THE DEBT BUYING INDUSTRY

A White Paper

DBA
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The debt buying industry is a critically important segment of the nation's credit-based economy. This white paper will explain the industry, the economic benefits that are returned to originating creditors and consumers, the regulatory framework in which the industry operates, recent state regulatory trends, and DBA International's Debt Buyer Certification Program.

Who are Debt Buyers and What Do They Do

Debt buyers are companies that purchase contractual-based accounts receivables (hereinafter referred to as "accounts") from originating creditors on the secondary market. The types of accounts can differ dramatically based on the asset class that was the foundation of the contractual agreement not to mention other factors such as whether the accounts:

- Are associated with "consumer" or "corporate" obligations,
- Are "performing" or "nonperforming,"
- Have "guarantees" made by third parties, or
- Have "collateral" for payment.

A debt buyer analyzes all of these factors as well as numerous others when valuing accounts prior to purchase. For example, whether an account is characterized as "performing" or "nonperforming" will significantly impact what the originating creditor can expect to receive for the sale of the account on the secondary market. Performing accounts are frequently valued at or near face value whereas nonperforming accounts are usually valued at a discount due to the challenges associated with rehabilitating contractual performance.

When a debt buying company purchases an account from a creditor, it essentially purchases the contract and all rights, benefits, and liabilities that were held by the creditor that are associated with the contract – which includes receiving payments on performing accounts and the right to collect on all nonperforming accounts.

While debt buying companies are often characterized as "debt collectors" which thereby makes them subject to the federal Fair Debt Collection Practices Act (FDCPA), this is not automatically the case. The mere act of purchasing accounts from an originating creditor is not a determining factor for FDCPA compliance. Rather, the determining factor is based on the type of accounts that are purchased. For example, if a debt buyer purchases accounts that are performing, or are the obligations of a corporation, or that consist of federally guaranteed student loans, the FDCPA would not apply. However, if a debt buyer purchases nonperforming consumer accounts, the FDCPA would apply.

Debt buying companies employ thousands of U.S. taxpayers nationwide and operate in all 50 states. While most debt buying companies are privately held small businesses that operate on a state or regional basis there are also a number of publicly traded companies. The largest companies each typically employ over 1,000 individuals.

Many debt buyers specialize in specific asset classes of accounts, such as credit cards, auto loans, corporate, medical, student loans, or utility while others handle the entire spectrum of asset classes.

The Credit Based Economy

The use of credit is a cornerstone of the United States financial system. American businesses, consumers, and the government itself rely on the availability and extension of credit by originating creditors to purchase goods and services.

Approximately $2.8 trillion in non-mortgage consumer receivables are outstanding at any given time.[1] Though credit card debt is often associated with these outstanding receivables, revolving credit actually makes up only about 36 percent of the total balance. Non-revolving credit such as auto loans, student loans, utilities, and other types of loans make up the remainder of the balance.

Originating creditors extend credit with the expectation they will be repaid by the consumer. Given that over 90 percent of all accounts in the U.S. are repaid pursuant to the terms of the contractual agreement, creditors have been able to focus their energies on the products and services they provide rather than expending significant resources on collection efforts that are not a core element of their business model. For those accounts that default, debt buyers provide originating creditors a convenient secondary market to receive economic value for their nonperforming accounts.

At the point of initial delinquency, the originating creditor may attempt to collect the balance owed on an account internally or may use a third-party collection agency. Many accounts are successfully restored in these early collection attempts as the average consumer generally recognizes their responsibility to honor their contractual obligations.

However, by the time an account is more than 180 days old and several unsuccessful collection attempts have been made, the likelihood that the originating creditor will receive payment has greatly diminished. In fact, federal law requires banks to “charge-off” distressed accounts at this point, largely to ensure that the financial health of banks are not being obscured by the diminished expectations of payment from the nonperforming accounts they own.

The act of “charging-off” an account is merely an accounting action and has no impact on the underlying contractual obligation owed to the originating creditor. Because originating creditors still have an asset with value, it is at this point that they may choose to sell that asset to debt buyers who are better equipped to return the nonperforming

[1] “G. 19 Statistical Release.” August 7, 2013. U.S. Federal Reserve Board. Preliminary data for quarter ending June 30, 2013. http://www.federalreserve.gov/releases/g19/current/

accounts to a performing status. By creating a market for charged-off receivables, debt buyers return money to originating creditors, which reduces their losses, improves shareholder value, and creates capital that can be used to support the extension of new credit to consumers.

