

# BUSINESS LAW TODAY

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## Do You Think Banks Are Debt Collectors? The CFPB and the FTC Do

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The views expressed herein are the authors' and do not necessarily reflect the views of their respective law firms or trade association.



On November 6, 2013, the Consumer Financial Protection Bureau (CFPB or Bureau) issued an Advance Notice of Proposed Rulemaking (ANPR) for debt collection. With over 150 itemized questions about first- and third-party collection issues, the CFPB signaled that it would conduct a rulemaking aimed at regulating not just third-party debt collectors, but also banks and other creditors. Such an expansive undertaking would require the CFPB to rely on its rulemaking authority under the Fair Debt Collection Practices Act (FDCPA) for debt collectors as well as its rulemaking authority to prevent unfair, deceptive, or abusive acts or practices (UDAAP) under Title X of the Dodd-Frank Wall Street Reform and

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## THE LAST LAUGH



## BLS TRIVIA QUESTION

Question: Prior to 1990, only

Consumer Protection Act of 2010 (Dodd-Frank Act) for consumer creditors. After a number of delays, on July 28, 2016, the CFPB released its outline of proposals under consideration (Proposals) aimed at “debt collectors” subject to the FDCPA. At that time, the Bureau announced that it would release the other proposals affecting creditors and first-party collectors “in the next several months,” raising concerns that it would bifurcate the rulemaking.

Banks and other creditors, however, may still fall within the ambit of these July 28 Proposals because of the growing circuit split over whether a bank collecting on a debt acquired in default is a “debt collector” for purposes of the FDCPA. In today’s marketplace, where banks and other lenders purchase loan portfolios that often include some percentage of nonperforming or defaulted accounts, these institutions face growing uncertainty as to whether they are subject to the FDCPA’s statutory obligations with respect to defaulted debt that they purchase. Such uncertainty must be resolved well before the Bureau issues FDCPA regulations.

### **The FDCPA Sets Forth Seemingly Clear Definitions**

According to legislative history, Congress did not intend for the FDCPA to apply to creditors such as banks and other consumer lenders. Unlike debt collectors, these institutions have a “desire to protect their good will when collecting past due accounts,” which acts as an intrinsic restraint against abusive behavior. S. Rep. No. 95-382, at 2 (1977), *reprinted in* 1977 U.S.C.C.A.N. 1695, 1696. As a result, the FDCPA applies to only “debt collectors,” who Congress found “are likely to have no future contact with the consumer and often are unconcerned with the consumer’s opinion of them.” Thus, when passing the FDCPA in 1977, Congress was explicit that the Act is meant to target debt collectors, announcing that the statute has three purposes: (1) “to eliminate abusive debt collection practices by debt collectors”; (2) “to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged”; and (3) “to promote consistent State action to protect consumer against debt collection abuses.”

Although Congress clearly intended for the FDCPA to apply only to the collection activities of debt collectors and not creditors, several circuit courts have found that traditional consumer creditors, such as banks, are subject to the FDCPA.

#### Are You a Debt Collector?

The definition of “debt collector” under the FDCPA is two-pronged: the first prong explains who is a debt collector, whereas the second prong provides who is not a debt collector.

two states in the United States had enacted legislation allowing for the formation of limited liability companies. Can you name those two states?

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### **IN THE NEXT ISSUE**

The mini-theme of next month’s *Business Law Today* will be Business and Corporate Litigation, covering such topics as conducting business with tribes in the aftermath of the Dollar General Supreme Court split; the Defend Trade Secrets Act; authenticating digital evidence at trial, and more. Other features will include taxes on legal settlements, offer and sales of securities and exemptions, and highlights from the Section’s Spring Meeting in New Orleans.

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1. You are a debt collector if you are:
  - any person whose *principal purpose* is to collect debt (principal purpose test);
  - any person who *regularly* collects debts *owed to another* (regularly collects test); or
  - any person who collects *its own debts*, using *a name other than its own* (false name test).
2. You are *not* a debt collector if, among other exceptions, you are “collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity concerns a debt which was *not in default* at the time it was obtained by such a person.”

## Are You a Creditor?

Similarly, the FDCPA’s definition of “creditor” is two-pronged, with the first prong explaining who is a creditor and the second setting forth who is not.

