Second Set of Comments

to the

Bureau of Consumer Financial Protection

Docket No. CFPB-2015-0007
80 Fed. Reg. 14,365

Request for Information Regarding the Credit Card Market

Submitted by the

National Consumer Law Center

on behalf of its low-income clients

June 17, 2015

The National Consumer Law Center[1] is pleased to submit the following comments on behalf of our low-income clients to the CFPB's Request for Information Regarding the Credit Card Market. These comments specifically focus on the issues of collection of credit card debts and add-on products.

1. Collection of Credit Card Debts (Request (k))

The CFPB has asked a number of questions regarding the collection of past due amounts on credit cards. We address these questions separately, and also discuss several other issues, including the need to itemize the debt between interest and principal and ending the unfair and deceptive practice where collectors issue an IRS Form 1099-C and then proceed to collect on the debt.

a. What practices are used to minimize losses from delinquent customers prior to charge off and with what results?

Credit card companies typically start their collection efforts with a series of form letters,[2] then graduate to phone calls and possibly referral to a collection agency or to a lawyer for

[1] The National Consumer Law Center (www.nclc.org) is a nonprofit organization specializing in consumer issues affecting of low-income and elderly people. NCLC publishes twenty practice treatises, most of which are updated annually and which describe the law currently applicable to all types of consumer transactions. These comments are filed on behalf of our low-income clients and written by NCLC attorneys April Kuenhoff, Chi Chi Wu, Margot Saunders, Robert Hobbs, and Carolyn Carter.
2 *See, e.g.*, Kimball, Am. Bankers Ass'n, *Improving Collection Letters* (1984).

suit. Collection contacts, "duns," generally increase over time in severity of tone and in expense to the collectors.

The initial contacts are usually letters with a more or less friendly reminder of the past-due amount. These are followed by letters requesting that the consumer call the creditor to discuss the problem, which are meant to suggest that the problem of nonpayment is somewhat serious.[3]

In addition to requesting payment, some credit card companies agree to modify the terms of the debt through temporary interest rate reductions,[4] fixed payment plans (lasting up to 60 months),[5] or suspending delinquency fees.[6] Not all borrowers are eligible to access such modifications, and the criteria for eligibility are not clear.

If the consumer does not pay the debt or enter a modification program, credit card companies gradually increase the frequency of the initial "soft" collection methods over time as the debt becomes more delinquent.[7] At some point after an account is 90 days delinquent, the credit card company will likely transfer it to one or more collection agencies that work on a contingency basis to recover the debt.[8] Collection employees often have salary incentives based on the amount they collect.[9]

Credit card debts are typically charged off by the time the debt is 180 days past default.[10] This is required by regulatory guidance.[11]

b. Itemizing the Debt between Interest and Principal

One pre-charge off issue is the division of credit card debt between interest, principal, and fees. In order to preserve the ability of consumers to dispute "any portion of" the

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3 Dalié Jiménez, Dirty Debts Sold Dirt Cheap, *Harvard Journal of Legislation* 9 (Winter 2014); NCLC, Fair Debt Collection § 1.5.1.
4 *American Express Company's 2014 Annual Report, which is available at: http://ir.americanexpress.com/Cache/1500069129.PDF?Y=&O=PDF&D=&FID=1500069129&T=&IID=102700; Bank of America Corporation's 2014 Annual Report, which is available at: http://media.corporate-ir.net/media_files/IROL/71/71595/AR2014.pdf; Capital One's 2014 Annual Report, which is available at: http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NTczNTI5fENoaWxkSUQ9Mjc1OTk4fFR5cGU9MQ==&t=1.*
5 *Id.*
6 *American Express Company's 2014 Annual Report.*
7 *Dalié Jiménez, Dirty Debts Sold Dirt Cheap, Harvard Journal of Legislation* 9 (Winter 2014); NCLC, Fair Debt Collection § 1.5.1.
8 *Id.*
9 NCLC, Fair Debt Collection § 1.5.2.
10 *See, e.g., American Express Company's 2014 Annual Report; Bank of America Corporation's 2014 Annual Report; Capital One's 2014 Annual Report.*
11 See Fed. Fin. Inst. Examination Council, Uniform Retail Credit Classification and Account Management Policy, 64 Fed. Reg. 6,655 (Feb. 10, 1999).

debt under the Fair Debt Collection Practices Act,[12] the different parts of the debt must be itemized.

Creditors should be affirmatively required by the CFPB to keep specific records on how payments have been applied to principal interest and fees, so that – when requested by a consumer who is seeking verification of the debt – the breakdowns between principal, interest, and fees can be provided.

The itemization of principal, interest, and fees for consumers is important for several reasons:

- It is basic information that consumers deserve to know about debts that they are alleged to owe. The information helps consumers to identify whether the debt is theirs.

- Under the IRS Code, the principal of a cancelled debt is considered income to the debtor but forgiven interest and fees may not be taxable.[13] Consumers must have the precise breakdown of the forgiven debt in order to be able to prepare their taxes accurately.

- When the consumer has repaid many multiples of the amount received but most of the payments have been allocated to interest and fees and there remains a substantial amount due, the credit transaction may be unconscionable.[14]

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12 15 U.S.C. § 1692g(a)(4) requires the debt collector to send the consumer a written notice containing "(4) a statement that if the consumer notifies the debt collector in writing within the thirty-day period that the debt, <u>or any portion thereof</u>, is disputed, the debt collector will obtain verification of the debt . . . ."

[13] Unpaid interest may be included in the 1099 received by the consumer, but is not necessarily properly included in the income upon which taxes are due. *See* IRS Publication on Cancelled Debt, *available at* http://www.irs.gov/publications/p4681/ch01.html.

