

Testimony

before the

Subcommittee on Financial Institutions and Consumer Credit  
of the  
House Committee on Banking and Financial Services

regarding the proposed

The "Financial Institution Regulatory Streamlining Act of 1998"

July 16, 1998

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U.S. Public Interest Research Group

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Madame Chairman and Members of the Committee, the **National Consumer Law Center**<sup>1</sup> thanks you for inviting us to testify today regarding the impact of the proposed Regulatory Relief Act on consumers. We offer our testimony here today on behalf of our low income clients, as well as the **Consumer Federation of America**<sup>2</sup> and the **U.S. Public Interest Research Group**.<sup>3</sup>

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<sup>1</sup> The **National Consumer Law Center** is a nonprofit organization specializing in consumer credit issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys around the country, representing low-income and elderly individuals, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have. As a result of our daily contact with these practicing attorneys, we have seen examples of predatory lending to low-income people in almost every state in the union. It is from this vantage point--many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities--that we supply this testimony today. *Cost of Credit* (NCLC 1995), *Truth in Lending* (NCLC 1996) and *Unfair and Deceptive Acts and Practices* (NCLC 1997), are three of twelve practice treatises which NCLC publishes and annually supplements. These books as well as our newsletter, *NCLC Reports Consumer Credit & Usury Ed.*, describe the law currently applicable to all types of consumer loan transactions.

<sup>2</sup> The **Consumer Federation of America** is a nonprofit association of some 250 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

<sup>3</sup> The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

There should be no misunderstanding: this proposed bill provides no benefits to consumers. Although there are many updates and improvements to federal consumer protection laws that are needed, not one has been included in this bill. However, we are very appreciative of the fact that in its present form, this House version of the Regulatory Relief bill does not include many of the very dangerous provisions which are included in the Senate equivalent - S. 1405. The Senate bill includes provisions which would 1) undermine the protections against kickbacks in section 8 of the Real Estate Settlement Procedures Act (Section 206 of S.1405); 2) make four anti-consumer amendments to the Fair Debt Collections Practices Act (Section 207 of S. 1405); and 3) repeal the anti-tying provision in the Bank Holding Company Act (Section 204). The proposed House bill does however, include one amendment to the Truth in Lending Act which is not good: Section 401 would replace the historical table on APR changes for open end variable rate home loans with a meaningless statement of no value to consumers.

We seek to accomplish several goals with this testimony today: 1) to persuade members to include some necessary updates and clarifications to consumer laws which would benefit both consumers and the financial services industry; and 2) to convince the members of the Subcommittee *not* to amend the bill to insert anti-consumer amendments. First, however, we urge you to fix the language in section 401 of the proposed bill which amends the Truth in Lending Act.

**I. Fix the Truth in Lending Amendment in Section 401.** Section 401 would replace the historical table on APR for open end variable rate home loans with the rather meaningless statement that periodic payments may increase substantially. This change mirrors that which occurred for variable rate closed end home loans in the regulatory relief bills passed in 1996 (amending TILA § 128(a)(14)). While we have never maintained that historical information provided for an imaginary \$10,000 loan was all that valuable, it does still provide some useful information to those consumers who are willing to study it. The replacement language in this bill as well as that in the 1996 law on closed end credit, really serves only one purpose -- to reduce creditor compliance burdens.

While this amendment is virtually identical to the new disclosures required for closed end credit under TILA Section 128, that should not be the basis for passage of this provision. There are significant distinctions between open and closed end credit. First, there are many more abuses in open end credit, especially because the protections of the Home Ownership and Equity Protection Act do not apply to open end credit. Secondly, because all of the disclosures required for open end credit are so much less specific and meaningful than those required for closed end credit, the initial disclosures do not provide essential information about the potential real costs of the open end credit to the consumer. For example, under current law, consumers are not told the actual payments that they may be required to make under an open end loan; they are not told the total amount of finance charge that could be paid; and they are not told the total amount that their payments may equal. This is not fair to consumers, the disclosures that are provided for open end credit should be at least as meaningful as those provided for closed end credit.

If one truly wanted to make the disclosure of the risks involved in variable rate open end credit secured by the home meaningful to the consumer, in addition to the change proposed in § 401 of this bill, subsection (H)(ii) of § 127A(2) would be replaced with information about the highest

annual percentage rate, and the highest minimum payment based on the actual loan terms. In addition, information about how long it could take to repay the outstanding balance at the highest interest rates, as well as the total possible cost should be included. To do this, the amendment would rewrite subsection (H) as follows:

(H) a statement of

- (i) the maximum annual percentage rate which may be imposed under each repayment option of the plan;
- (ii) the minimum amount of any periodic payment which may be required, based on a ~~-\$10,000 outstanding balance~~ the maximum amount which can be withdrawn under each such option when such maximum annual percentage rate is in effect; ~~and~~
- (iii) the earliest date by which such maximum annual interest rate may be imposed; and
- (iv) the total number of payments, and the total amount of the payments it would take to repay the outstanding credit if the maximum amount were withdrawn and the maximum annual percentage rate were applied to this amount under each such repayment option of the plan.

This information would not be difficult for a creditor to provide. Any creditor can determine this information for a specific loan with a computer in a matter of minutes. Yet, it would afford very helpful information to consumers which is not currently provided.

