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COMMENTS FROM THE CIVIL COURT COMMITTEE AND CONSUMER AFFAIRS COMMITTEE ON PROPOSED RULEMAKING BY THE NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES REGARDING DEBT COLLECTION

The New York City Bar Association ("City Bar") submits these comments pursuant to the New York State Administrative Procedures Act with regard to DFS's proposed 23 N.Y.C.R.R. 1 (the "Proposed Rule"), published on August 21, 2013. We commend the New York State Department of Financial Services ("DFS") for seeking to enhance regulation and oversight of debt collection through its rulemaking authority. As described further below, debt collection consistently ranks as a top sector for consumer complaints by New Yorkers with federal, state, and local consumer protection agencies. The City Bar strongly supports the Proposed Rule subject to the suggestions and comments set forth below.

1. ILLEGAL DEBT COLLECTION PRACTICES WARRANT RULEMAKING BY DFS

Debt collection agencies are currently regulated under New York State law pursuant to the Fair Debt Collection Law (Art. 29-H of the General Business Law) and under the federal Fair Debt Collection Practices Act ("FDCPA"). In the City of New York, consumers also enjoy protections required by the New York City Department of Consumer Affairs, in its licensing rules for debt collectors. Despite the statutory protections provided by these provisions, the number of consumer complaints against debt collection agencies generally rank at or near the top complaint category for regulatory agencies. The Consumer Financial Protection Bureau ("CFPB") reported in its annual report for 2013 that "approximately 30 million individuals, or 14% of American adults, had debt that was or had been subject to the collection process."[1] The CFPB report notes that the debt collection industry "remains a top source of consumer complaints"[2] and that the Federal Trade Commission ("FTC"), which is the federal agency that tracks consumer complaints, "continues to receive more complaints about the debt collection industry than any other specific industry."[3]

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[1] CONSUMER FINANCIAL PROTECTION BUREAU, "FAIR DEBT COLLECTION PRACTICES ACT: CFPB ANNUAL REPORT 2013" 8 (Mar. 20, 2013), *available at* http://files.consumerfinance.gov/f/201303_cfpb_March_FDCPA_Report1.pdf (last visited Oct. 10, 2013).

[2] *Id.* at 2.

[3] *Id.* at 14.

New Yorkers file complaints against debt collectors in significant numbers. The New York City Department of Consumer Affairs ("DCA") reported that, in 2012, debt collection abuses were the top complaint for the fifth year in a row.[4] Similarly, the New York State Consumer Protection Division reported that in 2011 debt collection was the second highest complaint, next to Do Not Call registry violations.[5] The types of complaints against debt collectors commonly include failure by collectors to verify their ownership of the debt owed, failure to verify the identity of the debtor, improper service of process in filed debt collection lawsuits, and improper garnishment of debtors' wages and bank accounts.[6]

In the past few years, the FTC has undertaken a comprehensive review of the debt collection industry, and in February 2009, it released a lengthy report with findings and recommendations for changes in the debt collection system, stemming from its two-day public workshop in 2007.[7] Also in 2009, the FTC hosted a series of regional roundtables, bringing together representatives from the debt collection industry, consumer advocates, academics, government officials, and representatives of the judicial system to discuss consumer protection problems arising out of debt collection litigation. As a result of these roundtables, the FTC issued a follow-up report that concluded that the system for resolving consumer debt collection disputes is broken and recommended significant litigation and arbitration reforms to improve efficiency and fairness to consumers.[8] One of the main reasons that debt collection practices have attracted heightened attention is the growth of "debt buying" and the problems associated with the debt buyer industry, which is cited by DFS in its Regulatory Impact Statement.[9]

Although observers acknowledge that some collection agencies comply with the law, it is clear that debt collection abuses generate significant numbers of complaints from New Yorkers and that enhanced oversight and regulation by DFS through its rulemaking authority will help

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[4] Press Release, N.Y.C. Dep't. of Consumer Affairs, Department of Consumer Affairs (DCA) Names Debt Collectors Top Complaint for the Fifth Year in a Row (Mar. 5, 2012), *available at* http://www.nyc.gov/html/dca/html/pr2013/pr_030513.shtml (last visited Oct. 10, 2013).