[14] Consider the classic case of Ruth Owens, a consumer from Cleveland, Ohio who did try to repay her debt, but was driven hopelessly into default by her credit card lender. In May 1997, Ms. Owens stopped using her credit card, made no further purchases or cash advances, and tried to pay off her debt to her credit card lender. At that time, she owed $1,963. From May 1997 until her account was sent for collection in May 2003, not one penny of Ms. Owens' $3,492 in payments went to reduce her balance. Instead, the credit card lender charged Ms. Owens various fees that consumed all of her payments and caused her debt to grow even larger:

Over-limit Fees $1,518.00
Late Fees $1,160.00
Credit Insurance $369.62
Interest and Other Fees $6,008.66
Total $9,056.28

Despite having received substantial payments for six years, the lender claimed that Ms. Owens still owed $5,564 when it filed a collection lawsuit against her. In other words, after having paid $3,492 on a $1,963 debt, Ms. Owens' balance grew to $5,564. *Discover Bank v. Owens*, 822 N.E.2d 869 (Ohio Mun. Ct. 2004). *See also* Klewer v. Cavalry Investments, LLC., 2002 WL 2018830 (W.D.Wis. 2002) (describing case in which debt buyer bought a credit card account

- The itemization may also reveal illegal charges or other defenses to the debt.[15]

In this day of electronic records, there is no reason that credit card companies cannot provide a breakdown of the amount of principal that has been charged and repaid on an account as well as the interest and fees that have been assessed against the account. This information should also be transferred to any subsequent debt buyers and debt collectors so that it remains available to the consumer and can be updated to reflect any payments.

We are *not* advocating that the CFPB change the rules governing the allocation of payments. We are simply advocating that the *disclosure* about these different elements of the total due be made available to consumers upon request. Additionally, while it would be preferable, we are *not* asking the CFPB to *require* that specific items purchased in each transaction be disclosed in this itemization.

This regulation would require that creditors keep an ongoing itemization of the application of payments to purchases versus interest and fees. This itemization will benefit all parties to the transaction. The consumer can see the extent to which her payments are applied to purchases, the debt collector will receive an itemization of the debt which will distinguish between principal and interest, and, if the non-payment of the debt is reported to the IRS, both the IRS and the consumer will know which part of it is due to purchases and which part comes from finance charges.

In sum, the CFPB should require that collectors and creditors provide an itemization of the principal, interest, and fees charged on the account in response to a request for verification of the debt. The disclosure provided to the consumer for open-end credit should look something like this:

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where the last payment was in 1993, debt was charged off in 1995 for $2,538.96, and the debt buyer stated in 2001 that the balance was $12,446.14.).

[15] *Stratton v. Portfolio Recovery Assocs., LLC*, 770 F.3d 443, 449 (6th Cir. 2014) (debt seller's waiver of contractual interest waived the debt buyer's entitlement to prejudgment interest under state law and stated a FDCPA claim); *Grochowski v. Daniel N. Gordon, P.C.*, 2014 WL 1516586 (W.D. Wash. Apr. 17, 2014) (Midland may have waived interest at the state statutory rate when MCM sent two different notices to plaintiff indicating that the accrued interest was $0.00 and the interest rate is 0%); *McDonald v. Asset Acceptance L.L.C.*, 296 F.R.D. 513 (E.D. Mich. Aug. 7, 2013) (debt buyer wrongfully sought interest on credit card accounts that had been waived by the credit card bank before the sale of the debt); *Terech v. First Resolution Mgmt. Corp.*, 854 F. Supp. 2d 537 (N.D. Ill. 2012) (same holding as *Simkus*); *Simkus v. Cavalry Portfolio Servs., L.L.C.*, 2012 WL 1866542 (N.D. Ill. May 22, 2012) (claim stated that creditor waived its right to charge interest after the charge-off of plaintiff's debt, thereby preventing the debt buyer from retroactively charging additional interest upon assignment).

Date of Tran-saction	Merchant	Amount of Purchase	Fee Applied	Interest Applied	Payment	Balance Due	Amount Due for Goods & Services
8/5/12	Walgreens	$45.00					$45.00
8/15/12	Kroger	$95.00					$140.00
8/30/12				$0.00		$140.00	
9/3/12					$140.00	$0.00	$0.00
9/14/12	Best Buy	$200.00				$200.00	$200.00
9/20/12	Walgreens	$45.00				$245.00	$245.00
9/30/12				$3.68		$248.68	
10/10/12					$200.00	$48.68	$45.00
10/30/12				$0.73		$49.41	
11/5/12					$10.00	$39.41	
11/30/12				$0.59		$40.00	$45.00
12/5/12					$10.00	$30.00	
12/30/12				$0.45		$30.45	$45.00
1/30/13			$35.00	$0.98		$66.43	$45.00
2/28/13			$35.00	$1.52		$102.95	$45.00
3/30/13			$35.00	$2.07		$140.02	$45.00
4/30/13			$35.00	$2.63		$177.64	$45.00
5/30/13			$35.00	$3.19		$215.83	$45.00
6/30/13			$35.00	$3.76		$254.60	$45.00

Total Balance Now Due	$254.60
Part of Balance for Goods & Services	$45.00
Part of Balance Due for Interest & Fees	$209.60

In this itemization, a record is kept of the application of the payments to fees and interest as distinct from the consumer's purchases. As the CFPB knows, payments above the minimum are allocated according to the rules established by the Credit CARD Act. Pursuant to regulatory prompting, the minimum payment itself usually consists of all fees, interest, and 1% of the principal. Most credit card contracts require payments to be applied first to fees, then to interest, and only then to principal. Thus, here it was assumed that creditor would apply payments first to fees and interest, then to purchases.