**II. Necessary Updates and Changes to the Truth in Lending Act.** There have been no pro-consumer amendments to the Truth in Lending Act since the Home Ownership and Equity Protection Act was passed in 1994. Yet, there are a number of necessary amendments to this essential law that Congress should consider whenever it reviews the laws governing consumer credit. These amendments would include the following:

**1) Clarify that the right of rescission can be used to as a defense to foreclosures of homes.** The right of rescission under TILA has for many years been the primary tool used by advocates for low income consumers to save their homes from foreclosure, especially in abusive loan situations. As the result of the recent Supreme Court decision in *Beach v. Ocean Federal Bank* [1998 WL 183852 (April 21, 1998)], rescission is no longer available after three years from the date of the loan. This amendment would allow consumers to assert the right of rescission in defense to a foreclosure, regardless of the length of time it had been since the loan was made. The right of rescission is the primary remedy for violations of the Home Ownership and Equity Protection Act. Without this amendment, lenders providing abusive loan terms will be able to violate TILA with impunity, simply wait three years until they file for a foreclosure, and suffer no consequences from their violation of federal law. When the *Rodash* changes were made in 1995 Congress specifically

refused do what the Supreme Court just did in the *Beach* case.

**Amendment:** Add a new sentence, after the second sentence of 130(e) of the Truth in Lending Act (15 U.S.C. §1640(e)) as follows:

"This subsection also does not bar a person from asserting a rescission under §125, in an action to collect the debt as a defense to a judicial or non-judicial foreclosure after the expiration of the time periods for affirmative actions set forth in this section and section 125."

**2) Ban the Use of the Rule of 78s as a method of calculating rebates on closed-end loans of 5 years or less.** The Rule of 78s is an antiquated method of determining the proper amount of interest to be rebated when a credit transaction is paid ahead of schedule. Its use always causes the creditor to receive more interest than is actually due, which results in a hidden prepayment penalty. The Rule of 78s encourages the practice of loan "flipping" and is an unfair burden on consumers who pay off loans voluntarily, consumers who refinance loans, and consumers who default on loans.

For example, on a \$15,000 four year loan at 18% APR, if the borrower refinanced after 18 months, the borrower would be overcharged \$323; a \$5,000 five year loan at 30% (a typical small loan rate) refinanced in the 24th month would yield the creditor an extra \$300 in unearned interest charges.

Congress took the first step in 1992 by requiring lenders to use the actuarial method to calculate rebates for loans *over* 61 months duration (15 U.S. C. § 1615). Another step was made against the Rule in 1994 when the Home Ownership and Equity Protection Act defined use of the Rule as a prepayment penalty which is forbidden for HOEPA covered loans, regardless of the loan term. The cumulative cost impact to consumers of the Rule of 78s is significant.

**Amendment:** Amend subsection (b) of 115(e) of the Truth in Lending Act (15 U.S.C. §1614(b)) as follows:

- (b) For the purpose of calculating any refund of interest or other charges required under subsection (a) for any precomputed consumer credit transaction ~~of a term exceeding 61 months~~ which is consummated after September 30, 1993, the creditor shall compute the refund based on a method which is at least as favorable to the consumer as the actuarial method.

**3) Increase the jurisdictional limit in the Truth in Lending Act and Consumer Leasing Act from \$25,000 to \$50,000.** When TILA was originally passed in 1968, the \$25,000 limit on covered transactions was more than sufficient to ensure that most automobiles and credit card transactions were included within TILA's umbrella. The value of \$25,000 in 1968 dollars is \$125,000 in today's money. As a result, today many consumer credit transactions are not protected

by TILA. The problem is compounded by the fact that many state laws do not provide usury ceilings or substantive limits on credit terms for many transactions over \$25,000.

**Amendment:** Amend Section 104(3) of the Truth in Lending Act (15 U.S.C. § 1603(3)) and Section 181(1) of the Consumer Leasing Act (15 U.S.C. § 1667(1)) by deleting "\$25,000" wherever it appears and replacing it with "\$50,000".

**4) Increase the statutory damages in the Truth in Lending Act and Consumer Leasing Act from \$1,000 to \$2,000.** The 1995 amendments to TILA addressed this problem for loans secured by homes, now other credit transactions should be protected from inflation as well. The minimum recovery of \$100 should also be increased to \$200 for the same reasons.

**Amendment:** Amend Section 130 of the Truth in Lending Act (15 U.S.C. § 1640) by deleting "\$100" wherever it appears and replacing it with "\$200", and by deleting "\$1,000" wherever it appears and replacing it with "\$2,000".

**5) Clarify that actual damages under Truth in Lending should be awarded regardless of the consumer's reliance on the incorrect disclosures.** TILA was always intended to be enforced against lenders based on their compliance, not on whether the consumer could prove that but for the incorrect disclosure the consumer would have obtained a better deal. Some recent court cases have incorrectly held that in order to obtain actual damages under TILA the consumer must prove detrimental reliance.

