

THEY DEAL IN BILLIONS

A BBB Study of the Debt Collection
Industry, Its Soaring Growth and
Problems for Consumers



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INTRODUCTION

As complaints against collection agencies soar against the background of a burgeoning debt collection industry in which individual companies deal in billions of dollars of old debts, the Federal Trade Commission (FTC) in a 2010 report labeled the collection process “a broken system.”

“There is a massive industry buying and selling large portfolios of debt for pennies on the dollar, and a court system in which debt collectors are able to get court judgments without proof that they own the debt or even that the consumer owes any debt,” according to a joint report issued earlier this year by Consumers Union, publisher of Consumer Reports, and a consumer advocacy group.

The FTC reports that the debt collection industry was the most complained about industry with 130,036 complaints logged last year, a 17% increase over the prior year. Complaints to Better Business Bureaus (BBBs) around the country ranked debt collectors as the sixth most complained about industry in 2009, and as complaints mounted, the fifth in 2010. And the Missouri attorney general says debt collecting was the most complained about industry in his office last year. In trying to find a solution to the growing problem, the FTC has held workshops and roundtable discussions and in its latest move, has ordered nine of the largest debt collection companies in the country to provide detailed information on their operations.

To determine how consumers in its service area are faring in this turmoil, the BBB in St. Louis conducted this in-depth examination of the debt collection industry. While the study focuses on Missouri, the activities of national debt collection agencies that affect area consumers also are reviewed.

SOURCES

This study used the following sources and/or their Web sites: The BBB’s local and national databases; FTC reports and news releases; attorneys general offices in Missouri and other states; Case.net, the Missouri courts tracking system; Pacer, the tracking system for U.S. courts; collection agencies; consumer advocacy groups; mainstream news stories; BBB surveys of complainants, collection agencies, and businesses that use collection agencies; federal and state laws; Missouri Supreme Court; General Accountability Office (GAO); BBB news releases; industry trade associations; Library of Congress; Federal Deposit Insurance Corporation (FDIC); and Securities and Exchange Commission (SEC).

WHY MORE CONSUMERS ARE COMPLAINING

Angry consumers complain about many practices of debt collectors, the most frequent one being harassing telephone calls, according to the FTC. This is forbidden under the federal Fair Debt Collection Practices Act (FDCPA).

A St. Louis BBB survey of complainants produced the same results as more than two-thirds of respondents said they were called at least five times and a third saying they were called at least 20 times. Other violations of the FDCPA alleged by complaints filed with the BBB and FTC include calling about a non-existent or “phantom” debt; calling the wrong party; and threats to ruin the consumer’s credit, sue the individual, cause the consumer to lose his or her job or be sent to jail.

Respondents to the BBB survey wrote: “Threatened to file criminal charges of check fraud. They did contact friends and allege I would soon be arrested,” and “They threatened to try and take my disability away and keep ruining my credit for the rest of my life and keep me from ever becoming gainfully employed.”

According to per capita statistics provided by the FTC, consumers in the District of Columbia are most likely to complain about debt collection practices, followed by those in Oregon, Delaware, Florida and Arizona. Missouri ranked 21st on the list, and Illinois was 39th.

There are numerous theories for the sharp increase in complaints. One says that as more people lost their jobs they fell delinquent in paying their debts such as credit cards. Other reasons cited include higher levels of unsustainable debt, the millions of auto-dialed calls made by the industry, increased accessibility to complaint systems, and increased public education about filing complaints. The most probable reason may be the rapid growth of the debt buying and selling industry in the past decade, coupled with the increase in the nation’s consumer debt and aggressive tactics by debt collectors including lawsuits and garnishments.

In many cases, according to complainants and statistics, all or parts of this scenario occur. ABC Company, a debt buyer-collector, buys a portfolio of hundreds of credit card debts charged off by First XYZ Bank, among them a debt of Ms. Jean Consumer. The ABC Company tries to persuade Ms. Consumer to make payments on the debt, sometimes

with harassing telephone calls or threats. If unsuccessful, ABC Company files a lawsuit, often with scanty information regarding the debt. When Ms. Consumer fails to appear in court for any of a variety of reasons, a default judgment is entered. ABC Company then garnishes Ms. Consumer’s wages.

