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New US consumer debt collection regulations are a boon for larger players

Blog post by Global Counsel USA President, Erin Caddell, 5 January 2021

Unnoticed by most amidst the tragedies and dramas of 2020, US regulators last month completed a years-long effort to update the rules surrounding the unglamorous but important function of collecting delinquent consumer debt. Effective November 2021, the new rules are a positive for larger US-based debt-collection firms, which buy or service non-performing loan portfolios for banks and other creditors, and are well-placed to handle the increased compliance burden necessitated by the policy changes. Helped by a more certain regulatory environment, debt collectors could also play a bigger role should the US economy weaken considering the large recent increases in consumer debt driven by ultra-low interest rates.

Congress passed the Fair Debt Collection Practices Act (FDCPA) in 1977 to attempt to eliminate abusive practices by debt collectors and to promote consistent practices among US states. The FDCPA did not envision a world of e-mail, text messages or even voice mail, nor did it foresee an industry with more than 7,800 participants and some $12 bn in revenue, as exists today. Created by the Dodd-Frank Act in 2010, the Consumer Financial Protection Bureau (CFPB) began jointly enforcing the FDCPA along with the Federal Trade Commission (FTC). The CFPB in 2013 started a process to update the FDCPA to incorporate new technology as well as other changes in the debt-collection industry, but was unable to complete its efforts before the end of the Obama administration.

While the Trump administration reversed Obama-era policies in many areas, the CFPB moved forward with the debt-collection rulemaking process, in part due to urging by the industry itself. The debt-collection rule was proposed in 2019 and finalised in October and December of 2020. Though president-elect Joe Biden is likely to look to tighten regulation in several areas of financial services, a Biden-appointed CFPB director is unlikely to overturn the debt-collection rule given that the effort spanned administrations from both parties and enjoys the support of most stakeholders.

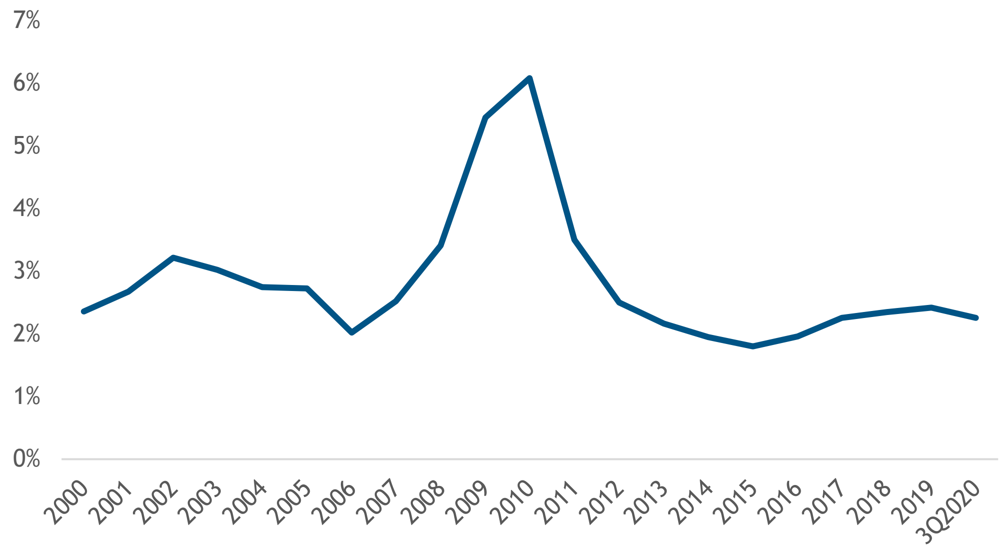
The final rule reflects a balance of the competing interests of consumer advocates and industry. The rule specifies that a debt collector may not place more than seven telephone calls to a debtor in a seven-day period (and not before 8 am or after 9 pm in the consumer's time zone), or for seven days after engaging in a conversation with the consumer. The rule permits use of e-mail and text messages, but the debt collector must provide the consumer with a simple method for opting out of such communications. The rule also permits debt collectors to leave voice mail messages that do not discuss the debt, but merely ask the consumer to call the debt collector back, with the voice mails not counting against the call thresholds.

The industry has generally welcomed the new rules, and given the long timeframe of their development, has been preparing to comply for years. Ashish Masih, CEO of Encore Capital (ticker: ECPG), one of two large, publicly traded US-based debt collectors, said in November: "The CFPB's new industry rules… provide much-needed clarity and create uniformity in the fair treatment of US consumers in debt collection… we are well prepared to fully implement them with no significant incremental operational changes."

The public markets greeted the new regulations with a shrug. Encore shares, with an equity market cap of $1.2 bn, traded in a tight range throughout 2020 and as of January 4th were trading at 4.1x consensus 2021 EPS estimates. At a market cap of $1.8 bn, peer firm PRA Group (PRAA) ended the year trading at a 12.1x 2021 consensus EPS, and with a similarly range-bound stock. Debt collection is a business that will always operate under a spotlight. And both publicly traded companies have run afoul of regulators in the past: in separate but coincident settlements with the CFPB in 2013, Encore agreed to pay $52m in fines and refunds to consumers, while PRA agreed to pay $27m in response to claims that both companies improperly pressured customers in attempting to collect debts and purchased debt from third parties without adequately verifying their accuracy.

We appreciate investors' caution. That said, we have seen companies in other heavily scrutinised sectors, from for-profit education to non-bank mortgage servicing, learn from brushes with regulators to improve their business practices in ways that have won favour from their customers and supervisors. A tighter regulatory environment also drives out smaller players unable to meet the more stringent compliance requirements, benefiting those that remain. The US debt-collection market is fragmented, with the top four players (including Encore and PRA) representing an estimated 31% of revenue in 2019, according to IBIS.

Net Charge-Off Rate - Loans to Individuals (US)



Source: Federal Deposit Insurance Corp. (FDIC)

The more stable policy firmament would be an advantage for debt-collection firms if the long period of low US consumer loan delinquencies reverses even modestly. Following the 2008 recession, earnings per share from continuing operations more than doubled for both Encore and PRA from 2009 to 2012, and shares of the firms rose several-fold from their lows in early 2009. Despite rising US unemployment and the massive economic disruption caused by the covid-19 pandemic, consumer loan delinquency and charge-off rates generally *fell* in 2020 as many individuals used the government stimulus checks and increased unemployment benefits to pay down debt, while others reined in spending. But this trend may well prove temporary if policymakers – or the global capital markets – rein in the monetary and fiscal stimulus that rules the day.

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Debt collectors will never be popular. But they are willing to step in during periods of rising credit stress to buy or service troubled consumer loan portfolios from banks who find they have bigger problems to tackle, and work with consumers to clear their debts and improve their credit score. Following the CFPB rule, debt collectors face an improved environment even if the economy does well and will prove even more vital if the US economy – and the consumer – come under further pressure.