**Amendment:** Amend Section 130(a) of the Truth in Lending Act (15 U.S.C. § 1640(a)) by rewriting subsection (1) as follows:

"(1) any actual damage, without the need for proof of reliance;"

**6) Clarify that assignees have liability under Truth in Lending.** Truth in Lending § 131 limits liability for monetary damages against assignees to those arising out of violations "apparent on the face of the disclosure statement," which encompasses both the disclosure statement itself and "other documents assigned." The intent of the limitation of liability was to balance the need to assure that there was adequate incentive for creditors to comply with the Act, while at the same time limiting the exposure of innocent secondary market purchasers. This provision sometimes must be interpreted along with a separate federal consumer protection regulation designed to assure that consumers are not deprived of consumer protection laws by virtue of the "trafficking" in consumer paper among the business and investment community. The Federal Trade Commission trade regulation rule concerning the Preservation of Consumers' Claims and Defenses, 16 C.F.R. § 433. (The "FTC Holder Rule.") That rule requires that contracts for the credit sale of goods or services contain a provision by which the assignee (or holder, in the case of a purchase money loan was made by a creditor related to the seller) agrees to stand in the shoes of the original creditor with respect to claims and defenses which the consumer may have against the seller. Courts have expressed disagreement as to how these two federal provisions relate in transactions to which both apply. (Perhaps the most common situations are auto loans and home improvement loans, often door-to-

door home improvement loans.) A large portion of the transactions to which the FTC holder rule applies are ones in which the assignee is not an "arms-length, true secondary market purchaser," but rather has a business relationship with the seller. Often, in fact, the assignee is one in name only, having made the original decision to grant the credit, and determined the terms of the credit. Indeed, it is often the "assignees" who either prepare the credit documents, or provide instruction and training to the "seller/creditors" as to how to prepare the credit documents. As a matter of policy, then, it would be inappropriate to exclude the consumers rights under the Truth in Lending Act from the protection of the FTC rule. This amendment would clarify that §131(a) of Truth in Lending does not exclude the consumer's Truth in Lending claims from the protection of the FTC Holder Rule

**Amendment:** Amend § 131(a) of the Truth in Lending Act (15 U.S.C. § 1641(a)) as follows:

Add after last sentence in § 131(a) the following sentence:

"Nothing in this section shall act as a limitation on liability imposed on assignees pursuant to other federal statutes or regulations. "

**III. Do Not Include Anti-Consumer Amendments in this Bill.** The Senate bill has six anti-consumer provisions. We commend you for excluding most of the anti-consumer provisions currently included in the S. 1405 (you have included one anti-consumer amendment, in section 401). We urge you to ensure that these sections are not added to this or other bills passed by the House this session. Attached as Appendix I to this testimony is a detailed analysis of what is wrong with the anti-consumer provisions in sections 206, 207 and 401 of S. 1405. We hope this analysis will be helpful in resisting any efforts to include these provisions in the House regulatory relief bill.

In addition, we understand that some members of this committee are contemplating including HR 2019, the Consumer Disclosure and Rental Purchase Agreement Act, as a part of the House regulatory relief bill. **We strongly urge you to reject any efforts to include legislation on rent to own or rental purchase agreements, except Mr. Kennedy's pro-consumer bill on rent to own: HR 3060.**

HR 2019 is a very bad bill for consumers.<sup>4</sup> It would not provide consumers with adequate or timely disclosure of the information they need to make informed judgments about the rental purchase transaction. (See Appendix II for a more detailed analysis.) Although HR 2019 would add a new section to the Consumer Credit Protection Act, in many crucial ways, consumers would not be protected under these provisions. Indeed, the bill is really just a massive protection for the industry efforts to avoid consumer protections under state and other federal laws.

There a number of serious problems with HR 2019: these include:

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<sup>4</sup>This analysis of HR 2019 was provided by an expert in rent-to own transactions, David Ramp an attorney with the Legal Aid Society of Minneapolis, Mn. Appendix II is a letter from Mr. Ramp providing a more detailed analysis of the harms that consumers will suffer if the provisions of HR 2019 are passed.

- All other sections of the federal Consumer Credit Protection Act limit federal preemption of state laws to laws that are inconsistent with the particular subsection and then only to the extent of the inconsistency. HR 2019 would require a court to throw out an entire state law based on one inconsistency.
- The Consumer Credit Protection Act requires that all consumer disclosures be provided *before* the consummation of the transaction. HR 2019 gives the dealer the option to provide price tag disclosures and contract disclosures at the time of consummation. Price tag disclosures are particularly important for conveying information to the consumer *before* the decision to obtain the item has been made, yet this is not required.
- HR 2019 would allow the RTO dealer to show the cash price as either the manufacturer's suggested retail price *or whatever price the dealer sets*. The difference between the cash price and total price that would be paid by the consumer over the term of the rental purchase is crucial information. It conveys the relative cost of renting to own compared to other methods that might be used to buy the same goods. RTO dealers have routinely inflated cash prices to conceal the high price of renting to own. This bill would allow this misinformation to continue to be provided.
- No other provision of the Consumer Credit Protection Act requires a consumer to show a "willful" violation of the statute to obtain damages. HR 2019 would require a consumer to show a dealer's intent. This is an impossible standard, reducing any consumer protections that might be valuable in the bill to unenforceable "recommendations."
- Every other provision of the Consumer Credit Protection Act requires the award of a reasonable attorney's fee as decided by the court to a prevailing consumer. HR 2019 makes no similar provision. As RTO customers are overwhelmingly poor, this omission effectively closes the courthouse door to consumers attempting to enforce this act.

Thank you for your consideration of these issues on behalf of low and moderate income consumers. I would be happy to respond to any questions.

**Appendix I**  
**Problems with Anti-Consumer Amendments in the S. 1405**

**I. RESPA Amendment - Affinity Group Exception in Section 206 of S. 1405.** The main problem is that allowing affinity groups to receive kickbacks for referrals and endorsements of settlement services would open the door for significant consumer abuses, and would unequivocally have the effect of *increasing the costs of settlement services for consumers*. The original purpose of RESPA was to ensure fair and open competition in the marketplace to keep the costs of settlement services as low as possible.