In February 2012, ACA International, a national trade association representing third-party contingency collection agencies, released its most recent PricewaterhouseCoopers LLP survey that showed the collection industry returned $44.6 billion to creditors in 2010. The cumulative economic return to creditors was equal to 2.5 percent of all U.S. corporate profits before tax, 4.7 percent of before tax profits of all U.S. domestic non-financial corporations, and 9.9 percent of the before tax profits of all U.S. domestic financial corporations.[2]

Putting Complaints into Perspective

The total raw number of collection-related complaints is often cited as evidence of a systemic problem within the collection industry. However, raw numbers only tell part of a story as they are frequently used without any context and can suggest or imply conclusions that may or may not be accurate. For example, even though the majority of "complaints" in a recent DBA International analysis of Federal Trade Commission (FTC) data are against unknown or fictitious entities, which is often a sign of a fraudulent criminal enterprise, the raw number is frequently used to suggest wrongdoing by legitimate and legally compliant companies. Despite the raw number of complaints, the following statistics demonstrate that very few U.S. consumers ever experience a "default" status (which usually occurs when an account is 180 days past due) on their accounts:

- Approximately 95 percent of all consumer debt is paid off on time;
- According to the Fair Isaac Corp., less than half of all consumers have been reported as 30 or more days late on a payment;
- Approximately three out of 10 consumers have ever been 60 or more days overdue on any credit obligation; and
- Approximately two out of 10 consumers have ever been 90 or more days overdue.

As these statistics confirm, only a very small percentage of accounts ever wind up in collection. Of all the contacts that third-party collectors make each year, only 0.002 percent of those consumers complained to the FTC.[3] And that statistic is significantly inflated due to incorrect categorizing of simple inquiries, complaints against government entities or originating creditors, and complaints stemming from the illegal and fraudulent activit of criminal enterprises as "debt collection" complaints.

[2] "The Impact of Third-Party Debt Collection on the National and State Economies." ACA International. February 2012, page 6.
[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 the 24,486 complaints received, 85.9 percent were settled by the companies. That is well above the 76.7 percent average resolve rate for all other industries in the United States. In fact, the collection industry has consistently ranked among those industries with the highest resolve rates in the nation.[4]

The collection industry understands that contacting consumers to seek payment on contractual obligations is a difficult task and most consumers would prefer not to receive these calls. The very nature of the subject matter tends to create an emotional situation that is uncommon in most other industries. It is an unfortunate truth, however, that not all consumers pay their bills and subsequently the services of the collection industry are required.

Collection Helps Consumers

While the percentage of consumers who fail to honor their contractual obligations on time is small, the dollar figures associated with consumer default are staggering. According to the Federal Reserve, at the end of the second quarter of 2013, Americans' revolving debt – essentially all general-purpose credit cards and private label credit cards – was approximately 849.1 billion.[5] For the same quarter, commercial banks wrote off 3.83 percent, or some $22 billion, of their credit card losses.[6]

Creditors often respond to financial losses by changing their lending standards in ways that make it harder for the average U.S. consumer to obtain credit. News organizations including *Reuters*, *The New York Times*, *Financial Times* and the *Wall Street Journal's Market Watch*, have reported that banks have significantly increased their lending standards to reduce their exposure to loss. In one article, Curt Beaudouin, an analyst at Moody's Investment Services told the *Financial Times* "We are getting back to an old-fashioned basis of lending, providing credit only to people who have the ability to repay".[7]

Credit is a simple idea that has become a part of our national fabric, from the loans that make receiving a college education, buying a car, or purchasing a home possible, to the revolving credit that makes smaller purchases convenient. In today's economy, it is incredibly difficult to operate without access to at least some form of credit. For instance, credit cards are used as an assurance when renting a car or movie. Hotels require credit cards upfront to ensure guests pay their bills. For many U.S. consumers, it would be

[4] "2012 Complaint and Inquiry Statistics." Better Business Bureau Web. Aug. 2013. http://www.bbb.org/us/2012-complaint-and-inquiry-statistics/.
[5] "G. 19 Statistical Release." U.S. Federal Reserve Board. August 7, 2013. Revised data for quarter ending March 31, 2013. http://www.federalreserve.gov/releases/g19/current/
[6] "Statistical Release: Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks." U.S. Federal Reserve Board. Data for quarter ending March 31, 2013. 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

difficult to make large dollar purchases such as refrigerators or automobiles without the ability to spread the cost out over a period of time through the use of credit.