[5] *Hearing on the Effectiveness of the Consumer Protection Division (CPD) Within the Department of State (DOS)* 19-20 (Nov. 28, 2012), N.Y.S. Assembly Standing Committee on Consumer Affairs and Protection, [hereinafter Hearing of Effectiveness of the CPD] (Testimony of Marcos Vigil, Deputy Secretary for Business and Licensing, N.Y.S. Dep't. of State), *available at* http://assembly.state.ny.us/write/upload/hearings/2012/20121128Consumer.pdf (last visited Oct. 10, 2013)..

[6] *Id.* at 34-35 (testimony of Kirsten E. Keefe, Senior Staff Attorney, Empire Justice Center).

[7] FEDERAL TRADE COMMISSION, COLLECTING CONSUMER DEBTS: THE CHALLENGES OF CHANGE, (Feb. 2009), *available at* http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf (last visited Oct. 10, 2013)..

[8] FEDERAL TRADE COMMISSION, REPAIRING A BROKEN SYSTEM: PROTECTING CONSUMERS IN DEBT COLLECTION LITIGATION AND ARBITRATION (July 2010), *available at* http://www.ftc.gov/os/2010/07/debtcollectionreport.pdf (last visited Oct. 10, 2013).

[9] *See Regulations: Proposed Regulations*, New York State Department of Financial Services (Sept. 25, 2013), http://www.dfs.ny.gov/legal/regulations/proposed/propdfs.htm#contentarea (last visited Oct. 10, 2013).

ensure appropriate and adequate consumer protection, especially of economically distressed and other vulnerable persons.[10]

2. COMMENTS TO THE PROPSED RULE

We set out below comments, suggestions, and questions concerning the Proposed Rule.

a. Comments With Regard to Definitions

Definition of "Debt."

Section 1.1(d) of the Proposed Rule defines "debt" as "any obligation or alleged obligation of a natural person for the payment of money or its equivalent which arises out of a transaction wherein credit has been offered or extended to a natural person, and the money, property or service which was the subject of the transaction was primarily for personal, family or household purposes." Section § 1.1(d) also contains an exclusion, which states:

> Debt shall not include any obligation or alleged obligation of a consumer for the payment of money or its equivalent which arises out of credit extended directly to a consumer exclusively for the purpose of enabling that consumer to purchase consumer goods or services directly from the seller.

The exclusion stems from New York Financial Services Law 104(a)(2)(B), the DFS enabling statute. Financial Services Law 104(a)(2)(B) states:

> Financial product or service shall also not include the following, *when offered or provided* ***by*** *a provider of consumer goods or services:* (i) the extension of credit directly to a consumer exclusively for the purpose of enabling that consumer to purchase such consumer good or service directly from the seller, (ii) the collection of debt arising from such credit, or (iii) the sale or conveyance of such debt that is delinquent or otherwise in default. N.Y. Fin. Servs. §104(a)(2)(B) . . . ." (Emphasis added.)

However, as drafted, the exception described in §1.1(d) departs from the wording of the enabling statute, making the exception broader in the rule than in the statute. The proposed rule omits language indicating that, in order to be excluded from the debt collection regulations, the debt must have been extended *by the seller* exclusively for the purchases *from the seller*. It is susceptible to a different meaning than the statute has. If §1.1(d) is not amended to correspond to the authority conferred by Financial Services Law §104(a)(2)(B), debt collectors might argue

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[10] We note that New York State does not have a statewide licensing requirement for debt collectors. The City Bar generally supports passage of bills proposed in the New York State Legislature that would impose this requirement. See New York City Bar Association, Report on A.455 and S.219 Which Would Amend the General Business Law By Requiring the Licensing of Debt Collection Agencies and Amend the Civil Practice Law and Rules Regarding Pleading Requirements (Reissued and Updated Apr. 2013), *available at* http://www2.nycbar.org/Publications/reports/reportsbycom.php?com=143 (last visited Oct. 10, 2013).

that the collection of debts arising from consumer credit extended by a third party for purchases exclusively from a designated seller is excluded from DFS regulation. To conform to the statute, the rule should be amended to read as follows: Debt shall not include any obligation or alleged obligation of a consumer for the payment of money or its equivalent which arises out of credit extended directly to a consumer by a seller exclusively for the purpose of enabling that consumer to purchase consumer goods or services directly from the seller."