RESPA currently allows anyone to be paid for services that are actually rendered. RESPA's section 8 only prohibits the payment of "referral fees." Section 206 of S. 1405 would allow an affinity group to be established -- for a common purpose -- by anyone other than a settlement service provider. (Does anyone really know what an affinity group is?) Then the affinity group could make endorsements of settlement service providers *and receive payment for the endorsements* so long as disclosures are provided to consumers.

The effect of this amendment would be to allow the payment of a fee to an affinity group for something *other* than services actually rendered. As a result, endorsement fees could be paid in large sums to anyone, (including realtors) for referrals to lenders, title insurance companies, and others. While home buyers might believe that the endorsement was a true recommendation about the *value* of the services provided by the settlement service provider to whom they were referred, in fact the only reason the referral would have been made was because the referring party was receiving a kickback for making it. This was exactly the reason for the original prohibition in RESPA's section 8.

There are a number of problems with this proposal:

- 1) There is no requirement that the consumer receive the benefit of, or indeed *any* benefit from the referral made as the result of the endorsement. Given this, the consumer could believe that the endorsement is made for his benefit, when the actuality of the situation could be that because of the endorsement the settlement service is *more* expensive than it would have been if the consumer had gone to the provider directly. For example, the referral could be provided by a group (such as a church, an alumni association, a trade association, an employer) -- in the guise of providing good advice to the consumer -- that a certain settlement service provider is the best one to use. Yet under the language in the amendment, if the referral were made by an affinity group, there would be nothing to prohibit the settlement service provider from *increasing* the price charged to the consumer and splitting the increased price with the affinity group.
- 2) There is no prohibition against affinity groups being established by affiliates, subsidiaries or parent organizations of settlement service providers. So long as that loophole exists, the limitation against settlement service providers setting up the affinity group is effectively meaningless. So for example, an affiliate of a corporate realtor which is not itself a

settlement service provider could establish an affinity group. The realtor could then endorse a particular lender. Once the consumer uses that lender, at the suggestion of the realtor, the affiliate of the lender -- the affinity group -- would receive a kickback, or referral or endorsement fee. Such a system would clearly undermine the purposes for which RESPA was created: to protect consumers from unnecessarily high settlement charges and certain abusive practices (12 U.S.C. § 2601). The payment of a fee for steering should remain illegal, otherwise the referral could still be made to the detriment of the consumer.

The potential for abuse that could result from an affinity group endorsement that section 206 would allow should be contrasted with the allowable activities of affinity groups under current law. (See appendix I: article from Saturday, January 24, 1998, Washington Post.) Under current law, affinity groups make endorsements of settlement services which are generally considered to be legal. Current law allows endorsements of settlement service providers by affinity groups so long as *the consumer receives the benefit of the referral*. In the Long & Foster- Costco relationship described in the article, the consumer would have received a rebate from the realty company as the result of the referral from the affinity group. Clearly consumers will benefit from this type of arrangement (although realtors may not). This arrangement is considered to be legal because of the exception to the definition of "required use" in 24 C.F.R. § 3500.2(b):

However, the offering of a package (or combination of settlement services) or the *offering of discounts or rebates to consumers* for the purchase of multiple settlement services does not constitute a required use. . . . The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process. (Emphasis added.)

Given that this language is already in RESPA, and thus endorsements by affinity groups which result in a discount to the consumer are currently legal, the only reason to change the law would be to allow endorsements by affinity groups which do *not* result in a benefit to the consumer. Passing S. 206 will increase the costs of settlement services to consumers.

Additionally, the Mortgage Reform Working Group, comprised of representatives of any industry and consumer group that wants to join, has been meeting regularly and extensively for the past seven months in an effort to comprehensively draft a rewrite of RESPA, as well as the Truth in Lending Act. Section 8 protections are very much on the table in these discussions. If the Working Group is to have any real hope of accomplishing reform, it does not make sense for Congress to pass piece meal legislation amending either of these two laws at this point. For that reason alone this amendment should be rejected.

Finally, while eviscerating the major substantive protection of the Real Estate Settlement Procedures Act (RESPA) -- the prohibition against unearned referral fees -- this amendment would not even appear in the U.S. Code within the statute it amends. As such, there would be no enforcement mechanism to ensure compliance even with the minimal standards of the proposed

amendment.

**II. Fair Debt Collection Practices Act Amendments in Section 207 of S. 1405.** When considering proposed changes to the Fair Debt Collections Practices Act (FDCPA), one should keep in mind that the FDCPA does *not* make it possible for consumers to avoid paying the debts that they owe. This law only stops abusive, deceptive collections practices by debt collectors. As Congress recognized when it passed the Fair Debt Collection Practices Act in 1977:

(a) There is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy.

Further, the FDCPA only stops the bad actions of debt collectors:

(e) It is the purpose of this subchapter to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses.

15 U.S.C. § 1692.

Section 207 of S. 1405 would make it much easier for abusive debt collection practices to occur without redress throughout the United States.

**1) Section (a) would exempt all communications made under state or federal Rules of Civil Procedure from the FDCPA.** This is overly broad, and would clearly result in abusive and deceptive collections practice.

For example, currently in § 1692(e)(15) the FDCPA makes the “false representation or implication that documents are not legal process forms or *do not require action by the consumer*” a violation. This provision prohibits a collector from misleading a consumer who has been sued into believing that the consumer need only send payments to the collector, when in fact legal inaction will result in a default judgment.

