CRL Review: "Debt Collection Agencies and the Supply of Consumer Credit"

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In *Debt Collection Agencies and the Supply of Consumer Credit*, Viktar Fedaseyeu examines state-level data to assess the effect of state laws limiting third-party debt collectors on the availability of revolving lines of credit (i.e., credit cards).[1] **The debt-buying industry claims that this paper demonstrates that consumers are harmed by these laws and thus regulations should be rolled back, or otherwise curtailed. However, the model used in this analysis does not support the conclusion that consumers are harmed.** Our review below details the limitations of the approach this study employs for drawing conclusions about the impact of debt collection laws on the ability of consumers to obtain credit.

Limitations of the Research Methodology

This paper finds that the presence of state debt-collection laws results in reduced numbers of third-party debt collectors operating in a state, lower recovery rates on credit card loans, and less credit card availability. To evaluate this impact, Fedaseyeu created an index of changes in state debt-collection laws. This index uses six variables, each of which are weighted equally (with a value of one): (1) the existence of a board or commission to regulate third-party debt collectors, (2) licensing requirements, (3) bonding requirements, (4) declaring certain practices unlawful, (5) allowing a private right of action, and (6) making violations a criminal offense. Since law changes are additive, this index construction would result in one state appearing to have greater consumer protections (or, put another way, greater restrictions on debt collection) if they have two of the weaker provisions as compared to another state which may have just a single, but incredibly strong, consumer protection.

For example, state A might have a regulatory board, licensing requirements, and bonding requirements; while state B might have a regulatory board and licensing requirements, but instead of bonding requirements, make violations a criminal offense. Both would be considered "3" on the scale, but state B would actually have more consumer protections. The index is also not useful to examine changes within a state. For example, if state C took away a bonding requirement but added a private right of action, its index number would not change when in fact the change would add substantial consumer protections overall.

The index is also inaccurate because Fedaseyeu notes that many of the changes in state laws he observes are mere adjustments to licensing fees, bonds, or administrative fines, and that these increases are primarily due to inflation—treating all of these changes the same misstates the impact of various legal regimes. To better model the effects of state debt-collection laws, this analysis should distinguish between different degrees of consumer protections, and perhaps give more attention to those changes of greater substance. In fact, in an earlier version of this paper, Fedaseyeu looked at restrictions on practices separated from licensing restrictions. This model found that restrictions on practices did not

[1] CRL reviewed the July 3, 2015 version of this paper, retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330451.

have a statistically significant impact on the number of new revolving lines of credit.[2] Finally, although the paper is repeatedly cited by the debt-buying industry to oppose laws aimed at debt buyers, the paper does not distinguish between general debt-collection laws and those that focus on debt buyers.

Concerns Regarding the Selection of Variables

As noted previously, this study looks at changes in (1) the number of debt collectors in a given state; (2) loan recovery rates; and (3) new credit card originations. **Even if the methodology were improved to address the problems outlined above, we also have concerns about the conclusions drawn from examining the impacts to the first two of these variables.**

First, Fedaseyeu finds that an increase in the number of debt collection laws in a given state is associated with a decline in the number of debt collectors. However, large debt-collection companies are responsible for a disproportionate share of total business.[3] Therefore, if a particular debt collection licensee leaves a state this may have a widely varying impact on a state's economy and the ability to collect debts, depending on the share of business generated by that company. Fedaseyeu's research is silent on this important point.

Second, Fedaseyeu attempts to examine the change in credit card loan recovery rates, but must rely on data solely from credit unions. He notes that this data may not "generalize to commercial banks," which originate the bulk of credit cards and that "credit unions may rely less on third-party debt collectors than commercial banks…" These two limitations call any conclusions drawn regarding the relationship between recovery rates and debt-collection laws into question.

Even if the analysis was constructed in such a manner that the author could prove his hypothesis, he notes that this would not mean that debt-collection laws necessarily hurt consumers. We strongly agree with this important point. Laws that encourage lenders to do reasonable underwriting are critical to a well-functioning and responsible lending marketplace. If restrictions on third-party debt collectors decrease new credit because they encourage a greater emphasis on responsible underwriting, then those laws ultimately benefit consumers. In addition, if legal changes force some debt collectors to operate under consumer protections, that is an appropriate improvement in public policy. As Fedaseyeu notes, "…the welfare effects on regulations that affect credit availability depends on the characteristics of borrowers whose access to credit is affected by these regulations. It may therefore be that some regulations that reduce credit access, such as stricter debt-collection laws, can improve consumer welfare." However, given our concerns with the analysis outlined above, we cannot conclude that credit access is in any way associated with the extent to which a state has debt-collection laws.

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[2] The earlier version of the paper is dated August 2014, retrieved from https://www.philadelphiafed.org/research-and-data/publications/working-papers/2013/wp13-38R.pdf.

[3] For example, the Consumer Financial Protection Bureau found that the largest debt collection companies (those with at least $10 million in annual receipts) make up just four percent of all debt collection firms but 63% of annual receipts. See *Defining Larger Participants in the Consumer Debt Collection Market* at http://files.consumerfinance.gov/f/201210_cfpb_debt-collection-final-rule.pdf for more information about the composition of the debt collection industry.