Amending the language is important because certain merchants offer their financing through credit cards that are issued by banks exclusively for purchase from the identified merchant. For example, many retail chain stores offer branded credit cards to allow shoppers to make purchases exclusively from that store. Similarly, automobile dealers offer financing at the dealership to buy cars from that dealership. These merchants, however, do not themselves extend the credit. Rather, it is a bank – an entity that is distinct from the merchant – that extends the credit. The rule should make clear that these debts are not excluded. [11]

b. Comments With Regard to Disclosures

We commend DFS for the focus and attention placed on disclosures in the Proposed Rule. Disclosures can serve as an important mechanism to educate and protect consumers and we acknowledge the great challenge of crafting disclosures that cover essential points and do so succinctly and effectively.

Recommendation Regarded Initial Disclosures

We recommend that the Proposed Rule include initial disclosures that inform consumers of their right to stop contact from collectors and the prohibition against the use of false statements, impersonation of law enforcement, or threats of imprisonment. These disclosures would help consumers avail themselves of effective defenses against all-too-common debt collection abuses – harassing, abusive, and deceptive debt collection calls.

Importantly, § 1.2(b), which addresses the information that should be included in initial disclosures with the consumer with regard to the collection of a defaulted debt, should include the date of last payment or, when no payment was made, when the payment was due to be made.

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[11] As discussed above, we acknowledge that the definition of "debt" and exceptions to that definition arise from the enabling statute, NY Financial Services Law §104(a)(2). In this respect, the DFS rule departs from the definition of "debt" as defined in the long-established and interpreted FDCPA. The FDCPA defines "debt" as follows: "The term 'debt' means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment." 15 U.S.C. 1692a(5). As drafted, the Proposed Rule provision would not protect significant numbers of consumers, particularly vulnerable consumers who fall victim, for example, to rent-to-own establishments. Also excluded would be collection of debts by landlords, who routinely file post-possessory actions to collect on money judgments in New York City Civil Court. Courts are seeing greatly expanded debt collection litigation by landlords. Ideally, legislation should be enacted to capture the full range of consumer debts within the scope of debt collection regulation.

Disclosures Related to the Statute of Limitations

The collection of time-barred consumer debt is an area of demonstrated abuse by the debt collection industry[12] and we commend DFS for including disclosure requirements in the Proposed Rule that apply to this type of debt. We raise the following concerns regarding the Proposed Rule's current language:

- Section 1.3(a) requires disclosures with respect to time-barred debts "[i]f a debt collector knows or has reason to know that the statute of limitations for a debt may be expired. . . ." The rule does not contain an objective standard to determine when a debt collector has actual or constructive knowledge that the debt is time-barred. Without an objective standard, debt collectors could evade this requirement. Moreover, determining the statute of limitations depends on certain factors, such as how "default" is defined,[13] and under New York's borrowing statute, the home state of the original creditor.[14] We recommend inserting the following language as a subsection (b) to Section 1.3:[15]

  > "A debt collector must maintain reasonable procedures for determining whether the statute of limitations applicable to a debt it is collecting has expired."

- Section 1.3(a) does not require disclosure of the possibility of time-barred debt at a particular time. Thus, the disclosure could be made following extensive settlement negotiations and on the brink of payment when consumers may be disinclined to focus on this aspect of the debt or when disclosure would be least effective. We recommend that the Proposed Rule be amended to require the 1.3(a) disclosure to be made in every communication with the consumer.