Consider why it is so important that all communications from a debt collector be covered by the FDCPA, even those made pursuant to the rules of civil procedure. In one survey of judgment debtors in Washington D.C. a finance company was found to have frequently misled consumers into believing that they need not respond formally to legal process. Consumers reported that they called the finance company or its lawyer after a receiving a summons and offered to catch up on their payments if the suit was dropped. The consumers were assured that everything would be taken care of once the back payments were received. Then, after accepting the promised post-summons

payments from the consumers and assuring the consumers that their payments would obviate the need to defend the creditor's suit, the finance company took default judgments against these consumers.<sup>5</sup> Another survey found that this type of false advice was prevalent in the collection industry.<sup>6</sup> This representation by a debt collector that the consumer need not respond to a summons violates § 1692e(15). Such activity would not be illegal under the FDCPA if § 207 of S. 1405 passes.

Further, it is violation under current law for collection agencies to file suit for an inflated amount, or to include an illegal fee, or to fail to rebate unearned interest or credit insurance premiums in the requested relief.<sup>7</sup> This amendment would presumably make this activity perfectly legal, as well.

**2) Section 207(b) would exclude the collection of bad checks from the FDCPA.** There is no good reason for excluding the collection of bad checks from coverage under the FDCPA. Many courts have considered the issue, and have held that dishonored checks are debts covered by the Act.<sup>8</sup> Moreover, even if one could distinguish between a check and a debt, there is no good policy reason not to prohibit abusive practices in the collection of bad checks.

Given the high potential for abusive practices during the collection efforts for bad checks, it is particularly important that FDCPA protections apply. For example, a well known, but troublesome collection tactic is to threaten consumers with prosecution under criminal bad check statutes. Some collectors even solicit checks from financially distressed consumers, with complete indifference to the sufficiency of funds to cover the check, knowing that the possibility of a bad check prosecution provides the collector with powerful collection leverage.<sup>9</sup>

There are a variety of situations in which bad checks are written. They vary from the professional criminal check kiter, to the embezzling employee, to the financially desperate parent buying food without funds, to the consumer who gives a check not expecting it to be cashed, to the consumer who made an inadvertent error in balancing the checkbook and cannot immediately cover the check, to the person who expected their check to be covered by a deposited check that

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<sup>5</sup> H. Sterling & P. Shrag, *Default Judgments Against Consumer: Has the System Failed?* 67 Denver U.L. Rev. 357, 370-372 (1990).

<sup>6</sup> D. Caplovitz, *Consumers In Trouble*, note 3 at 205 (Free Press 1974).

<sup>7</sup> 15 U.S.C. § 1692e(2)(A): "The false representation of the ...the character, amount . . . or any debt."

<sup>8</sup> See, e.g. *Ryan v. Wexler & Wexler*, 113 F.3d 91 (7th Cir. 1997); *Bass v. Stolper, Koritzinsky, Brewster & Neider, S.C.* 111 F.3d 1322 (7th Cir. 1997); *Draper v CRA Sec. Systems, Inc.* 117 F.3d 1424 (9th Cir 1997); *Ditty v. Check Rite, Ltd.*, \_\_\_F. Supp. \_\_\_, 1997 WL 471115 (D. Utah 1997); *Johnson v. CRA Security Systems*, 1997 WL 241861 (N.D. Cal. 1997).

<sup>9</sup> See e.g. *United States v. Central Adjustment Bureau, Inc.*, 667 F.Supp. 370 (N.D. Tex. 1986) (collector violated 15 U.S.C. § 1692f(3) by soliciting postdated checks with the purpose of threatening criminal prosecution), *aff'd per curiam*, 823 F. 2d 880 (5th Cir. 1987); *G.C. Services Corp.*, 83 FTC 1521 (1974) (complaint alleged that collection agency solicited postdated checks and later threatened criminal prosecution if the check was dishonored).

bounced.<sup>10</sup> Surely, this Congress does not want to condone abusive collection tactics against all of these consumers.

Also, it is a violation of the FDCPA for a debt collector to collect “any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.”<sup>11</sup> One example of a potentially illegal charge that is disallowed by this provision is a dishonored check fee. Despite the provision in the FDCPA, there are numerous cases holding collection agencies violated the law by attempting to collect illegal fees when collecting on dishonored checks.<sup>12</sup> Should that activity now be made legal? Consumers would be considerably harmed if this amendment passed.

### **3) Section 207(c) would add language to the FDCPA specifying that collection activities and**

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<sup>10</sup> On a nationally administered test, 99% of 17 year olds and 84% of adults were not able to correctly balance a sample checking account. National Assessment of Educational Progress, Consumer Math (GPO 1975). One percent of checks are dishonored; of those 71.2% are for insufficient funds, 2.7% drawn on uncollected funds, 4.4% drawn on closed accounts, 2.7% stop payment orders, 4.9% ,missing endorsements. and 14.1% for other reasons, including bank errors. *Statement of Preston Martin to House Banking Subcommittee*, 70 Fed. Res. Bull. 319 (1984). One of 5245 returned checks (2 or every 1 million checks written) are a loss to a bank. W. Stafeil, *The Impact of Exception Items on the Check Collection System, A Quantitative Description* (Bank Admin. Instit. 1970).

<sup>11</sup> 15 U.S.C. § 1692f(1).