Typically in an open-end account, any fees or interest that are left unpaid after a payment will be rolled in the outstanding balance. When this happens, it becomes extremely difficult for the average consumer to know what part of a principal balance at any single point in time is comprised of purchases as distinct from interest or fees. The above itemization keeps track of this application of payments to allow for a review of the application of the payments over time. This way, a consumer can distinguish between the amount due for purchases and the amount due for interest and fees.

c. What practices are used to secure recoveries post charge off and with what results?

The Office of the Comptroller of the Currency (OCC) explains that:

> When a bank charges off a debt, it realizes a loss, but the borrower generally continues to have an obligation to repay the loan. At that point, the bank faces a business decision on how to recover that loss or not to pursue collection of the debt. Debt collection may take several forms, including continued efforts by the bank to collect it on its own, the hiring of a third party to collect the debt on its behalf, or the sale of the debt to an unaffiliated third party, which generates a partial recovery.[16]

If the debt is sizable and thought to be collectible and if the creditor's efforts to this point have been unsuccessful, the creditor/debt buyer is likely to turn to a lawyer or collection agency for suit or evaluation for suit. Almost all of the millions of collection suits filed against consumers each year are ineffectively contested and result in default judgments against the consumer.[17]

After judgment and depending on the state remedies, the creditor/debt buyer will seize a portion of wages, other income, or bank accounts, obtain a lien on the consumer's house, and/or seize a consumer's car. A creditor/debt buyer will frequently seize exempt income or property asserting that he did not know it was exempt or that the burden of asserting the exemption lies with the consumer.[18] The creditor/debt buyer may file a lien on the home. If the debt is too small to warrant active collection, the collector may report negative information to be placed on the consumer's credit report and sit back until the consumer needs to sell the home or needs good credit to buy a car or take out a loan, a practice referred to as "parking." At that point the consumer may pay off the old debt to complete the sale or loan. Or, the creditor/debt buyer may aggressively pursue the consumer with legal remedies and/or phone calls and letters.

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[16] Office of the Comptroller of the Currency, *Shining a Light on the Consumer Debt Industry* 2 (July 17, 2013), available at: http://www.occ.gov/news-issuances/congressional-testimony/2013/pub-test-2013-116-oral.pdf.

[17] Jessica Silver-Greenberg, *Lender Drops Pursuit of Debt*, WALL ST. J., June 24, 2011, at C1 ("Roughly 94% of collection cases filed against borrowers result in default judgment in favor of the lender, according to industry estimates.").

18 See, e.g., *Beler v. Blatt, Hasenmiller, Leibsker & Moore, L.L.C.*, 480 F.3d 470 (7th Cir. 2007) (postjudgment attachment of a bank account containing exempt Social Security funds); *Hogue v. Palisades Collection, L.L.C.*, 494 F. Supp. 2d 1043 (S.D. Iowa 2007) (garnishing a bank account after receiving an affidavit from the consumer that the account contained only exempt Social Security funds). See generally NCLC, Fair Debt Collection § 5.6.2.

d. Charging Interest Post Charge Off

Many debt buyers that purchase charged off credit card debt are billing consumers for interest. The CFPB should require debt buyers to itemize all interest and fees included in post charge off debt. Moreover, the CFPB should prohibit debt buyers from charging any interest for the period between charge off and the debt buyer's purchase of the debt.

At charge off, many creditors cease charging interest on the debt. As the Sixth Circuit explained in a recent decisions, "[b]y charging off the debt and ceasing to charge interest on it, [the original creditor] could take a bad-debt tax deduction, I.R.C. § 166(a)(2), and could avoid the cost of sending [the consumer] periodic statements on her account, 12 C.F.R. § 226.5(b)(2)(i)."[19]

If the original creditor sells charged-off credit card debts to a debt buyer, the debt buyer frequently attempts to add interest to the debt post charge off. Typically, the new owner of the debt seeks to apply either the credit card's contractual rate of interest[20] or the default prejudgment interest rate of the state where the consumer resides.[21]

Some debt buyers are even seeking to collect interest for the post charge-off period prior to their purchase of the debt.[22] In other words, where a debt is charged off on January 1, 2014 and sold to a debt buyer on July 1, 2014, some debt buyers are attempting to collect interest for the period of January 1, 2014 to July 1, 2014 **– before they even own the debt**.

In light of these practices and the likelihood that consumers will be confused about what interest (if any) they owe post charge off, the CFPB should issue a regulation requiring itemization of any interest or fees post charge off.[23] The CFPB should also issue a regulation making it clear that, where interest has been waived by the original creditor, charging interest for the period prior to the debt buyer's ownership of the debt is an unfair and deceptive practice in violation of the Fair Debt Collection Practices Act.[24]

e. Post Charge-Off Tax Consequences

Another post charge off issue is the issuance of 1099-C forms and associated tax consequences for the consumer. Debt collectors and creditors frequently send consumers an IRS Form 1099-C stating that all or part of a debt is cancelled, indicating that the

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[19] *Stratton v. Portfolio Recovery Assocs., L.L.C.*, 770 F.3d 443, 445 (6th Cir. 2014).
[20] *See, e.g., Madden v. Midland Funding, L.L.C.*, __ F.3d __, 2015 WL 2435657, at *2 (2d Cir. May 22, 2015) (debt buyer Midland Credit stated that the applicable interest rate was 27%, the rate in the consumer's Cardholder Agreement).
[21] *See, e.g., Stratton v. Portfolio Recovery Assocs., L.L.C.*, 770 F.3d 443, 446 (6th Cir. 2014).
[22] *Id.*
[23] It should be possible for the debt buyer to continue the pre charge off itemization maintained by the original creditor as the original creditor should be required to transfer this information to any subsequent owner of the debt.
24 See, e.g. McDonald v. Asset Acceptance L.L.C., 2013 WL 4028947 (E.D. Mich. Aug. 7, 2013).