A PROFITABLE INDUSTRY THAT DEALS IN BILLIONS

The history of the debt buying and selling industry is traced to the 1980s and the savings and loan crisis. Then, the government liquidator of failed savings and loan institutions

auctioned off to the private sector for collection over \$450 billion in failed savings and loan assets. Seeing a new market niche, debt buyers thereafter began to purchase other kinds of debt as well, primarily credit cards that were charged off. Regulations require banks to charge off credit card type debts 180 days after delinquency. In 1995, debt buyers purchased debts with a face

value of \$12 billion. By 2008, that figure skyrocketed to an estimated \$215 billion, according to a 2010 joint report by four consumer advocacy groups. The FTC estimates that the nine largest companies buy 75 percent of the nation’s consumer debts that are sold.

Sometimes a broker may buy charged-off debt portfolios from a creditor and then resell them to debt buyer-collectors. In the past decade, a leading broker says that it had sold \$100 billion in charged-off debts, and through its Web site it has hosted an electronic auction platform.

During the first quarter of 2011, prices paid by debt buyer-collectors ranged from three to seven cents per face value dollar, according to an industry source. The prices fluctuate depending on a number of factors. The highest prices are for “fresh” debt, or debt purchased directly from the creditor. In a daisy chain, a buyer-collector may sell debts remaining in a portfolio, on which it has been unable to collect, to another

**Prices Range
From Three to Seven
Cents Per Face
Value Dollar**

buyer-collector at a lower price, and that buyer-collector to another with the pricing tier consisting of fresh, secondary, tertiary and finally quads, which may sell for less than a penny on the dollar.

Filings with the SEC this year of two publicly traded companies show that the debt collection industry is a profitable one and profitability is soaring. Combined, the two reported net income of \$123 million in 2010, an average increase of 58% over the prior year. During the year, they reported buying distressed debts with a face value of \$17.7 billion for about four cents on the face value dollar.

The FTC, law enforcement agencies and consumer advocacy groups have raised several concerns regarding practices in the debt collection industry. They include:

- **Inaccurate or Insufficient Information**

Often portfolios with insufficient or inaccurate information are purchased by debt buyer-collectors. The information may be simply an electronic spreadsheet with minimal information regarding the debt. As portfolios are passed down the line to other collectors with the scanty information, the debtor often may have no idea why the unknown company is trying to collect on a debt.

In 2010, one of the nation's largest debt collectors paid \$1.75 million to settle FTC charges that the company allegedly made repeated telephone calls to collect from the wrong person, to collect the wrong amount, or both. "Debt collectors had better make sure their information is accurate, or they could end up paying a big penalty," an FTC spokesman said. The BBB survey of complainants found that more than half of the respondents said they were contacted regarding a debt they did not believe they owed, sometimes referred to as "phantom debts."

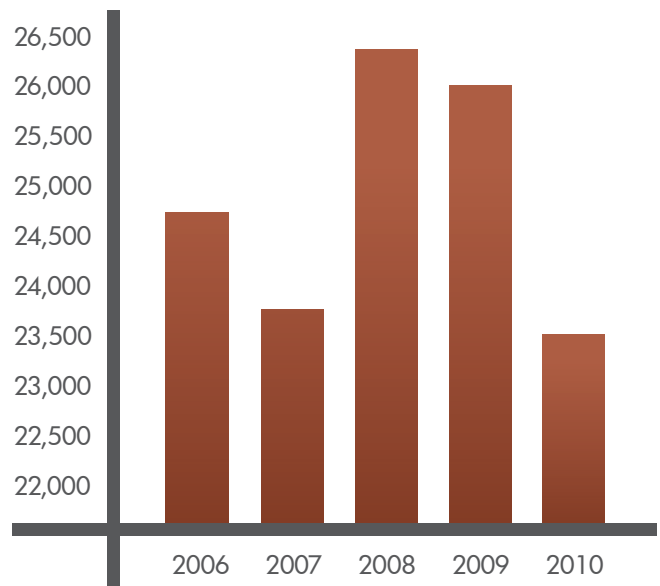
- **Overloaded Court Dockets**

"The vast number of debt collection suits filed in recent years has posed considerable challenges to the smooth and efficient operation of courts. The majority of cases on many state court dockets on a given day often are debt

collection matters," the FTC noted in a 2009 report. A BBB sampling of cases in St. Louis City and County courts, excluding domestic relations, juvenile and criminal cases, determined that 14.9% of the remaining cases in the county and 13.9% in the city involved debt collections.

But the courts in Missouri do not appear to be overburdened with debt collection suits, or at least they are keeping up with the increased work and even getting ahead. Statistics from the Missouri Supreme Court show that year-end pending cases in the state's circuit and associate courts, where debt collection cases would be filed, rose from about 78,000 in 2000 to about 108,000 in 2008, but then dropped to about 101,000 in 2009 and about 97,000 in 2010. As above, these figures do not include domestic relations, juvenile or criminal cases. Figures regarding St. Louis City and County courts parallel the statewide trend, with City cases peaking at 12,470 in 2004 and dropping to 8,539 in 2010. County pending cases grew from 13,085 in 2000 to 22,584 in 2008 and then dropped to 18,199 in 2010.