<sup>12</sup> *See, e.g. Newman v. Checkrite California, Inc.*, 912 F. Supp. 1354 (E.D. Cal. 1995) (lawyers collecting debts for a check collection agency violated 15 U.S.C. § 1692e and 1692f by adding an \$85 charge that was not authorized by the contract or state law and labeling it a "legal notice" fee and misrepresenting that the fee was legally due); *West v. Costen*, 558 F.Supp. 564 (W.D.Va. 1983) (imposition of \$15 service charge on each bad check it collected violated 15 U.S.C. § 1692f(1) since there was no evident of contract providing for the charge and the charge was not expressly permitted by state or federal law. Attempt to collection such charges violated 15 U.S.C. § 1692e(2)); FTC Official Staff Commentary § 808(11).

**communications can continue during the 30-day period during which the consumer has the right to request verification of the debt.** This amendment is the same as was added to and then deleted from the “regulatory relief” bill introduced in 1995 (S.650) and there are still the same problems with it. The proposed language is subtle but bad for consumers.

Currently, the FDCPA provides consumers the essential right to ensure that the debt which the collector is seeking them to pay is really owed by that consumer, or has not already been paid. This right is referred to as “the right to validation.” The law requires that in the initial communication with the consumer, the debt collector must provide consumers with a statement that the consumer has thirty days to notify the collector and request verification of the debt.<sup>13</sup> This is intended to minimize instances of mistaken identity of a debtor or mistakes over the amount or existence of a debt.

The problem arises when the information providing the consumer notice of this important right is accompanied by insistent demands for payment of the debt *within* that 30 days. In many cases, the overriding message the consumer receives is that the debt must be paid immediately, not that the consumer has 30 days in which to request verification of the debt to assure that the consumer really owes the requested amount.

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<sup>13</sup> 15 U.S.C. § 1692g(a)(4)..

In the leading case on the placement of a validation rights notice,<sup>14</sup> the U.S. Court of Appeals required that the validation notice "must be large enough to be easily read and sufficiently prominent to be noticed--even by the least sophisticated debtor. Furthermore, to be effective, the notice must not be overshadowed or contradicted by other messages or notices appearing in the initial communication from the collection agency."<sup>15</sup>

In that case the validation rights notice failed these tests because it was dwarfed and contradicted by the dunning message. As the court said:

The required debt validation notice is placed at the very bottom of the form in small, ordinary face type, dwarfed by a bold faced, underlined message three times the size which dominates the center of the page. More importantly, the substance of the language stands in threatening contradiction to the text of the debt validation notice.<sup>16</sup>

Other examples in the courts of overshadowing and misleading notices include:

- The front of the form demands "IMMEDIATE FULL PAYMENT" and commands the consumer to "PHONE US TODAY," emphasized by the word "NOW" emblazoned in white letters nearly two inches tall against a red background. The message conveyed by those statements on the face of the form, flatly contradicts the information about the right to verification of the debt contained on the back.<sup>17</sup>
- Demand for payment within the 30 day period to request verification with only a reference in smaller print to see the reverse side containing the validation notice printed in light gray ink which made it difficult to read.<sup>18</sup>

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<sup>14</sup> *Swanson v. Southern Oregon Credit Service*, 869 F.2d 1222 (9th Cir. 1988).

<sup>15</sup> *Swanson* at 1225.

<sup>16</sup> *Swanson* at 1226.

<sup>17</sup> *Miller v. Payco General American Credits, Inc.*, 943 F.2d 482, 484 (4th Cir. 1991) .

<sup>18</sup> *United States v. National Financial Services, Inc.*, Clearinghouse No. 47,970 (D. Md. 1993).

- The validation notice was sent on the back of a demand letter which contained conflicting deadlines and which overshadowed the notice by being in larger typeface.<sup>19</sup>

The effect of the amendment in S. 1405 would be to overrule these cases prohibiting the overshadowing. The collection activities would proceed in such a way as to obliterate the consumers' notice of the essential right to obtain validation.

While it would clearly be preferable for there to be no amendments to this section of the FDCPA, there is, however, a compromise possible. The debt collectors want to be able to continue to collect a debt during the 30 day waiting period. Consumer advocates want to ensure that while the debt collectors are pursuing these debt collection efforts, the notice of the right to validation is not overshadowed. Both these goals can be accomplished by rewriting the new subparagraph (d) of § 1692g as follows:

(d) except as provided in subsection (b), collection activities and communications may continue during the 30 day period so long as the activities and communications do not overshadow or contradict the information provided in subsection (a) of this section.

**4) Section 207(d) would exclude from the FDCPA all communications to collect debts owed under the Higher Education Act.** This proposed amendment to the Fair Debt Collection Practices Act (FDCPA) would exclude from coverage any collection abuse relating to a student loan made pursuant to the Higher Education Act (HEA), no matter how egregious that practice and even when the abuse is perpetrated by a private for-profit collector hired by a private enterprise.

Student loan debtors in default are many types of people with many reasons for their default. Perhaps the most common category is low income consumers who went to for-profit trade schools that swindled them and then closed down, leaving the students without any of the promised job skills and thus with no financial ability to repay the loans. Other borrowers in default are those who have become disabled, lost their job, or who are otherwise financially unable to keep up with loan payments. Those financially able should repay their student loans, but no American should be subjected to illegal debt collection harassment.