Many individuals may not realize that collection activities protect the average U.S. consumer by (1) ensuring they continue to have access to credit at affordable interest rates which would not otherwise exist if defaults on credit were uncollectible and (2) enhancing consumer purchasing power by mitigating the losses that businesses would otherwise have to pass on to consumers in the form of higher prices. The 2012 ACA International PricewaterhouseCoopers LLP survey estimated a $396 average savings per American household in 2010 which is the amount consumers would have had to absorb if businesses had to raise prices to cover the unrecovered debt.[8]

Consumer Protection Laws

The collection industry is one of the most heavily regulated industries in the nation when it comes to consumer protections. Debt buyers and collectors must comply with the federal Fair Debt Collection Practices Act (FDCPA), the Fair Credit Reporting Act (FCRA), the Fair and Accurate Credit Transaction (FACT) Act of 2003, the Gramm-Leach-Bliley Act (GLB), the federal Telephone Consumer Protection Act (TCPA), the Servicemembers Civil Relief Act (SCRA), and the United States Bankruptcy Code, as well as numerous other federal and state consumer protection laws. The industry is also supervised or monitored by multiple governmental agencies, including but not limited to, the Consumer Financial Protection Bureau (CFPB), the Federal Trade Commission (FTC), the Federal Communications Commission (FCC), the 50 state Attorneys General, and licensure laws in 32 states with a number of bonding and corporate registration requirements in the remaining states.

The CFPB is the primary regulator of debt buyers and collectors at the national level. Its primary regulatory tool is the FDCPA. Approved by Congress in 1977, the Act provides over 45 prohibitions and mandates to ensure that consumers are treated in a fair and ethical manner, including provisions to eliminate abusive practices in the collection of consumer debt, promote fair debt collection, provide consumers with an avenue for disputing collection attempts, and prescribe penalties and remedies for violations of the Act. However, another stated (albeit infrequently cited) purpose of the FDCPA is "to insure those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged" and can collect on legitimately owed obligations.[9] While the FDCPA governs collection activity at the national level, each state generally has its own set of laws that govern the industry. Whenever state and federal laws conflict, collectors must follow the more restrictive standard.

In a 2009 report, the Government Accountability Office (GAO) concluded that the FDCPA, while a mainstay of federal consumer protection efforts, is outdated and no

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[8] "The Impact of Third-Party Debt Collection on the National and State Economies." ACA International. February 2012, pages 6-15.

[9] Fair Debt Collection Practices Act. 15 USC 1692 (e). http://www.ftc.gov/os/statutes/fdcpa/fdcpact.shtm

longer reflects the way today's consumers communicate or the way the collection industry operates. The debt buying industry generally accepts these findings and is working with government 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 industry.

DBA International strongly supports the three recommendations for Congressional action contained in the GAO report as a much needed and overdue step to update the FDCPA for the benefit of the consumer and business communities alike. The first area is to improve the amount of information attached to each account to ensure contact is made with the proper consumer. This will greatly reduce the chance of mistaken identity and also gives consumers greater protection when dealing with collectors.

The second is to allow collectors to use modern forms of technology as an approved method of communication. When the FDCPA was written, landline phones and U.S. mail were the only referenced forms of communication because they were essentially the only forms of communication that existed at that time. Today, even though approximately 34 percent of the U.S. adult population (80 million individuals) live in houses with only cell phones[10] and the use of email, texting, and social media has essentially replaced the U.S. mail service, the language contained in the FDCPA has remain unchanged, effectively preventing collectors from using these technologies to work with consumers.

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 creation of the CFPB in 2011 which has both oversight and rule-making authority over the FDCPA. Nevertheless, any changes to this law are the purview of Congress and so far Congress has failed to make the statutory changes to the FDCPA that are needed to allow the CFPB to address modern day situations.

Current Trends at the State Level

Due to the lack of Congressional action to update the FDCPA, some states have independently sought consumer reforms at the state level. DBA International generally supports these efforts provided that the language is written in a neutral and balanced manner that considers the valid and legitimate interests of both the consumer and business communities.

Generally, legislative action at the state level seems to be following one of four trends not addressed by the FDCPA. The first trend is to require collectors to be licensed. DBA does not oppose legislation of this nature provided that it is applied uniformly to industry participants.

[10] "Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, January–June 2012." Centers for Disease Control and Prevention. December 2012, page 2. http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201212.pdf

The second trend is to provide additional account documentation. DBA supports uniform standards on account documentation provided that they serve a legitimate purpose and is information that originating creditors are required to maintain. In fact, DBA has developed a specific and uniform industry standard on data and documentation within the DBA International Debt Buyer Certification Program.