1. You are a creditor if you are:
  - any person who “offers or extends credit creating a debt”; or
  - any person “to whom a debt is owed.”
2. You are not a creditor if you “receive[] an assignment or transfer of a debt *in default* solely for the purpose of facilitating collection of such debt for another.”

## **A Circuit Split Nevertheless Arose**

Congress stated that the FDCPA was primarily “intended . . . to cover[] independent debt collectors” because, unlike creditors, they lack an intrinsic restraint against abusive behavior. Although Congress understood this to encompass “third persons who regularly collect debts for others,” a debt buyer that purchases defaulted debt and collects on it for its own account clearly meets the FDCPA’s definition of “debt collector” because the debt buyer:

- meets the principal purpose test as its business is to collect debt; and
- is not excluded from the debt collector definition because it purchased the debt when it was in default.

Yet, the same debt buyer *also* meets the FDCPA’s definition of “creditor” with respect to such debt because the debt buyer is:

- a person “to whom a debt is owed;” and
- not excluded from the creditor definition because the purchased debt was not “transfer[red] . . . solely for the purpose of facilitating collection of such debt for *another*.”

The FDCPA did not address those instances in which an entity meets both definitions, and only debt collectors have FDCPA obligations. Yet, courts did not want debt buyers to escape the purview of the FDCPA. As a result, two different approaches arose, and banks purchasing loan portfolios that include nonperforming or defaulted accounts have found themselves caught in the middle.

## The “Mutually Exclusive” Approach and the Importance of When Debt Went into Default

The Third, Sixth, and Seventh Circuits have adopted a “mutually

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exclusive" view. Under this approach, an entity that acquires a debt and subsequently seeks to collect on it must be either a "creditor" or "debt collector" under the FDCPA with respect to that debt, as those terms are mutually exclusive. In these circuits, an entity is a creditor and exempt from the FDCPA's requirements if it originated the subject debt or if it purchased the subject debt when such debt was not in default. On the other hand, the entity is a debt collector if it purchased a debt that is in default at the time of the transfer. Thus, under the mutually exclusive approach, an entity that fails to meet either the principal-purpose test or the regularly collects test may nevertheless be considered a debt collector for FDCPA purposes if it obtains a debt that it is in default at the time of assignment and subsequently attempts to collect upon that debt.

The Seventh Circuit best explained the justification for the mutually exclusive approach in *Schlosser v. Fairbanks Capital Corporation*, 323 F.3d 534, 536 (7th Cir. 2003), where the court found that a company that "acquire[s] [performing] debt [and] continues to service it . . . is acting much like the original creditor," whereas a company that acquires defaulted debt must have "acquire[d] the debt for collection [and] is acting more like a debt collector." To justify this approach, some courts look to the exception in the FDCPA's definition of "creditor" and find that any person who receives assignment of an account in default is doing so "solely for the purpose of facilitating such debt for another." Even if the entity owns the debt and is thus the person to whom the debt is owed, these courts find that the exception takes them out of the definition of "creditor" because the debt was originally owed to another. See *McKinney v. Cadleway Properties, Inc.*, 548 F.3d 496 (7th Cir. 2008) (finding that the definition of creditor excludes those who acquire and attempt to collect a debt in default).

### The Other Approach

On the other side of the divide, the Fourth, Ninth, and Eleventh Circuits have found that that the terms "creditor" and "debt collector" are *not* mutually exclusive. Under this approach, a person must meet either the "principal purpose," "regularly collects," or "false name" tests in order to be considered a debt collector for FDCPA purposes. Accordingly, a company with a principal business purpose of extending credit, such as a bank, that acquires defaulted debt in the ordinary course of business and seeks to collect upon such debt is not classified as a debt collector because it does not meet any of the three tests set forth under the definition. However, a company whose principal business is acquiring defaulted debt for collection purposes, such

as a debt buyer, can be classified as both a debt collector and a creditor. By virtue of meeting the FDCPA's definition of "debt collector," such a company is subject to the FDCPA's restrictions on collection activity. Thus, unlike the mutually exclusive approach, this view recognizes that not every person acquiring debt in default "acquires the debt for collection."

