

THE DEBT BUYING INDUSTRY

A White Paper



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The debt buying industry is a critically important part of the nation's credit-based economy. This white paper will explain the industry, the economic benefits that are returned to banks and consumers, the existing regulatory framework and the impact of current regulatory trends affecting the debt buying industry and their impacts on the consumer.

What Debt Buyers Do and How They Do It

Debt buyers are companies, both private and public, that purchase portfolios of performing and non-performing receivables originated from lenders, including banks and other financial institutions. Not all debt-buying companies are debt collectors. While some companies in our industry are debt collection attorneys or have in-house collection departments, others engage third-party collection agencies to work with consumers.

The hundreds of companies in the debt buying industry employ thousands of U.S. taxpayers. While most companies are small businesses and have fewer than 50 employees, a small number of debt buyers are publicly traded and most of these companies have a thousand employees or more.

Many debt buyers specialize in specific types of debt, such as credit card receivables or auto loans, medical or utility debt while others will handle the entire spectrum of consumer receivables. In fact, approximately \$2.4 trillion in non-mortgage, consumer debt is outstanding at any given time.¹ While most people associate credit card debt with debt collections, revolving credit makes up only about 36 percent of the total outstanding debt. Non-revolving credit such as auto loans, student loans, utilities and other types of loans make up the remainder of the debt collection marketplace.

Debt buyers represent a vital part of the overall consumer debt collection market. Typically, the original lender – the bank or financing company – will attempt to collect the loan itself, usually hiring a private collection agency or a series of agencies to do the work. Many debts are collected in the first or second attempt as most people recognize their responsibility to pay back monies they borrow.

By the time a debt is more than 180 days old and several collection attempts have been made, the likelihood that it can be collected is diminished. In fact, laws require banks to write-off or charge-off bad debts at this point.

Contrary to belief, charged-off debts are still an asset with value. Lenders, looking to extract that value, can either continue to pursue traditional collection strategies or sell the portfolio. By creating a market for charged-off receivables, debt buyers return money to

¹ “G. 19 Statistical Release.” May 6, 2011. U.S. Federal Reserve Board. Data used as of Dec. 31, 2010. <http://www.federalreserve.gov/releases/g19/current/>

the original lenders, easing their losses, improving shareholder value and creating capital that can be used to support additional lending.

When a debt buyer begins its efforts to collect an unpaid debt, one of the very first steps in the process is to conduct pre-collection screening to help mitigate errors and improve the rate of accurate consumer contact.

The Fair Debt Collection Practices Act and similar state regulations and laws put clear restrictions on what steps a collector may take. Letters and telephone collections are, by far, the most popular and constructive tool for collections. Debt buyers and collectors – collectively known as the accounts receivable management industry – make 4 billion contacts each year.²

When letters and telephone calls are not successful in resolving a consumer debt, filing suit in state court is an alternative. It is used on a limited basis to collect from consumers who typically have the means but have avoided paying.

Putting Collections into Perspective

It's frequently the case that some groups point to the total number of complaints filed against debt buyers and debt collectors as evidence of systemic problems with the industry. These numbers need to be considered in perspective.

Debt buyers play a small role in the overall consumer credit market. It is a fact that:

- About 95 percent of all consumer debt is paid off on time;
- According to the Fair Isaac Corp., less than half of all consumers have ever been reported as 30 or more days late on a payment;
- Only three out of 10 have ever been 60 or more days overdue on any credit obligation;
- 77 percent of all consumers have never had a loan or account that was 90+ days overdue;
- And fewer than 20 percent have ever had a loan or account closed by the lender due to default.

As a result, only a small percentage of loans ever go to collections. Of all the contacts that third-party collectors make each year, only 0.002 percent of those consumers complained to the Federal Trade Commission.³ And that statistic too might be inflated: The FTC does not specify how many of those complaints were valid claims, nor if the complaints were regarding the collector or the original issuer.

² Mayer, Caroline E. "As Debt Collectors Multiply, So Do Consumer Complaints." Washington Post. The Washington Post Company, 28 July 2005. Web. 18 Aug. 2010. <http://www.washingtonpost.com/wp-dyn/content/article/2005/07/27/AR2005072702473.html>.

³ "Annual Report 2010: Fair Debt Collection Practices Act." U.S. Federal Trade Commission. Washington, D.C., 2010. Print.

The Better Business Bureau also accepts complaints about debt collections. Of 14,966 complaints received, 84 percent were settled by the companies. That is well above the 75 percent resolve rate for all industries. In fact, our industry has consistently ranked among those industries with the highest resolve rates.⁴

The collection industry understands that contacting consumers to pay unpaid bills is a difficult task and most consumers would prefer not to receive these calls. It is an unfortunate truth, however, that not all consumers pay their bills and subsequently the services of the collection industry are required.