amount of cancelled debt will be treated as taxable income to the consumer by the IRS. The principal of a cancelled or forgiven debt is considered taxable income to the consumer by the IRS, with a number of important exceptions, including the dispute of the debt, the debtor's insolvency, or discharge in bankruptcy.[25]

Understandably, a consumer receiving such a form, who then reports the income on that year's tax return, will expect that the debt is really cancelled and will not result in future debt collection. Nevertheless, it is quite common for debt collection to continue despite the issuance of a 1099-C and despite the fact that the consumer has already paid taxes on the "cancelled" debt. Consumers that subsequently pay debt collectors can theoretically file an amended tax return to recover taxes paid as a result of the 1099-C. However, most consumers do not know this is an option and most would be unable to amend their tax returns without professional assistance, which is beyond the financial means of low-income consumers.

We encourage the CFPB to study this issue further to determine how to end the unfair and deceptive practice of issuing a 1099-C and then proceeding to collect on the debt.

f. To what extent do card issuers use third-party contingency collection agencies for collections of accounts and how are such relationships managed?

A contingent fee collection agency is most likely to be hired by the creditor if the debt is not secured by collateral, is small, is for health services, or if the consumer appears to be judgment proof.[26] Most contingent fee collection agencies engage in the full range of collection activities permitted by law and charge a contingent fee, i.e., retaining a contracted portion of money collected.[27] While varying by the amount and age of the debt to be collected, a trade group estimated the average portion of the collected debt retained by contingency agencies at 28%.[28] These agencies may take a real or fictitious assignment of the debt, which may be necessary in some states to comply with laws regulating the unauthorized practice of law. It was estimated in 2007 that there were 6500 collection agencies in the U.S.[29]

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25 Internal Revenue Code, 26 U.S.C. §§ 61(a)(12), 108. See National Consumer Law Center, Consumer Bankruptcy Law and Practice § 15.5.5.6 (10th ed. 2012), updated at www.nclc.org/library (litigation tax consequences for prevailing clients).

26 NCLC, Fair Debt Collection § 1.5.2.

27 See *Scally v. Hilco Receivables, L.L.C.*, 392 F. Supp. 2d 1036 (N.D. Ill. 2005) (some description of the collection agency's contract with the debt buyer); In re *Goldstone*, 839 N.E.2d 825 (Mass. Dec. 16, 2005) (Sears paid its collection lawyer 1/3 of collections plus court costs until 1987 when the agreement was changed to 45% of collections without reimbursement for uncollected court costs).

28 Fed. Trade Comm'n, *Collecting Consumer Debts: The Challenges of Change*, A Workshop Report 3 (Feb. 2009).

29 ACA Int'l, Collections Information (Jan. 15, 2007), available at www.acainternational.org/Reporters.aspx?cid=5431.

Credit card companies may also work with collection law firms. Utilizing various business models, these firms posted nearly $1.2 billion in revenue in 2006.[30] One type specializes in filing a high volume of consumer collection suits, nearly all of which end up as default judgments. The lawyer typically would be retained on a contingent fee basis, retaining a portion, for example, 15–50%, of any amount collected.[31] Another type of collection law firm has more lay collectors or "paralegals" than lawyers and operates as a contingent fee collection agency when it first receives the debt and then offers its litigation services after the dunning process runs out of gas. Other lawyers may simply send or furnish the creditor with a dunning letter or series of letters for a small flat fee or pursuant to a retainer. A law firm may buy the debt it is collecting.[32] If a lawyer misrepresents his role in the collections—for example, holds himself out as a lawyer but does not review the creditor's claim—his letter or call may violate the law.[33]

g. To what extent do card issuers sell charged off accounts to debt buyers and on what terms and with what restrictions?

i. Debt buying and selling are changing the debt collection landscape

In recent years, hundreds of collection agencies have sprung up that purchase consumer debts, most often credit card debts that have been written off by the originator. The debt buyer usually pays only pennies on the dollar for the debt, but seeks to collect the full amount from the debtor.[34]

The debt buying industry has grown at an astonishing rate. According to one source, sales of consumer debts amounted to about $5 billion in 1993 and rose over twenty-fold to $120 billion in 2005, then fell during the recession.[35] The market is quite concentrated, with approximately 10 firms buying more than half of the debt that is sold.[36]

The central problem with this business is that debt buyers are more persistent in seeking payments on very old debts, for which they have little information.[37] The consumer

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30 Fed. Trade Comm'n, *Collecting Consumer Debts: The Challenges of Change, A Workshop Report* 14 (Feb. 2009).
[31] NCLC, Fair Debt Collection § 1.5.3.
32 See *Chulsky v. Hudson Law Offices, P.C.*, 777 F. Supp. 2d 811 (D.N.J. 2011) (may be illegal in New Jersey).
33 *Clomon v. Jackso*n, 988 F.2d 1314 (2d Cir. 1993). See § 5.5.6.2, infra.
[34] *See, e.g.*, Fed. Trade Comm'n. *The Structure and Practices of the Debt Buying Industry* (Jan. 2013), available at: https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf.
[35] *See, e.g.,* Hunt, Robert M., *Understanding the Model: The Life Cycle of a Debt* p. 19 (June 6, 2013).
36 Robert Hunt, Fed. Reserve Bank of Pa., *Understanding the Model: The Life Cycle of a Debt* at 18 (2013)*, available at* http://www.ftc.gov/bcp/workshops/lifeofadebt/UnderstandingTheModel.pdf (presented at the FTC- CFPB Roundtable).
[37] Asset Acceptance Capital Corp. Annual Report on Form 10-K for 2012 at 3 (collecting on debts for 10 years or more after debt purchased); Encore Capital Group, Inc. Annual Report on

involved may likewise have no information about the claim or its source. Debt buyers may buy claims and then bring thousands of lawsuits seeking to convert those claims into long-lasting and effectively incontestable judgments. Debt buyers may flip consumers into new credit accounts, or simply put purchased debts on consumers' credit reports as delinquent debts, ruining their credit ratings.[38] When debt buyers collect these old debts, consumers have less to spend on current necessities. That depresses the financial outlook of households and diminishes the consumer sector of the local economy.

