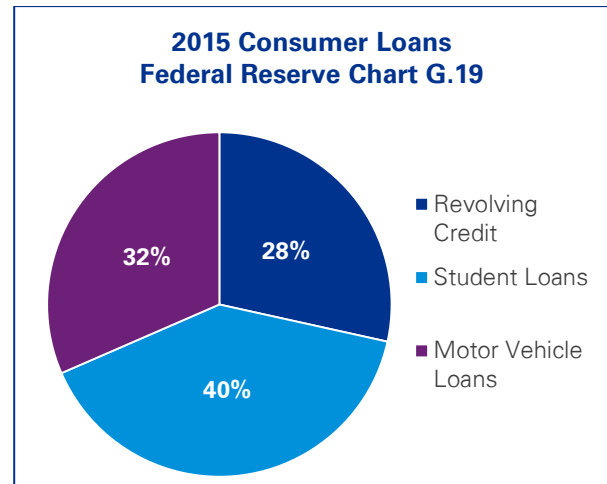
The detailed outline released by the CFPB provides insight into the kind of regulatory proposals that may emerge from industry consultations, long before a NPR has been issued. A broad range of consumer lending activities will be impacted by tighter debt collection standards.

Banks in particular have a window to implement strong third party vendor management standards in advance of the new standards being finalized. At the same time, banks have an opportunity to reassess existing data management and governance structures regarding delinquent and at-risk credit exposures that could become subject to debt collection. Investments in data automation and digitization now will facilitate both enhanced credit risk assessments as well as minimize regulatory compliance burdens when new rules are articulated in 2017. Finally, banks should revisit now both their current compliance and debt collection practices as well as their underlying assumptions regarding consumer credit portfolios in order to assess potential future exposure and related provisioning levels associated with potentially slower collections processes.

Potentially tighter debt collection standards will also impact a broader range of consumer lenders. Alternative lenders that provide small business loans, secured consumer credit (auto lenders), unsecured consumer credit (credit card companies) and student loans as well as a range of online lending platforms may reassess

assumptions regarding LDG rates and related portfolio risk exposures.

Federal Reserve data illustrates the wide impact tighter debt collection standards will have in the consumer lending sector. As the chart illustrates, the consumer lending market encompasses student lending, auto lending and revolving credit.



With respect to consumer debt, Federal Reserve research indicates that student loan debt loads nearly doubled between 2007 and 2014.³ By 2015, only 37% of student loan borrowers were current and actively paying down their student loan debt while default rates exceeded 25%.⁴ In addition, default rates on auto loans have hit a post-crisis high of 8.4%.⁵

The CFPB's outline therefore holds significant implications for a broad range of financial institutions, their third-party debt collection vendors, and debt collectors themselves. The CFPB outline provides these firms with the opportunity to update their practices and prepare for shifts in the regulatory environment that will materially impact the conduct and cost of their business operations. Strategic firms will take the opportunity to upgrade their compliance and management information systems.

³ Monthly Complaint Report, CFPB (July 2016), p. 6.

⁴ This is required by the Small Business Regulatory Enforcement Fairness Act (SBREFA). The CFPB estimates that three-quarters of all debt collection firms employ fewer than 20 people. CFPB Study of Third-Party Debt Collection Operations, July 2016.

⁵ Student Loan Press Briefing Presentation (Media Advisory), Federal Reserve Bank of New York (April 16, 2015)(presenting data and research results from research conducted by four authors; the presentation makes clear that it does not purport to express opinions of the Federal Reserve System or the Federal Reserve Bank of New York.

For additional information, please contact:



Barbara C. Matthews
Managing Director

Americas Financial Services Regulatory
Center of Excellence
T: 202-533-3443
E: bcmatthews@kpmg.com



Amy Matsuo
Principal and National Lead

Financial Services Regulatory Risk
Practice
T: 919-380-1509
E: amatsuo@kpmg.com



Carolyn Greathouse
Principal

Financial Services Regulatory
Risk Practice
T: 636-587-2844
E: cgreathouse@kpmg.com



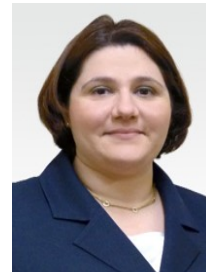
Stacey A. Guardino
Partner

Enterprise and Consumer Compliance
Financial Services Regulatory Risk
T: 212-954-4950
E: sguardino@kpmg.com



Todd Semanco
Managing Director

Financial Services Regulatory Risk
Practice
T: 412-232-1601
E: tsemanco@kpmg.com



Ursula Nigrelli
Director

Financial Services Regulatory
Risk Practice
T: 212-954-8103
E: unigrelli@kpmg.com

Authors:

Karen Staines, Director, Financial Services Regulatory Center of Excellence

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