Debt Collection is Consumer Protection

While the percentage of consumers who fail to pay their debts on time is small, the dollar figures can be staggering. According to the Federal Reserve, at the end of 2010, Americans' revolving debt – essentially all general-purpose credit cards and private label credit cards – exceeded \$800 billion.⁵ At the time, commercial banks wrote off 7.7 percent, or some \$62 billion, of their credit card losses.⁶

Creditors often respond to losses by changing their lending standards in ways that make it harder to obtain credit. Numerous news organizations, including *Reuters*, *The New York Times*, *Financial Times* and *Market Watch*, have reported that banks are significantly changing their lending practices to reduce their exposure to losses.

“We are getting back to an old-fashioned basis of lending, providing credit only to people who have the ability to repay,” said Curt Beaudouin, an analyst at Moody’s Investment Services told the *Financial Times*.⁷

Credit is a simple idea that has become a part of our national fabric, from the loans that make purchasing a home possible to the revolving credit that makes smaller purchases convenient. In today’s economy, it is incredibly hard to operate without access to at least some form of credit. For instance, credit cards are frequently used as assurance when renting a car or even a movie. Hotels require credit cards upfront to ensure guests pay their bills. It’s difficult to make large purchases without credit cards. Credit allows consumers to spread out the cost of buying large ticket items such as refrigerators or automobiles.

Debt collection is consumer protection because it protects the ability of responsible people to get the credit they need to maintain and improve their quality of life.

⁴ “2010 Complaint and Inquiry Statistics.” Better Business Bureau. Web. 5 Aug. 2011.
<http://www.bbb.org/us/2010-complaint-and-inquiry-statistics/>.

⁵ “G. 19 Statistical Release.” U.S. Federal Reserve Board. May 6, 2011. Data used as of Dec. 31, 2010.
<http://www.federalreserve.gov/releases/g19/current/>

⁶ “Statistical Release: Charge-Offs and Delinquencies on Loans and Leases at Commercial Banks.” U.S. Federal Reserve Board. Data used as of Dec. 31, 2010.
<http://www.federalreserve.gov/releases/chargeoff/delallsa.htm>

⁷ Kapner, Suzanne. “Surprise slowdown in US credit card losses.” *Financial Times* via FT.com. Aug. 26, 2010. <http://www.ft.com/cms/s/0/611b1210-b14c-11df-b899-00144feabdc0.html#axzz1Mq41cxKs>

Furthermore, consumers benefit from lower retail prices and stronger purchasing power, since consumers would likely be faced with higher prices if businesses were unable to recoup losses resulting from bad debt.

In 2008, ACA International, a trade group representing traditional contingency collection agencies, retained PricewaterhouseCoopers LLP to conduct a survey and economic analysis of third-party debt collections. The results of this survey are instructive, in that they show the effect that collecting overdue debts can have on all consumers.⁸

The ACA survey found that in 2007 the industry's collection efforts resulted in \$40.4 billion of debt being returned to creditors and the economy as a whole, representing an average savings of \$354 per American household that might have otherwise been spent had businesses been forced to raise prices to cover the unrecovered debt. Using 2007 prices that money translates into approximately 8 months of cellular phone service, 86 days of electricity or 127 gallons of gasoline.

Banks and Businesses Benefit by Working with Debt Buyers

While the economic benefits to consumers are important, the debt buying industry returns real money to creditors' bottom lines. ACA's analysis showed that the \$40.4 billion returned to creditors in 2007 was equivalent to a 20.9 percent reduction in business bad debt, and was equal to 2.2 percent of all U.S. corporate profits before tax, 3.9 percent of before tax profits of all U.S. domestic non-financial corporations, and 7.9 percent of the before tax profits of all U.S. domestic financial corporations.

Charged off consumer debt is a tangible asset with real economic value that provides a clear benefit to the creditors who sell it. Creditors are able to factor this value into their business model, knowing that they can collect a percentage on what might otherwise be a lost asset. Creditors are able to keep the cost of credit for all consumers lower and make credit more accessible to lower income consumers.

Existing Consumer Protections and Current Regulations

The entire accounts receivables management industry, including debt buyers, is regulated at both the state and federal levels.

Under current laws, the Consumer Financial Protection Bureau is the primary regulator of debt purchasers and collectors at the national level. Its primary regulatory tool is the Fair Debt Collections Practices Act. Implemented in 1977, the Act's purposes are to eliminate abusive practices in the collection of consumer debt, promote fair debt collection and to provide consumers with an avenue for disputing collection attempts. FDCPA sets legal standards under which debt buyers and collectors can conduct their business, defines the rights of consumers involved with collectors, and prescribes penalties and remedies for violations of the Act. It is sometimes used in conjunction with

⁸ "Value of Third-Party Debt Collection to the U.S. Economy in 2007: Survey and Analysis." ACA International. June 12, 2008, pages 5-7.

the Fair Credit Reporting Act. While the FDCPA governs debt collectors on the federal level, each state has its own set of laws that govern the industry. Whenever state and federal laws conflict, debt buyers and collectors must follow the more restrictive standard.