ii. Debt buyers have little information about the debt and often pursue claims that are not valid[39]

Debt buyers typically obtain very little information about the consumer debts they buy. An industry spokesman recently "acknowledged that it is common for a debt buyer to receive only a computerized summary of the creditor's business records when it purchases a portfolio."[40] The debt buyer may have no more than an electronic file listing the claimed balance due and partial information about the alleged debtor, without any information about the history of charges and payments to the account.

Debt buyers often lack basic documentation of the debt.[41] They do not have a copy of a signed contract, the charge slips, the application for the credit card, or a written assignment of the claim.[42] The account sales agreement with the credit originator may state that the creditor will provide those documents for a specific portion of the accounts without payment and for the rest with a specified payment. Some of those agreements limit the number of accounts for which documents may be provided in a given month and do not guarantee the availability of any account documents.

Form 10-K for 2013 at 66 (reporting payments in 2013 on accounts purchased prior to 1999); Portfolio Recovery Associates, Inc. Annual Report on Form 10-K for 2013 at 53 (reporting payments in 2013 on debt purchased in 1996). *See also Johnson v. Midland Credit Mgmt. Inc.*, 2006 WL 2473004 (N.D. Ohio Aug. 24, 2006) (debt buyer collecting on twenty-year-old defective watch account and fourteen-year-old Sears account).

38 See Farren v. RJM Acquisition Funding, L.L.C., 2005 WL 1799413 (E.D. Pa. July 26, 2005) ($61 purchase erroneously listed on credit report, apparently without other collection activity).

[39] This issue is covered in detail in the National Consumer Law Centers' Comments to the CFPB's Advance Notice of Proposed Rulemaking Regarding Debt Collection, which are available at: http://www.nclc.org/images/pdf/debt_collection/comments-cfpb-debt-collection-anprm-2-28-14.pdf.

[40] Federal Trade Commission, *Collecting Consumer Debts: The Challenges of Change*, A Workshop Report, at 22 (Feb. 2009).

[41] Fed. Trade Comm'n. *The Structure and Practices of the Debt Buying Industry* (Jan. 2013), available at: https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf.

42 See, e.g., Hartman v. Great Seneca Fin. Corp., 569 F.3d 606, 609 (6th Cir. 2009); *Debt Buyers' Ass'n v. Snow*, 481 F. Supp. 2d 1 (D.D.C. 2006); *Atlantic Credit & Fin., Inc. v. Giulana*, 829 A.2d 340 (Pa. Super. Ct. 2003); *Asset Acceptance Corp. v. Proctor*, 804 N.E.2d 975 (Ohio Ct. App. 2004).

Given the inadequate information they have about the debts they pursue, it is not surprising that debt buyers frequently pursue flawed claims. After a 2009 workshop, the FTC concluded that "the information received by debt collectors is often inadequate and results in attempts to collect from the wrong consumer or to collect the wrong amount."[43] Debt buyers may pursue debts that are beyond the statute of limitations, were discharged by the consumer in bankruptcy, or were disputed with the original credit card company years before by the consumer for fraud, nonperformance, or another problem.[44] Moreover, debt buyers' claims are sometimes inflated with interest and fees[45] compounding monthly over a great number of years without any accounting for that huge growth in the balance.[46] Debt buyers may not be able to show what charges and credits have been made to the account.[47]

iii. Abysmal documentation of who owns a debt[48]

Another issue with debt buyers is their abysmal documentation that they actually own the debts they pursue.[49] The failure of debt buyers to maintain adequate documentation that they own the debts they pursue leads them to abuse the court system by filing debt claims that they know they cannot prove unless they present false or robo-signed affidavits of ownership. It also subjects consumers to the risk of suit by entities that do not in fact own their debts.

The problems caused by multiple sales of the same debt are compounded by the fact that debt buyers often purchase large portfolios of accounts from creditors and then subdivide the portfolios into smaller segments and sell off those segments to different debt buyers. The same segment of a portfolio may be fraudulently sold to multiple buyers, or a debt buyer may purport to sell a portfolio that it does not actually own.[50] The sale to the debt