In *Henson v. Santander Consumer USA*, 817 F.3d 131, 138 (4th Cir. 2016), the Fourth Circuit explicitly rejected the view that a company that acquires a debt in default must be a debt collector for FDCPA purposes, explaining that such a view "turns the statutory provision upside down [by] failing to recognize that [section 803(6) of] the FDCPA defines debt collector by reference to those who are included in the various classes and then excludes, among others, the subset of persons who obtain non-defaulted debt to collect on it for others." Likewise, in *Davidson v. Capital One Bank (USA), N.A.*, 797 F.3d 1309, 1315 (11th Cir. 2015), the Eleventh Circuit found that section 803(6)(F)(iii) of the FDCPA should not be interpreted "to bring entities that do not otherwise meet the definition of 'debt collector' within the ambit of the FDCPA solely because the debt on which they seek to collect was in default at the time they acquired it. Section [803(6)(F)(iii)] is an exclusion; it is not a trap door."

A similar conclusion was reached by the Ninth Circuit in *Schlegel v. Wells Fargo Bank, N.A.*, 720 F.3d 1204, 1208 (9th Cir. 2013), which held that a company that acquires and subsequently seeks to collect upon debt in its own name *must* meet either the principal purpose or regularly collects test in order to be considered a "debt collector" subject to the FDCPA. In reaching its conclusion, the Ninth Circuit explicitly rejected the mutually exclusive view, concluding that it "fails to differentiate between debts 'owed to another' and debts originally owed to another but now owed to [the acquirer]." 720 F.3d at 1210.

### **Federal Enforcement Agencies Adopt the Mutually Exclusive Approach**

Both the CFPB and the Federal Trade Commission (FTC) have enforcement authority under the FDCPA, and both appear to be consistent in their approach.

#### The CFPB

In July 2015, the CFPB reached a negotiated consent order with Discover Bank and its affiliates (collectively, Discover) in which Discover neither admitted nor denied the CFPB's allegations that it violated the FDCPA, among other things. The purported wrongful conduct stemmed from Discover's acquisition of Citibank's student loan business line. Specifically, Discover expanded its own student

loan business by acquiring more than 800,000 student loan accounts from Citibank. In alleging that Discover violated the FDCPA when it failed to provide a validation notice required under FDCPA section 809 prior to initiating collection communications by phone with respect to 252 student loans that were in default when Discover acquired them from Citibank, the CFPB implicitly adopted the mutually exclusive approach. The consent order does not set forth the CFPB's rationale, instead providing only that Discover is a debt collector with respect to the loans that were in default when acquired from Citibank. *Discover Bank, et al., 2015-CFPB-0016 ¶ 46 (July 22, 2015)*.

Given the CFPB's conclusion, it appears that the agency has taken the view that a financial institution may be a debt collector even when it does not meet the principal purpose test, the regularly collects test, or the false name test.

### The FTC

In its amicus brief urging the Eleventh Circuit to review *en banc* the panel's decision in *Davidson v. Capital One Bank*, the FTC was much more transparent. It argued that the bank was a debt collector subject to the FDCPA with respect to the credit-card accounts that were in default at the time they were acquired from HSBC. The FTC argued that, "[a] company that regularly buys debts owed to others and collects them is a "debt collector" under the FDCPA for debts that were in default at the time it acquired those debts, even though, in acquiring them outright, the company was collecting them on its own behalf rather than "for" another entity with a continuing ownership interest in them." Brief for FTC as Amici Curiae Supporting Appellant, *Davidson v. Capital One Bank (USA)*, No. 14-14200-AA, 2015 U.S. App. LEXIS 19943 (11th Cir. 2015), at 9.

### **Conclusion**

When Congress enacted the FDCPA in 1977, it did not confer rulemaking authority on the FTC, the agency then tasked with enforcing and advising on the Act. Consequently, the FDCPA's scope has evolved largely as a result of case law. The growing circuit split demonstrates that the Act's reach with respect to institutions that are primarily engaged in extending consumer credit, such as banks, is still very much subject to debate. Thus, questions regarding the scope of the FDCPA, illustrated by recent cases such as *Henson v. Santander* and *Davidson v. Capital One*, are arising at the same time that the debt collection regulatory landscape—for both first- and third-party collection issues - is undergoing a seismic shift as the CFPB seeks to regulate debt collection activities.