A recent report from the Government Accountability Office (GAO) concluded that the FDCPA, while a mainstay of federal consumer protection efforts, is out of date and no longer reflects the way today's consumers communicate or the way the debt collection industry operates. The debt buying industry generally accepts these findings and is working with regulators to propose and enact new laws that bridge the gap between the outmoded regulation and modern methods of collecting without creating undue burdens on either the consumer or the collector.

The GAO offered three areas where Congress should modify FDCPA. DBA International continues to support the recommended changes. The first area is to improve standards of information attached to each account to ensure contact is made with the proper consumer. This will greatly reduce the incidence of mistaken identity and also give consumers greater protection when dealing with debt collectors.

The second is to allow for constantly evolving communications technology and the way different generations access it. When the law was written, landline phones and U.S. mail were the most common forms of communication. While cell phones and email are far more common today than landlines, debt collectors are effectively restricted from using these technologies to work with consumers. In addressing technology, a new version of FDCPA should take this into consideration.

The third area the GAO identified was the FTC's lack of rule-making authority. In many respects, this concern has been rendered unnecessary by the launch of CFPB. Nevertheless, any changes to this law are the purview of Congress, and so far Congress has failed to make the changes that keep the regulation current. DBA and other associations representing debt collectors and attorneys have publicly said they would like to see Congress act on most of the GAO's recommendations.

It is also worth noting that over the last several years, the FTC invested its resources in a public education campaign designed to help consumers understand their rights when approached by a debt collector. Much of this FTC-produced information is available online, in YouTube videos, articles and specific websites designed for the purpose. We anticipate that CFPB will continue this important work. Likewise, we anticipate that consumer protection groups and the media will continue their public education efforts. As a body, they have produced significant volumes of material explaining a consumer's rights under FDCPA, including articles, blogs, wiki entries and review sites. As a result, a motivated consumer has access to more information about debt collectors, the debt collection process and their rights under FDCPA than at any time in the past.

Current Trends in State Enforcement

In parallel with their federal-level activity, consumer protectionist groups are seeking changes at the state level. These groups argue that federal agencies have done too little, and that state enforcement mechanisms need to be stronger. Our industry already has effective enforcement at the federal level and we are working with state regulators and legislators to create useful change.

State attorneys general have also been very active in using the existing tools at their disposal to effectively end debt collection abuses in ways that do not overburden an entire industry.

Nevertheless, there continues to be state-level efforts to adopt new laws to limit the ability of debt buyers to operate. Generally, they are pursuing two avenues. The first is to require debt buyers to provide documentation on debts owed that the original creditors are not required to maintain.

A number of states have recently looked into concerns that debt buyers do not maintain sufficient information on the nature of the debts involved, most frequently an itemization of the charges that led to the debts in the first place. Legislators and regulators are asking a question that is, on its face, entirely reasonable: What did the debtor purchase that led to this situation? The belief is that having access to account statements and other information will provide debt buyers with a level of verification that the debt is actually owed by the debtor.

The challenge, however, is that frequently this information is not available. The original creditor is not required by law to itemize a debt when it's written off. Having no obligation to do so, most creditors do not maintain these records beyond legal document retention requirements. It is a legal inconsistency that cannot be reconciled.

Recognizing this is complex situation that needs attention, DBA is working with regulators on the state and federal level to find ways to bridge this inconsistency and incorporate more and better account information into the collection process.

The second avenue is to push for the adoption of shorter statutes of limitations, as little as two years in some cases, or the complete extinguishment of the debt when the statute has run out. The intent is to curtail abusive practices by restricting the time frame in which they can happen.

This approach is fraught with unintended consequences. Most significantly, this approach severely restricts the ability of debtors to settle their debts and clear their credit records, which must be maintained for a full seven years. Once a debt has been extinguished, a debtor cannot pay the money back even if he or she wanted to. Unsettled debts can hurt

individuals who need a clean credit report in order to secure a job, a promotion or a security clearance.

A second, but also significant, consequence of a shorter statute of limitations is the rush to litigate. Given a shorter window to collect bad debts, lenders or their collection agencies will spend less time negotiating settlements and more time litigating them. In the end, legal fees will be piled on top of the debts, increasing the burden on consumers.

While these approaches seem like attractive consumer protections to many politicians, we believe that they will ultimately end up hurting the very people they are intended to help.

In summary, debt buyers play a critical role in the American credit system, and consumers and businesses end up being the beneficiaries of debt buyers' efforts.

DBA International will continue to work with regulators and legislators at both the state and federal level to modify existing laws or create new ones that will strengthen consumer protections without creating significant burdens on the debt buying and collecting industry.

About DBA International

DBA International is the trade association and voice for the debt buying industry. One of the organization's chief responsibilities is to advocate, on behalf of its members, for responsible state and federal legislation that maintains a level playing field for debt buyers and debtors. At the same time, DBA International represents its membership to state and federal agencies and supports the industry where appropriate in appellate cases of significance. DBA sets ethical and business conduct standards for the industry. DBA requires its members to adhere to a Code of Ethics and has an Ethics Committee responsible for enforcing the code.

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