Pending Cases in St. Louis and St. Louis County Circuit & Associate Courts



(The figures do not include domestic relations, criminal or juvenile cases.)
Source: Missouri Supreme Court

- **Default Judgments**

In a high percentage of debt collection suits, a default judgment is entered against the debtor, which often paves the way for garnishment of the debtor's wages or attaching bank accounts. "Very few consumers defend or otherwise participate in debt collection litigation resulting in courts entering default judgment against them," the FTC notes. The explanations vary as to why debtors don't appear in court and consequently incur default judgments, depending on who is giving the reasons. "In general, industry representatives asserted that most debtors who default do so because they owe the debt and therefore recognize that disputing it would be futile. Consumer advocates, on the other hand, generally attribute the low participation rate to debtors not receiving notice of the action or to procedural hurdles that make it difficult and expensive for debtors to defend," the FTC noted.

some jurisdictions regarding "sewer service," i.e., a person charged with serving a summons on a debtor simply discards the summons and reports that it was served.

The debtor then has no knowledge of the suit, fails to appear and a default judgment is entered.

The BBB examined 900 suits filed during 2008, 2009 and 2010 in Missouri against consumers by three of the nation's largest debt buyer-collectors.

Default judgments were entered in 46% of the cases.

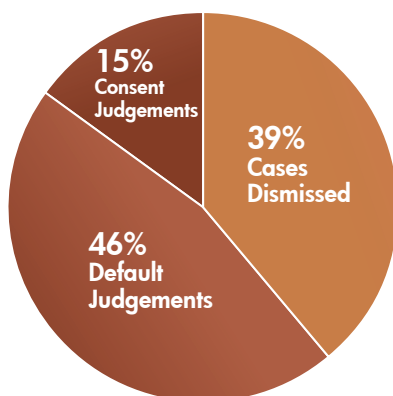
Default Judgements Are Entered In 46% Of Collection Cases

- **Bankruptcy and Time-Barred Debts**

Several debt buyer-collectors file as a creditor in bankruptcy cases, presumably seeking the full face value of a debt for which they paid pennies. Most of the filings were in Chapter 13 cases in which the consumer and the court work out a plan for the consumer to pay his or her debts. The federal Bankruptcy Code prohibits the collection of discharged bankruptcy debts.

Most states have laws prohibiting the collection of a debt that is a certain number of years old. The statute of limitations in Missouri on credit card type debts is five years. Debts older than that are said to be time-barred, and the statute of limitations may be used by the debtor as a defense in a collection suit. However, if a debt collector can persuade a debtor to make a token payment on a time-barred debt, the debt is revived and the collector can try to collect as if the debt were brand new. Suits against debtors regarding time-barred debts are a concern of federal agencies and consumer groups. "The Commission recommends that states change their laws to require collectors to prove that the debts they are collecting are not time-barred," the FTC said.

**Default Judgements in Missouri Courts
Of Three Large Debt Collectors 2008-2010**



(Figures are based on Case.net's listing of 900 closed cases filed by three of the largest collectors.)

The GAO states that consumer groups have complained that "debt collectors often file suits with weak evidence supporting the alleged debt, knowing that most likely the consumer will not appear in court and they will receive a default judgment." Allegations have been made in

COLLECTORS, CONSUMERS TAKE TO THE COURTS

During the past three years, three of the nation's largest debt collectors have filed suits or actions to collect debts from 18,382 consumers in St. Louis City and County Circuit and Associate Courts. In the past three years, they also have filed as a creditor in 221,757 Chapter 13 bankruptcy cases nationally, 6,478 of them in Missouri and 11,666 in Illinois.

During a class action suit against a debt collection company in U.S. District Court in Montana, it was discovered that the company had purchased thousands of debts from a bank which were backed with "robo-signed" affidavits attesting to the accuracy of the debts. The suit alleges that an employee of the bank "loaned the use of the name of her deceased mother to the operation and directed the others in the group to sign that name on thousands of the affidavits." The employee admitted that on some days she signed several hundred affidavits, the suit notes, in what the suit calls a "fictitious affidavit factory."



In the settlement reached in March 2010, the company agreed to pay 1,883 consumers amounts ranging from \$25 to \$200 depending on whether they were sued by the company or contested the suits.