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[43] Federal Trade Commission, *Collecting Consumer Debts: The Challenges of Change*, A Workshop Report, at 24 (Feb. 2009).
[44] *See* David Segal, *Debt Collectors Face a Hazard: Writer's Cramp*, N.Y. Times, Oct. 31, 2010.
45 *See Seeger v. AFNI, Inc.*, 2006 WL 2290763 (E.D. Wis. Aug. 9, 2006) (FDCPA and Wisconsin Consumer Act case against debt buyer for adding a 15% fee to Cingular bills was certified as class action).
[46] *See Wahl v. Midland Credit Mgmt., Inc.*, 556 F.3d 643 (7th Cir. 2009) (because of interest and late fees, purchase of less than $70 ballooned to over $1000 by time bad debt buyer purchased it).
47 See, e.g., Asset Acceptance Corp. v. Proctor, 804 N.E.2d 975 (Ohio Ct. App. Jan. 21, 2004).
[48] This issue is covered in detail in the National Consumer Law Centers' Comments to the CFPB's Advance Notice of Proposed Rulemaking Regarding Debt Collection, which are available at: http://www.nclc.org/images/pdf/debt_collection/comments-cfpb-debt-collection-anprm-2-28-14.pdf.
[49] *See Norfolk Fin. Corp. v. Mazard*, 2009 Mass. App. Div. 255 (Mass. App. Ct. 2009) (debt buyer failed to prove it was real party in interest despite introducing ten bills of sale for debt). *Cf. Reyes v. Kenosian & Miele, L.L.P.*, 619 F. Supp. 2d 796 (N.D. Cal. 2008) (Unifund failed to submit credible evidence that it was assigned the debt or that it was the proper party in its state collection case.).
[50] *See United States v. Goldberg* (S.D. Fla. Mar. 5, 2009), *available at* www.consumerlaw.org/unreported (debt buyer obtained accounts without paying for them and then resold them, even though original seller had voided sale because of nonpayment); *Wood v. M*

buyer may be evidenced by no more than an electronic file that can be easily duplicated and sold by an entity that does not own the debt.

The status of ownership is even more complex when debts are securitized. For example, to over-simplify, when credit card debt is securitized, the card issuer sells the right to receivables from a portfolio of credit card accounts. After changing hands a number of times, ownership of those receivables will reside in a trust that can issue securities in the assets held by the trust. The card issuer continues to ''own'' the account less the right to the receivables, and thus remains the party with the contractual relationship with the cardholder. The card issuer may also service the account.[51]

iv. Debt buyers and credit cards

In January 2013, the FTC reported that, "[i]ndustry-wide data show that bank sales of credit card debt directly to debt buyers account for 75% or more of all debt sold."[52] In July, 2013, the OCC summarized debt sales by large banks as follows:

> The majority of bank debt sales activity is concentrated among the 19 largest banking organizations, with the five largest making up about 82 percent of the annual total average sales of debt. On average, the 19 largest banking organizations have sold about $37 billion in charged-off debt sales in each of the past few years.
>
> . . .
>
> The vast majority of debt charged off by these large financial institutions and sold to third party debt collectors involves delinquent debt related to credit cards . . .
>
> . . .
>
> Recently, charged-off debt has sold for between $.05 and $.10 for every dollar of most types of debt. That price has increased lately as the overall supply of debt sold has declined.
>
> The volume of charged-off debt sold by the largest banks has decreased over the past few years. The drop reflects both the improvement in portfolio quality and a

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& J Recovery L.L.C., 2007 U.S. Dist. LEXIS 24157 (E.D.N.Y. Apr. 2, 2007) (at least three different entities claim ownership of a consumer debt). *See also Miller v. Wolpoff & Abramson, L.L.P.*, 2008 U.S. Dist. LEXIS 12283 (N.D. Ind. Feb. 19, 2008) (consumer obligated on debt even though another debt buyer is suing consumer on same debt), *aff'd*, 309 Fed. Appx. 40 (7th Cir. 2009).

[51] *See Tostado v. Citibank*, 2010 WL 55976 (W.D. Tex. Jan. 4, 2010).

[52] Fed. Trade Comm'n. *The Structure and Practices of the Debt Buying Industry* (Jan. 2013), available at: https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf.

> decision by some banks to limit or curtail their debt sales due to the heightened reputation and legal risks such activity can pose.[53]

In July 2013, two major banks – Chase and Wells Fargo – stopped selling credit card debt.[54] We are unaware of any other credit card issuers adopting similar policies.

A number of copies of contractual agreements (also known as forward-flow agreements) between original creditors and debt buyers are available online. For example, websites like Debt Buyer Agreements[55] and Consumer Debt Purchase and Sale Agreements[56] currently have the full text of at least 88 such agreements posted online. Given the complexities of debt buying described, it is obvious that debt buyers and sellers should maintain and exchange scrupulous documentation of ownership of debts. Yet the opposite is true. A review of these flow forward agreements shows that rarely do debt buyers have the documentation to establish that they own the debts they pursue.

For example, in 2013 the FTC published a review of 350 forward-flow agreements, concluding that debts were typically sold "as is" without any warranties as to the accuracy of the information and that debt buyers typically had limited rights to acquire copies of documents associated with the debt after the sale.[57] Similarly, a review of 84 forward-flow agreements by legal scholar Dalié Jiménez found that "most contracts disclaim all warranties and representations, many disclaim the accuracy of the information provided, and a few disclaim that the accounts comply with relevant consumer laws. In addition, most transactions do not include any documentation on the debts at the time of sale and severely limit its availability post-sale."[58]

To resolve this problem, the CFPB should issue a regulation that requires debt owners, debt buyers, and collectors to obtain and exchange full information about a debt whenever it is sold or placed for collection. Debt buyers and debt collectors should be prohibited from initiating collection activity unless and until they have acquired the basic information necessary to demonstrate that a debt is owed by a certain person in a certain