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[12] Courts have long held that threats to sue and actual lawsuits misrepresent the legal status of time-barred debt thus violating the FDCPA. *E.g. Kimber v Fed. Fin. Corp.*,668 F. Supp. 1480, 1489 (M.D. Ala. 1987). *See also, McCollough v Johnson, Rodenburg & Lauinger, LLC*, 637 F. 3d 939 (9th Cir. 2011). In 2012, the FTC obtained a $2.5 million penalty against Asset Acceptance, LLC, a national debt buyer, in connection with debt collection of time-barred debts and other abusive and deceptive debt collection practices. Press Release, Federal Trade Commission, Under FTC Settlement, Debt Buyer Agrees to Pay $2.5 Million for Alleged Consumer Deception: Firm Will Notify Consumers with "Time-Barred" Debt That it Will Not Sue to Collect (Jan. 30, 2012), *available at* http://www.ftc.gov/opa/2012/01/asset.shtm (last visited Oct. 10, 2013).

[13] Another concern is whether the debt collector is correctly measuring the statute of limitations from the date of non-payment to the original creditor. Because of the multiple sales that arise in the debt buying context, debt collectors may erroneously use the date of non-payment to a previous debt buyer as the date on which the statute of limitations began to run.

[14] *See* CPLR 202; *Portfolio Recovery Associates v. King*, 12 N.Y.3d 849 (2009).

[15] The current subsection (b) would become subsection (c).

- The 1.3(a) disclosure should make clear that the threat to sue and actual lawsuits on time-barred debt constitute violations of the FDCPA.

- Section 1.3(a) provides that, "[i]f the debt collector knows or has reason to know that the statute of limitations for a debt may be expired, before accepting payment on the defaulted debt," the debt collector must provide notice of that fact "in the same medium (e.g., via telephone, electronic communication) that the debt collector will accept payment." This phrase is vague, though this may be to a grammatical issue. It seems intended to require the debt collector to provide notice in the same medium "by which" the debt collector will accept payment. It should be corrected to make this meaning clear. Otherwise, it is susceptible to other meanings. We believe that such a disclosure alone would not provide effective notice, particularly with regard to telephonic and electronic communication. With telephonic communication alone, the chance of non-compliance in a historically troubled industry is significant; with electronic notification alone, the probability that consumers will not focus on and read the disclosure is also sufficiently significant to raise concerns about its efficacy. The proposed regulation is also problematic in that, unlike its New York City analog,[16] it does not require the disclosure to be made whenever payments is requested, but rather only before payment is accepted. Our recommendation that the § 1.3 disclosure be made in every communication with the consumer would ensure that the disclosure was also made with all written and other communications with the consumer, including the § 1.2 initial disclosures, § 1.4 written verification of debts, and § 1.5 written debt payment procedures.

- Section 1.3(a)(5) provides that "failure to pay a debt that the consumer owes, even if the statute of limitations has expired, may damage the consumer's credit history and credit score and may negatively affect the consumer's ability to obtain credit." We believe that this statement, without more, is misleading regarding the impact of a default to the consumer's creditworthiness. For example, many time-barred debts will be outside the seven-year period during which they are permissibly reported to a credit bureau pursuant to the Fair Credit Reporting Act.

In fact, on July 10, 2013, the Consumer Financial Protection Bureau released a bulletin on "Representations Regarding Effect of Debt Payments on Credit Reports and Scores."[17] In the bulletin, the CFPB noted that in the course of its supervisory examinations and enforcement investigations, it had observed a number of potentially misleading statements by debt collectors and debt buyers regarding the effect of debt payments on credit reports and credit scores. Among the potentially deceptive claims the CFPB observed being made were:

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[16] *See* 6 Rules of the City of New York § 2-191(14) (2013).

[17] CFPB Bulletin 2013-08, Representations Regarding Effect of Debt Payments on Credit Reports and Scores (July 10, 2013), *available at* http://files.consumerfinance.gov/f/201307_cfpb_bulletin_collections-consumer-credit.pdf (last visited Oct. 10, 2013).

- Payment on a debt that is already obsolete under the Fair Credit Reporting Act would lead to removal of negative information on a consumer's credit report, which in turn would improve a consumer's credit score or creditworthiness.
- Payment on non-obsolete debts will improve a consumer's credit score and creditworthiness, when in fact that debt collector or debt buyer does not furnish information to credit reporting agencies.