Private student loan collectors generally engage in some of the worst collection abuses. Consumers from all over the country report some of the worst collection abuses by private collectors hired on a commission basis to collect on student loans. These private bill collectors can have portfolios exceeding 100,000 loans; their only interest is to recover as much money at as little cost to them as possible.

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<sup>19</sup> *United States v. National Financial Services, Inc.*, 98 F.3d 131 (4th Cir. 1996).

Collectors are already flaunting congressional directives. The last reauthorization of the Higher Education Act and subsequent Congressional legislation created mechanisms to reduce defaults and also provided students in default with various rights, protections, and repayment plans. Private collectors typically are the only entities providing initial information to students about these rights and repayment plans. Unfortunately, we have seen evidence that private collectors are systematically misrepresenting and concealing these basic rights -- reasonable and affordable payment plans, closed school and false certification discharges, consolidation loans, the ability to avoid garnishment and tax intercepts through repayment plans, and the like. This is not surprising because collectors make little money if a student makes small affordable payments over a period of years or if the student receives a loan discharge because the school defrauded the student. These collectors instead try to squeeze out unaffordable amounts right away.

The effect of the amendment in S. 1405 would not be to protect the Student Loan Program, only abusive private debt collectors. Already the FDCPA does not apply to federal or state agencies, and there is thus no question of the FDCPA applying to the Department of Education or a state-run guaranty agency. The only parties who would profit by this amendment would be private entities who are in the business of collecting debts in default and who violate the standards set out in the federal statute. 31 United States Code § 3718(a)(2) requires that all private collectors hired by executive or legislative agencies of the United States must be subject to all federal laws relating to debt collection. There is no reason to provide special treatment to collectors hired by the Department of Education, when private collectors hired by other federal agencies must comply with the FDCPA. In addition, all private collectors in their contracts with the Department of Education agree to be bound by the FDCPA, and the Department has had no difficulty in finding collectors to sign such contracts. Why deprive Americans of this important protection from debt collection harassment when collectors readily agree to this liability?

There are a number of rationales offered for exempting communications made to collect loans made under the Higher Education Act, none survive close scrutiny:

- a. *It is argued that guaranty agencies are never abusive in their collection activities, and therefore do not need to be covered by the FDCPA.* First of all, it is not just the collection activities of guaranty agencies which will avoid coverage, but the debt collection agencies collecting *for* these agencies will escape scrutiny as well. Secondly, governmental, non-profit guaranty agency are already exempt from the FDCPA<sup>20</sup> Lastly, and most importantly, guaranty agencies have committed abusive collection practices in numerous instances *such that it is clear that the consumers need the protections of the FDCPA when guaranty agencies or their collection agencies are collecting these debts.*<sup>21</sup> (See Appendix II for two recent case histories

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<sup>20</sup> 15 U.S.C. §1692a(6)(C) exempts “any officer or employee of the United States or any State to the extent that collecting or attempting to collect any debt is in the performance of his official duties.”

<sup>21</sup>See *Brannon v. United Student Aid Funds*, 94 F.3rd 1260 (9<sup>th</sup> Cir. 1996) holding that student debtor may obtain damages from a guaranty agency for abusive collection practices in violation of FDCPA. For other examples of

of the problems with student loans.)

- b. *It is argued that the FDCPA adds no meaningful protections for debtors beyond those already provided by the Department of Education regulations on collecting student loans. This is frankly absurd. The rules that lenders, guaranty agencies and collection agencies must follow when collecting student loans require certain numbers and types of telephone and written contacts, require threats to affect the debtors credit, require threats of and then implementation of prejudgment wage garnishment and tax refund intercept. Unlike most other debts, consumers cannot escape liability for student loans by waiting, as there is no statute of limitations. Student loan debtors also are generally prohibited from discharging student loans by filing bankruptcy. There are some defenses for debtors to payment of student loans, based for example on a school's fraudulent activity or other misdeed. There are also required notices and hearings prior to executing garnishment and tax intercept orders. However, there are no protections against abusive, or deceptive collection efforts in these regulations. The regulations provide instructions on how best to force debtors to pay their student loans. **Given the broad powers that collectors of student loans have, consumers are even more in need of basic protections from their abusive collection activities than the general class of consumers.***

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allegations of abusive collection practices of guaranty agencies, *see Beaulieu v. American Nat'l Educ. Corp.*, CV 79-L-271, Clearinghouse No. 30892 (D. Neb. 1981); *Coppola v. Connecticut Student Loan Found.*, 1989 WL 33707 (D.Conn. 1989) (holding student loan servicing agency was not a debt collector since it obtained loan before default); *Games v. Cavazos*, 737 F. Supp. 1368 (D. Del. 1990) (U.S.A. Funds, a private federal student loan guarantee agency, exempted by §1692a(6)(C).