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[53] Office of the Comptroller of the Currency, *Shining a Light on the Consumer Debt Industry* 2-3 (July 17, 2013), available at: http://www.occ.gov/news-issuances/congressional-testimony/2013/pub-test-2013-116-oral.pdf (footnotes omitted).
[54] Maria Aspan and Jeff Horwitz, Chase halts card debt sales ahead of crackdown, *American Banker* (July 1, 2013), available at: http:// www.americanbanker.com/issues/178_126/chase-halts-card-debt-sales-ahead-of-crackdown-1060326-1.html; Maria Aspan, Wells Fargo Halts Card Debt Sales as Scrutiny Mounts, *American Banker* (July 28, 2013), *available at*: http://www.americanbanker.com/issues/178_144/wells-fargo-halts-card-debt-sales-as-scrutiny-mounts-1060922-1.html.
[55] http://debtbuyeragreements.com/archives/category/agreements.
56 http://dalie.org/contracts/.
[57] Fed. Trade Comm'n. *The Structure and Practices of the Debt Buying Industry* (Jan. 2013), available at: https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buying-industry/debtbuyingreport.pdf.
[58] Dalié Jiménez, Dirty Debts Sold Dirt Cheap, *Harvard Journal of Legislation* 15 (Winter 2014).

amount. In addition, before filing suit, debt buyers and debt collectors should be required to have records demonstrating ownership of the debt.

2. Credit Card Add-On Products (Request (h))

As the CFPB knows, add-on products can be a tremendous source of abuse. The Bureau has brought several enforcement actions against major credit card issuers - including Capital One, Bank of America, Chase, and Discover - for deceptive practices in their marketing of add-on products.[59] We greatly appreciate the CFPB's proactive and aggressive stance in taking action.

The two main types of add-on products are debt suspension/cancellation products and credit monitoring/identity theft prevention products. Both products raise significant concerns about the lack of value that they provide for consumers versus their costs, as discussed further below. The mere fact that sellers of these products must resort to deceptive and unfair marketing tactics to promote them speaks volumes about whether the products themselves are beneficial for consumers.

We recognize that the CFPB's enforcement actions have resulted in a substantial reduction in the marketing of add-on products by credit card issuers. However, some issuers, such as Wells Fargo, continue to promote add-on products.[60] More importantly, these reductions may only be temporary.

We believe that the CFPB must do more to protect consumers from deceptive marketing of add-on products, such as prohibiting "free trials" that automatically convert into a paid product. We also urge the CFPB to take a closer look at debt suspension/cancellation products and require that the issuer provide real, substantive, meaningful benefits, such as a minimum loss ratio.

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59 Consent Order, In re Bank of Am., N.A., Administrative Proceeding File No. 2014-CFPB-0004 (C.F.P.B. Apr. 9, 2014), available at http://files.consumerfinance.gov.; Consent Order, In re JPMorgan Chase Bank, N.A., Administrative Proceeding File No. 2013-CFPB-0007 (C.F.P.B. Sept. 18, 2013), available at http://files.consumerfinance.gov; Joint Consent Order, Order for Restitution, and Order to Pay Civil Money Penalty, In re Discover Bank, Greenwood, DE, Docket Numbers FDIC-11-548b/FDIC-11-551k& 2012-CFPB-0005 (F.D.I.C./C.F.P.B. Sept. 24, 2012) available at http://files.consumerfinance.gov; Stipulation and Consent Order, In re Capital One Bank, (USA) N.A., Administrative Proceeding File No. 2012-CFPB-0001 (C.F.P.B. July 17, 2012), available at http://files.consumerfinance.gov.

60 See, e.g., https://www.wellsfargo.com/insurance-identity-theft-protection/; https://www.wellsfargo.com/credit-cards/features/defense/.

a. Debt suspension/cancellation products

Debt suspension/cancellation products have been the subject of extensive criticism, both in their marketing and for being overpriced.[61] A report by the U.S. Government Accountability Office (GAO) found that in 2009, consumers paid approximately $2.4 billion for debt suspension/cancellation products on credit cards.[62] Yet cardholders only received twenty-one cents in tangible financial benefits for every dollar spent in fees.[63] In insurance terms (which is what this product really is), this translates into a "loss-ratio" of only 21 percent. In contrast, other insurance products pay out as much as 90 percent of premiums in benefits, according to industry experts.[64] The Consumer Credit Insurance Model Regulation from the National Association of Insurance Commissioners specifies that benefits provided must be reasonable in relation to the premiums charged and notes that the requirement is met if the loss ratio is 60 percent or more[65] - nearly three times the loss ratio of 21 percent for debt suspension/cancellation products.

The GAO report found that credit card issuers kept an astounding 55% of the $2.4 billion in fees as pretax earnings – or $1.3 billion as pure profit.[66] Issuers also spent 24 percent on administrative expenses, *i.e.*, they spent more on administrative costs than they paid out in benefits.[67] Thus, debt suspension/cancellation products are extremely profitable when they are offered.[68]

Debt suspension/cancellation products are expensive on an individual basis as well. The GAO report found that the annual cost of these products often exceeded 10 percent of the cardholder's average monthly balance on a credit card account.[69] Only 5.3% of

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[61] For a more extension discussion on the problems with debt suspension/cancellation products, see National Consumer Law Center, Consumer Credit Regulation § 6.3 (2012), *updated at* www.nclc.org/library.

[62] U.S. Gov't Accountability Office, Credit Cards: Consumer Costs for Debt Protection Products Can Be Substantial Relative to Benefits but Are Not a Focus of Regulator Oversight (Mar. 2011), at 29, *available at* www.gao.gov/products/GAO-11-311.

[63] *Id*.

[64] Carter Dougherty, JP Morgan Debt-Protection Fees May Drop on Consumer Bureau Rules, Bloomberg News, May 2, 2011 (quoting Edward Graves, Associate Professor of Insurance at the American College in Byrn Mawr, PA).

[65] U.S. Gov't Accountability Office, Credit Cards: Consumer Costs for Debt Protection Products Can Be Substantial Relative to Benefits but Are Not a Focus of Regulator Oversight (Mar. 2011), at 23, *available at* www.gao.gov/products/GAO-11-311.