In another class action suit filed against a debt collector in U.S. District Court in Ohio, the FTC and attorneys general in 38 states, including Missouri and Illinois, unsuccessfully raised strenuous objections to the proposed settlement prior to its approval earlier this year.

"In exchange for losing . . . significant substantive rights, class members receive only a small payment, capped at \$10. This bargain leaves class members in a significantly worse position than the status quo. By contrast, defendants, in essence, have insulated from attack over a million judgments entered nationwide, many of them defaults, thus protecting future collections on these judgments," the attorneys general said in their brief. The court responded that members of the class could still try to have judgments set aside "except where the sole reason for vacating the judgment is that an affidavit made without personal knowledge was used in the case." This would include affidavits that were robo-signed.

The settlement also awarded attorney fees of \$1.5 million.

In another class action suit against a collector, which was settled Feb. 17, 2010, it was alleged that the company threatened and obtained binding arbitration awards against Pennsylvania debtors in violation of the FDCPA. Forty-two debtors against whom the company obtained an arbitration award were awarded \$750 each and about 4,000 debtors who received the arbitration threat were awarded \$47. The company agreed to forgive about \$6 million in debts owed by the 4,000 consumers.

LAW ENFORCEMENT

The FDCPA prohibits numerous actions on the part of debt collectors. They include:

- harassing a debtor by calling repeatedly;
- using profane, obscene or other abusive language;
- calling before 8 a.m. or after 9 p.m.;
- threatening to use violence, garnish wages, cause job loss, have a debtor jailed if the debtor didn't pay or damage or ruin a consumer's credit rating unless the collector has the legal authority and intent to do so;
- revealing the debt to co-workers, family or friends, but may call to obtain debtor's location;
- contacting a person at his or her place of employment if the collector knows or has reason to know that the

employer prohibits such contact;

- contacting a debtor after receiving a written “cease and desist” order from the debtor.

Most states, including Illinois, have enacted their own FDCPA, often mirroring the federal statute.

Missouri is not among them and that fact has hindered law enforcement authorities from taking action against debt collectors. Attorney General Chris Koster sued two collection companies alleging violations of the state’s Merchandising Practices Act. But he was rebuffed by circuit and appellate courts which held that the act could not be used to prosecute debt collectors as there was no sale or advertising of goods involved. Koster’s appeal of the rulings was turned down by the Missouri Supreme Court.

Attorneys general in at least two states—Texas and Minnesota—have filed civil suits against debt collectors. Their cases are pending. The suits note that three collector employees testified that they signed 300 to 400 form affidavits per day without knowledge of the debt to which the affidavit attested. For years, it states, the collector has “deceived the Texas courts and undermined the fairness of the justice system on a massive scale.” The Minnesota suit notes that the collector “pursued many individual citizens out of court for payment of bills they do not owe or that they already paid. This occurs in part because the debt they purchase is so old and because electronic files they acquire from credit card, telecommunications, and other companies lack substantiation and contain errors.”

The FTC says it is continuing a “crackdown on scams that target consumers in financial distress.” A recent action involves a complaint filed Sept. 12, 2011, against a Van Nuys, Calif., operation that used several names. According to the complaint the company attempted to collect from a consumer who was unable to pay the balance due for her daughter’s funeral. During the calls, the company told her they were going to dig her daughter up and hang her from

a tree, if she did not pay the debt. At the FTC’s request, a U.S. District Court issued a preliminary injunction against the defendants and froze the company’s assets. The FTC recognized two BBBs in California for their help in the case. The FTC allegedly also is looking into reports that some

Minnesota courts are issuing warrants against debtors who do not show up in court and are placing them in jail for brief periods.

Agreements reached in March 2011 and October 2010 by the FTC with large debt collectors include two settlements, one for \$2.8 million and the other for \$1.75 million. But the FTC admits that “because the Commission receives more

than 70,000 third-party debt collection complaints per year, it is not feasible for federal government law enforcement to be the exclusive or primary means of deterring all possible law violations.” The FTC also notes that in enacting the FDCPA, “Congress made clear that the FDCPA was intended to be a ‘primarily self-enforcing’ statute, with private individual and class actions providing collectors with a powerful incentive to comply with the statute.” For individuals who sue a debt collector, the FDCPA provides statutory damages up to \$1,000 along with any compensatory damages and attorney fees.

Consumer groups point out that the \$1,000 allowed in 1977 when the FDCPA was enacted would be \$3,600 in 2008 dollars, and the \$500,000 allowed in class action suits would be \$1.8 million.