- c. *It is argued that as the FDCPA validation notice does not provide information regarding the student loan collector's rights and obligations regarding the collection of the debt, that requiring the FDCPA notice is confusing to student loan debtors. This is disingenuous. While the FDCPA notice may not require that the collector of student loans provide this information, there is **nothing to prohibit the collector from adding it to the required information.***<sup>22</sup> In fact, it especially important for student loan debtors to have the right to verification of the loan, because too often debtors are not informed what loan the collector is seeking, what school or time period the loan covered, or even whether the debtor was the student who incurred the loan.
- d. *It is argued that a collector cannot comply with the communications provisions of the FDCPA and the due diligence regulations governing student loan collections. This may indeed be true, and with the addition of only one other, very minute detail (which will be addressed below in paragraph f) is the only example of situations where the two conflict. **The appropriate response to this conflict is to address it specifically and narrowly, not to provide blanket exemptions for all student loan collections.** The regulations governing collections of student loans mandate "due diligence" on the part of the collector by requiring several written notices that must contain specific information regarding the loan and consequences of non-payment,<sup>23</sup> as well as several telephone contacts.<sup>24</sup> The FDCPA on the other hand, requires a collector to cease communications with a consumer if the consumer requests it.<sup>25</sup>*

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<sup>22</sup> The §1692g notice requires collectors to provide notice to the consumer of:

- (1) the amount of the debt;
- (2) the name of the creditor to whom the debt is owed;
- (3) a statement that unless the consumer, within thirty days after receipt of the notice, disputes the validity of the debt, or any portion thereof, the debt will be assumed to be valid by the debt collector;
- (4) a statement that if the consumer notifies the debt collector in writing within the thirty-day period that the debt, or any portion hereof, is disputed, the debt collector will obtain verification of the debt or a copy of a judgment against the consumer and a copy of such verification or judgment will be mailed to the consumer by the debt collector; and
- (5) a statement that, upon the consumer's written request within the thirty-day period, the debt collector will provide the consumer with the name and address of the original creditor, if different from the current creditor.

<sup>23</sup> 20 U.S.C. § 1078(c), 34 C.F.R. § 682.410(b)(5).

<sup>24</sup> 34 C.F.R. § 682.410(b)(6)(iii).

<sup>25</sup> § 1692c(c) provides:

If a consumer notifies a debt collector in writing that the consumer refuses to pay a debt or that the consumer wishes the debt collector to cease further communication with the consumer, the debt collector shall not communicate further with the consumer with respect to such debt, . . .

The FDCPA requires communications to cease at the consumer's request to provide a sanctuary for consumers from the constant dunning efforts of collectors. It allows the consumers a way to say "Enough, I've got the message." If a consumer requests that communications cease, that should end collections' communications. Nothing prevents the student loan debt collector from proceeding with the next step in the collection process: prejudgment garnishment, tax intercept or civil suit, *according to the prescribed time schedule*. The only difference is that the constant letters and telephone calls must cease in the interim. The FDCPA provides that after a cease communications' notice from the consumer the collector can still communicate to advise, among other things, that the collector "may invoke specified remedies."<sup>26</sup> The simplest and best way to resolve these conflicts is to provide that a collector of student loans is not required to continue the letters and phone calls after a receipt of a cease communication notice from the debtor. All other collection efforts can then proceed according to the prescribed time schedule.

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<sup>26</sup> § 1692c(c).

- e. *It is argued that the requirement in the student loan regulations to make diligent attempts to locate a consumer whose location is unknown conflicts with the prohibition in the FDCPA to contact third parties.* This is simply not true. There is a whole section in the FDCPA which allows collectors to pursue location information; it simply ensures that this activity is pursued in a manner which protects the consumer's privacy.<sup>27</sup>
- f. *It is argued that collectors of student debts need to communicate with consumers' employers to effectuate wage garnishment, and that compliance with the FDCPA would disallow this.* This is a very minor, but possible inconsistency between the two statutes. In FDCPA § 1692c(b) communications are only permitted with third parties for specific reasons, including those necessary to effectuate a *postjudgment* garnishment remedy. As collection regulations for loans made under the Higher Education Act allow *prejudgment* garnishment, conceivably communications made regarding *prejudgment* garnishment would violate the FDCPA (although there are no court cases or challenges of student loan collectors based on this very technical distinction). We would have no objection to amending § 1692c(b) to address this discrepancy as follows:

(b) Communication with third parties--Except as provided in section 1692b of this title, without the prior consent of the consumer given directly to the debt collector, or the express permission of a court of competent jurisdiction, or as reasonably necessary to effectuate a postjudgment judicial remedy, or a prejudgment administrative wage garnishment permitted under 20 U.S.C. § 1095a, a debt collector may not communicate, in connection with the collection of any debt, with any person other than the consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the attorney of the debt collector.

It would be unseemly for the United States to sanction worse collector behavior when these collectors represent the United States or a state guaranty agency than when these collectors represent credit card issuers, finance companies, and banks. The United States certainly wants to recover on defaulted student loans, but it need not do so by encouraging private entities to lie and harass America's youth and others seeking to improve themselves through education.

The FDCPA is the only federal control over private collectors collecting on student loans. The exclusion proposed in S. 1405 would provide *carte blanche* to these collectors. Even if the Department of Education could effectively regulate the collectors the Department hires when they collect on millions of accounts, the amendment also gives free reign to the even larger group of collectors hired by guaranty agencies, schools, and lenders.

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<sup>27</sup> § 1692b.

The proposed amendment would exempt all private collectors collecting under the HEA, even those working for private entities. The exemption would insulate from liability for abusive, harassing, deceptive or unfair collection activities:

- the illegal practices of private for-profit collection agencies hired by trade schools and other schools to collect on Perkins Loans;
- the illegal practices of private for-profit collection agencies hired by lenders and other private investors to collect Family Federal Education Loans (FFEL) (the new name for guaranteed student loans) that have lost their guaranteed status because of lender impropriety;
- the illegal practices of private for-profit collection agencies that are hired by such private entities as USA Funds to collect on FFEL loans;
- the illegal practices of private for-profit collection agencies hired by state guaranty agencies and the Department of Education; and
- the illegal practices of private guaranty agencies.