[66] *Id.* at 30.

[67] *Id.*

[68] *See, e.g.,* Andrew Johnson, Discover Shares Drop of News of FDIC Review, American Banker, July 1, 2011 (noting that debt protection and other fee-based products generated $412.5 million in income for Discover Financial Services in 2010,up 40% from the previous year).

[69] U.S. Gov't Accountability Office, Credit Cards: Consumer Costs for Debt Protection Products Can Be Substantial Relative to Benefits but Are Not a Focus of Regulator Oversight (Mar. 2011), at 27, *available at* www.gao.gov/products/GAO-11-311.

consumers who bought debt suspension/cancellation and carried a balance on their credit cards received a benefit in 2009, with an average amount of $607.[70]

b. Credit monitoring products

For years, the Big Three credit bureaus and their resellers, including credit card issuers, have heavily promoted the sale of high-priced credit monitoring, identity theft protection, and other subscription products, the marketing of which has been notoriously rife with deception and abuse. These abuses are well-documented. In addition to the CFPB's own actions against Discover, Chase, Bank of America, and Capital One, examples of these abuses include:

- The November 2014 joint action by the FTC and the Attorneys General of Illinois and Ohio against three companies that sold credit monitoring products online. These three companies allegedly lured consumers with "free" access to their credit scores and then billed them a recurring fee of $29.95 per month for a credit monitoring program the consumers never ordered. The three defendants agreed to pay $22 million in consumer refunds.

- The Federal Trade Commission (FTC) imposed a fine and consent decree against Consumerinfo.com d/b/a Experian Consumer Direct for deceptive practices in its promotion of credit monitoring products. The FTC alleged that Experian Consumer Direct failed to adequately disclose that consumers accepting the offer would automatically be signed up for a $79.95 monitoring service, if they did not affirmatively cancel within thirty days.[71]

- Congress was so concerned about the credit bureaus' aggressive and deceptive promotion of credit monitoring products, done while burying information about access to truly free credit reports and lower-cost credit scores required by the Fair Credit Reporting Act, that it included a requirement in the Credit CARD Act that any advertisement of a "free credit report" include a special disclosure referring consumers to www.AnnualCreditReport.com.

In addition to the marketing deception, consumers also have reported difficulties in canceling the service or getting refunds.[72]

Credit monitoring services are often marketed as a way to prevent identity theft. Not only do these services charge a steep fee for services that the consumer can obtain for free or less expense, such as obtaining credit reports and scores, they are ineffective in detecting certain forms of identity theft, such as when a thief uses the consumer's Social

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[70] *Id.* at 29.
[71] FTC v. Consumerinfo.com, Inc., SACV05-801 AHS(MLGx) (C.D. Cal. Aug. 15, 2005) (stipulated final judgment and order for permanent injunction).
[72] Stacey L. Bradford, *FreeCreditReport.com: Not So Free--Still*, SmartMoney.com, Dec. 5, 2008. For more information on creditor monitoring products, *see* National Consumer Law Center, Fair Credit Reporting § 3.3.3.1 (8th ed. 2013), updated at www.nclc.org/library.

Security number, but not the consumer's name, to obtain credit.[73] The best method to prevent new account identity theft, at least with respect to credit, is a security freeze, which is almost never promoted.

Another problem with the credit monitoring products is that, instead of providing a score that is actually used by lenders, such as FICO (which constitutes 90% of the scores sold to lenders), these products usually provide proprietary, in-house scores. These "educational" scores are essentially useless to consumers, because they do not tell consumers what they really need to know: the FICO score on which their credit decisions will likely be based.[74] Educational scores are meaningfully different from FICO scores in one out of five instances.[75]

The market for credit monitoring is very profitable. The Big Three credit bureaus alone had an estimated 26 million subscribers in 2010.[76] In addition, some of these credit bureaus sell these services at wholesale to other businesses, such as credit card issuers, which then offer the services to their customers under the reseller's brand name.[77]

Indeed, because of heavy promotion and potentially deceptive marketing practices, more consumers actually ended up paying for their reports than received them free. According to the CFPB, 15.9 million consumers obtained free annual credit reports through the centralized source, but 26 million obtained them through various credit monitoring services.[78]

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[73] *See, e.g.*, Millett v. TrueLink, Inc., 533 F. Supp. 2d 479 (D. Del. 2008) (lawsuit against credit monitoring service that failed to prevent identity theft; dismissal of UDAP and contract claims). *See generally* National Consumer Law Center, Fair Credit Reporting § 12.6.6.2 (8th ed. 2013), updated at www.nclc.org/library.

[74] In contrast, some issuers have recently begun offering the actual FICO they obtain to consumers, without charge. The offering of these free FICO scores, through the FICO Open Access Program, is a very positive development.

[75] Consumer Fin. Prot. Bureau, Analysis of Differences Between Consumer- and Creditor-Purchased Credit Scores 4 (2012), *available at* http://files.consumerfinance.gov/f/201209_Analysis_Differences_Consumer_Credit.pdf.

[76] Consumer Fin. Prot. Bureau, The Impact of Differences Between Consumer- and Creditor-Purchased Credit Scores: Report to Congress 10 (2011), *available at* www.consumerfinance.gov/wp-content/uploads/2011/07/Report_20110719_CreditScores.pdf.

[77] *Id*.

[78] Consumer Fin. Prot. Bureau, Key Dimensions and Processes in the U.S. Credit Reporting System: A review of how the nation's largest credit bureaus manage consumer data 27 (2012), *available at* www.consumerfinance.gov/reports/key-dimensions-and-processes-in-the-u-s-credit-reporting-system.