A bill is pending in Congress related to debt collection. House Bill 2361 would make it more difficult to collect time-barred debts and would require debt collectors to disclose to the debtor that the collector can’t take legal action against the consumer to collect the debt because it is time-barred and any payment may reset the statute of limitations. The bill has been referred to committee.

Missouri Is One Of Only A Few States Without Its Own FDCPA

FIGHTING BACK

Consumers are beginning to fight back and not only by filing complaints. In addition to the several class action suits in state and federal courts, individual consumers have filed suits against debt collectors in U.S. District Courts despite the low ceiling on the amount of statutory damages available. While the raw numbers may be small, and even minimal compared with the volume of business in the debt buying and collecting industry, nonetheless they are rapidly increasing.

A review of eight of the largest debt collectors reveals that in the past five years including 2011, consumers have filed about 4,200 suits alleging violations of the FDCPA. More telling is the fact that the number of suits jumped from about 370 in 2007 to approximately 1,300 in the first three quarters of 2011, an increase of about 255%. And in less than a year, from 2010 to the first three quarters of 2011, suits filed by individual consumers against debt collectors increased 47%.

THEY USE COLLECTION AGENCIES

The BBB also surveyed selected businesses to determine their experiences with debt collectors. There was a response rate of 10.1%. Of 389 respondents, 15% said they engage the services of agencies to collect delinquent accounts, but none said they sold their accounts outright to collectors. About 80% indicated they were satisfied with the services, but the remaining fifth were rather sharp in their criticisms. Said one, "They keep the money or they lie about it. I had three different companies, and only received about \$200 out of maybe \$10,000." More significant perhaps is the fact that only a third of those who hire collection agencies monitor their activities. However, those that do have devised creative monitoring systems. One company said, "We put in fake collections that go to one of our employees." Another noted that it has levels of collection that start "with a series of letters and then moves to the personal contact phase if we say so."

CONCLUSIONS

The BBB believes that consumers should pay their rightful debts and that creditors have a right to take action to collect those debts. But it's equally as important that those trying to collect debts abide by laws and ethical practices. As this study has documented, this hasn't always been the case. The meteoric growth of the debt buying and selling industry shares a portion of the blame for the soaring increase in complaints and the plethora of calls for reform by government agencies and consumer advocacy groups. Other reasons for skyrocketing complaint numbers may be the downturn in the economy, an extension of unsustainable credit and the ever increasing indebtedness of the

American public. In Missouri, law enforcement attempts are hamstrung by the lack of a state FDCPA which the vast majority of states have. And the FTC doesn't have enough staff to fully enforce the FDCPA. Missouri also lacks limits on when a time-barred debt can be revived, and requirements that a petition in a debt collection suit contain adequate information regarding the debt. There appears to be a lack of sufficient monitoring of debt collectors by the businesses that hire them. Improper activities of a debt collector will reflect on the company that hired the agency.

(See Recommendations on page 8.)

**Suits Filed By
Consumers Have
Increased By 255%**

RECOMMENDATIONS

The BBB recommends:

- That consumers work with their creditors if facing the inability to make payments on a debt.
 - That consumers check with reputable non-profit organizations for counseling regarding any indebtedness beyond their means.
 - That consumers respond to a court summons regarding a debt, even if it's a debt not owed. Doing so will eliminate problems that would arise later.
 - That consumers file complaints with the BBB and FTC regarding improper or illegal activity on the part of a debt collector.
 - That the Missouri Legislature join the vast majority of states in enacting its own Fair Debt Collection Practices Act modeled after the federal act. Such action would allow law enforcement officials to sue debt collectors for alleged violations.
 - That the Missouri Legislature, Supreme Court and/or the state's circuit courts enact legislation or adopt rules to prevent default judgments being entered based on insufficient or false information. As recommended by the FTC, such legislation or rules should require that a petition include at minimum (1) the name of the original creditor and the last four digits of the original account number; (2) the date of default or charge-off and the amount due at that time; (3) the name of the current owner of the debt; (4) the total amount currently owed on the debt; (5) the total amount owed broken down by principal, interest, and fees; and (6) the relevant terms of the underlying credit contract
- That the Missouri Legislature enact a full disclosure law requiring debt collectors trying to collect on a time-barred debt to tell consumers that the debt is time-barred and any payment may reset the statute of limitations.
 - That Congress consider the many changes urged by the FTC, GAO and consumer advocacy groups to amend the 33-year-old FDCPA.
 - That businesses closely monitor the activities of agencies they hire to collect on delinquent accounts.
 - That debt collector trade associations monitor the activities of their members more closely, including imposing penalties for proven violations of laws

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