- Payment on a non-obsolete debt to a debt collector or debt buyer who does furnish information to credit reporting agencies will improve that consumer's credit score or creditworthiness. The CFPB noted that "in light of the numerous factors that influence an individual consumer's credit score, such payments may not improve the credit score of the consumer to whom the representation is made." The CFPB also noted that the same could be said about the effect of a payment on a consumer's creditworthiness to any particular lender.

Payments on debts that have already been charged off by the original creditor have little, if any, effect on a consumer's ability to obtain credit. In reality, it is the obsolescence of the defaulted debt that has the greatest impact on the consumer's creditworthiness.

We recommend that DFS follow the lead of the Consumer Financial Protection Bureau and remove any mention of the effect that a debt payment will have on that consumer's credit. At the very least, we recommend that DFS include in the disclosure the fact that the length of time negative information can remain on credit reports is time-limited.

c. <u>Comments With Regard to Verification of Debts</u>

Section 1.4 provides that "[i]f a consumer disputes the validity of a defaulted debt or requests verification of a defaulted debt orally or in writing, a debt collector must provide the consumer written verification of the defaulted debt within 30 days of the dispute or request." We recommend that the Proposed Rule be amended to make explicit that the consumer can dispute the validity of a defaulted debt orally or in writing.

d. <u>Comments With Regard to Debt Payment Procedures</u>

Section 1.5 sets out needed protections for consumers in connection with debt payment procedures. Consumers are routinely subject to abusive and deceptive practices in connection with debt payment procedures, making this provision especially important. We recommend that § 1.5(a) explicitly require the debt collector to furnish with a "clear and conspicuous written document" detailing the agreement within five days after reaching the agreement and prior to accepting any payment. A settlement agreement drafted by a debt collector is likely to be one-sided with terms more favorable to the collector than the consumer. Consumers will generally not perceive that they are empowered to negotiate the terms of the agreement. This is particularly true of the least sophisticated consumers. The rule should be revised to prohibit certain terms from the settlement agreement, including but not limited to: a consumer's waiver of defenses and claims against the creditor or the debt collector, liquidated damages, penalty

provisions, attorney's fees for the collector in event of the consumer's default, continuing accrual of interest, and a confession or any admission of liability by the consumer. The rule should require that the settlement agreement include a "right to cure" with a notice and a grace period if a consumer is late with a payment. Consumers who are the subject of debt collection efforts are usually in financial distress with late payments very possible.

Ideally, DFS should publish a model agreement for debt collectors to use pursuant to this rule. The model agreement could serve as a safe harbor for debt collectors that are subject to this regulation. Further, we recommend that § 1.5(b) be amended to provide explicitly for a written accounting of the debt on at least a quarterly basis and upon written request. Finally, we believe that consumers may find the notice language regarding income exempt from collection set out in § 1.5(b)(2) to be confusing and complicated.

e. Comments With Regard to Communication Through Electronic Mail

We have a concern regarding § 1.6, which enables consumers to elect to communicate with the debt collector through electronic mail. Given the nature and extent of abusive and deceptive debt collection practices which the Proposed Rule seeks to address, we recommend that the key disclosures and notices set out in the Proposed Rule also be provided by the debt collector to the consumer in its initial electronic mail communication with the consumer. We also recommend that every electronic mail communication sent by the debt collector should include an opt-out mechanism for the consumer to cease further electronic mail communication. The opt-out mechanism should be clear and conspicuous. The Proposed Rule should also emphasize that if a debt collector reveals the existence of a debt with a third party through electronic mail as with any other means, the debt collector is liable for violating the FDCPA.[18]

3. CONCLUSION

In conclusion, the City Bar commends DFS for exercising its rulemaking authority to clarify the duties and obligations of debt collectors. Enhanced oversight and enforcement of the debt collection industry will help protect all New Yorkers but especially those most vulnerable to abusive, deceptive, and misleading practices.

October 2013

[18] Under the FDCPA any communication with third parties cannot be made "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 post-judgment judicial remedy, a debt collector may not communicate, in connection with the collection of any debt, with any person other than a 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." 15 U.S.C. 1692c.