The third trend is recent attempts by some states to require itemization of pre-charge-off principle, interest, and fees to substantiate the balance on a debt. The challenge, however, is that this type of information is not always available for all accounts, most notably revolving lines of credit such as credit cards. Revolving lines of credit are different from other forms of debt because of the consumer's option to carryover balances associated with prior purchases to the next statement which is then combined with balances from new purchases. The National Bank Act recognizes this inherent difficulty which explains why banks are not required to provide itemization of balances to consumers on credit card statements.

Recognizing this is a complex situation that needs attention, DBA is actively working with legislators and regulators at the state and federal level to find alternative approaches such as requiring <u>post</u>-charge-off balances be subject to a breakdown that provides consumers with information on how much of the balance consists of principal (here being the charge-off balance), interest, and fees. The reason why a breakdown of the balance is possible on post-charge-off accounts but not on pre-charge-off accounts is because post-charge-off accounts no longer are subject to revolving balances.

The fourth trend is to push for the adoption of shorter statutes of limitations, as little as two years in some cases, and/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, it severely restricts the ability of consumers 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 consumer 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, purchase a house, or obtain a security clearance.

Another unintended consequence of a shorter statute of limitations is the potential "rush to litigate." Given a shorter window to collect on accounts, originating creditors and debt buyers will spend less time negotiating settlements and working out extended payment plans and more time litigating them. In the end, legal fees will be piled on top of the debts, increasing the burden on consumers.

DBA International's Debt Buyer Certification Program

In March 2013, DBA launched a national Debt Buyer Certification Program that consists of both company and individual certification. The goal of the program is to provide additional consumer protections through the adoption of uniform industry standards and best practices.

Company certifications will be granted to those Debt Buyers who comply with 20 uniform certification standards based on recognized industry best practices. These standards address core principles including account documentation, chain of title, consumer complaint and dispute resolution, posting of contact information for the Chief Compliance Officer, establishing a CFPB portal for the receipt of consumer complaints, statute of limitation compliance, representations & warranties, vendor management, credit bureau reporting, resale, as well as other relevant operational procedures. Certification is a requirement of DBA membership.

Individual certifications will be required for each certified company's Chief Compliance Officer and will be a voluntary designation for others within the industry. Certification will be granted to those who complete 24 credit hours of relevant industry education requirements every two years. Included within the 24 credit hours are several mandatory classes, including an Introductory Survey Course (for initial certification), a Current Issues Course (for recertification); and Ethics Courses. Additionally, individuals who hold the individual certification must pass a criminal background screening conducted by DBA International.

The DBA International Debt Buyer Certification Program was designed to provide three distinct compliance audits in order to ensure multiple and varied opportunities to verify compliance. These audits include an independent third-party audit on all 20 standards that will be conducted on a regular basis, a limited compliance audit if a violation of a specific standard is suspected, and self-compliance audits to be regularly performed by each certified debt buyer's Chief Compliance Officer.

In most cases, when a certified debt buyer is found not to be conforming with a standard they will be asked to enter into a remediation agreement with a plan to achieve conformity. If remediation is not possible, disciplinary action may occur, including expulsion from DBA International.

Summary

Debt buyers and the collection industry play an integral and necessary role within the complex credit based economy. The ability of debt buyers to purchase distressed accounts from originating creditors provides benefits not only to the originating creditors but to all consumers and businesses that rely on the availability of credit at reasonable rates for their purchasing needs.

DBA International is committed to continuing our collaborative efforts with regulators, legislators, consumer groups, and other industry participants at both the state and federal level to ensure that new consumer protections are adopted when appropriate and existing laws are strengthened and modified to reflect modern realities without impairing the vital role of the debt buying and collection industry.

About DBA International

DBA International (DBA) is the nonprofit trade association that represents the interests of public and private companies that purchase performing and nonperforming receivables on the secondary market. Founded in 1997 by a small group of companies to provide a forum to advance best practices within the industry, today DBA has grown to represent over 500 companies. DBA provides its members with networking, educational, and legislative advocacy opportunities through an annual conference, an executive summit, regional seminars, state and regional committees, newsletters, webinars, teleconferences, and other media. DBA maintains a code of ethics and a national certification program that promote uniform industry standards of best practice which member companies must comply with in order to maintain membership. DBA is headquartered in Sacramento, California.

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