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February 2012

CFPB Proposes Parameters for Jurisdiction of Larger Participants in Debt Collection and Consumer Reporting Markets

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As a follow up to the Consumer Financial Protection Bureau's ("CFPB") June 2011 notice of proposed rulemaking ("Notice") on determining which markets it should cover and which entities in such markets should be deemed "larger participants" under its nonbank supervision program,[1] the agency issued its first proposed rule defining "larger participants" ("Proposal").[2] The Proposal addresses two of the six consumer financial product and service markets the CFPB identified in the Notice — (i) consumer debt collection, and (ii) consumer reporting activities. Under the "larger participant" authority set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA"),[3] the CFPB is required to define the "larger participants" subject to its nonbank supervision program by July 21, 2012."[4] Thus, the remaining four areas identified in the June 2011 Notice — (i) consumer credit and related activities, (ii) money transmitting, check cashing, and related activities, (iii) prepaid cards, and (iv) debt relief services — are expected to be addressed by the CFPB in the relatively near future.

Statutory Background

Pursuant to the DFA, the CFPB is required to identify the markets for "other consumer financial products or services" that will be covered by its nonbank supervisory program,[5] as well as the "larger participants" of such markets that will be subject to the CFPB's jurisdiction under the program. Pursuant to this authority, the CFPB can supervise persons/entities covered by its nonbank supervision program, including requiring reports and conducting examinations, to monitor and oversee compliance with existing federal consumer financial law, as well as to detect and assess risks to consumers and consumer financial markets.

While the DFA authorizes the CFPB to examine all nonbank mortgage companies, payday lenders, and private education lenders, its supervision of other markets providing consumer financial products and services generally must be conducted via its supervision of "larger participants" in such markets. Thus, the "larger participant" rule is a critical component of the CFPB's overall nonbank supervision program, and the Proposal provides the first opportunity to understand how the CFPB may implement the larger participant rule. Further, while the Proposal only addresses two of the six consumer financial products and services markets that the agency identified in the Notice, it provides important insights relevant to the other four markets identified in the Notice, as well as other potential future markets that the CFPB may draw into its "larger participant" jurisdiction.

Overview of the Proposal

The Proposal includes four sections that: (i) define relevant terms for purposes of the larger participant rule, (ii) define the covered markets for consumer debt collection and consumer reporting and a test to determine the larger participants in each market, (iii) address timing with respect to how long a "larger participant" designation will be effective, and (iv) set forth the procedural requirements that the CFPB will follow in determining that a nonbank covered person is a "larger participant" subject to the rule. The larger participant test for the two markets covered by the Proposal are based on a measure of "annual receipts." For consumer debt collection, the proposed threshold is $10 million in annual receipts, and for the consumer reporting market, the threshold is $7 million in annual receipts. Amounts that count toward the annual receipts determination must come from activities related to the market in question, but also include annual receipts from such market activities conducted by affiliated companies of a nonbank covered person. In utilizing the annual receipts test for the two markets covered by the Proposal, the CFPB notably cautioned that it has not made a determination on whether "annual receipts" are the appropriate measure for the other four markets it is considering including under its larger participant nonbank program.

Under the timing provision of the Proposal, a designated "larger participant" will retain that status for a period of not less than two years after the first day of the tax year in which it meets the applicable measurement test for its covered market (i.e., consumer debt collection or consumer reporting). The Proposal also imposes certain recordkeeping requirements on covered persons to determine whether a person qualifies as a larger participant of a covered market. Finally, the Proposal includes a procedure for a covered person to dispute a "larger participant" designation.

Annual Receipts Test

For the two markets covered by the Proposal, the CFPB has elected to apply an annual receipts test to identify the relevant "larger participants" in each market. In applying the annual receipts test, the Proposal notes that the agency was guided by the method of calculating "annual receipts" utilized by the Small Business Administration, which generally includes total income plus cost of goods sold (as required to be reported to the IRS). Pursuant to the annual receipts test, the CFPB proposes to measure annual receipts for a person/entity's most recent three fiscal years, including annual receipts from affiliated companies.

Consumer Debt Collection Market

In structuring the parameters for the consumer debt collection market, the Proposal indicates that the market generally includes the collection of debt related to "consumer credit, certain consumer leases, and a variety of other consumer financial products or services," but not certain other debt, such as medical debt.[6] In identifying the relevant market participants, the Proposal notes that there are three main categories: (i) third-party debt collectors, (ii) debt buyers, and (iii) law firms and attorneys that conduct collection activities. However, the Proposal does not subdivide the three distinct categories into separate markets for purposes of applying the larger participant analysis. Instead, the Proposal notes it is difficult to identify an effective bright line or useful data to devise separate market tests for the three categories of debt collection participants and, thus, it considers all participants as operating in one (i.e., the same) debt collection market.

In applying the annual receipts test to identify the larger participants in the debt collection market, the Proposal notes that annual receipts provide a reasonable basis of measurement because they measure the level of participation in the market as well as an entity's impact on consumers. In effect, annual receipts represent recoveries that are the result of market participation, and the level of market participation can be discerned by the total amount of a participant's annual receipts. The

Proposal also discusses certain other aspects of annual receipts that justify its use as a reasonable and reliable measure.

In arriving at a $10 million annual receipts threshold to identify a larger participant in the consumer debt collection market, the Proposal notes that this level is appropriate because it captures only 4% of all market participants (175 of 4500 firms), but approximately 63% of annual collections receipts. The Proposal states that this threshold would permit the CFPB to oversee the debt collection activities of nonbank firms that interact with a "significant portion of consumers with debt under collection."[7] Further, this level would produce sufficient coverage of debt collection activities nationally to enable the agency "effectively to identify and assess risks to consumers in [the debt collection] market and assess nonbank covered persons' compliance with Federal consumer financial laws."[8]

Notably, the CFPB rejected suggestions for a much higher $250 million annual receipts threshold that would have captured only the seven largest debt collection firms (representing 20% of aggregate annual collection industry receipts). In this regard, the CFPB drew a distinction between a rule focused on larger participants versus the "largest participants," and rejected the latter approach. Interestingly, the Proposal referenced the comment of one of the largest national debt buyers that the rule should not be focused on just the largest market participants because "some of the most significant risks to consumers come from smaller debt collection companies."[9] The Proposal embraces this notion.

Consumer Reporting Market

The Proposal states that the consumer reporting market is an appropriate area for supervision given the broad, supporting role credit reports play in the provision of consumer financial products and services. Consumer reports often serve as a gatekeeper and help determine product availability and pricing. The Proposal's overview of this market notes that it is comprised of: (i) the largest consumer reporting agencies, (ii) consumer report resellers, and (iii) specialty consumer reporting agencies. Similar to the consumer debt collection market, the Proposal declines to treat these components as separate submarkets, citing the unavailability of adequate data to devise individualized tests for each.

The Proposal defines "consumer reporting" as "collecting, analyzing, maintaining or providing consumer report information or other account information used or expected to be used in any decision by another person regarding the offering or provision of any consumer financial product or service."[10] However, the Proposal excludes from this definition the retention and analysis of information that solely relates to transactions between a person and a consumer, sharing this information with an affiliate or another person engaged in consumer reporting, or providing consumer report or account information that is used, or expected to be used, solely in a decision regarding the offering or provision of a non-consumer financial product or service (e.g., a decision regarding employment or government licensing).

The CFPB believes that the proposed $7 million threshold is reasonable in that it allows its nonbank supervision program to cover not only the largest consumer reporting agencies, but other "larger" firms, such as specialty reporting agencies. The Proposal provides that this threshold would cover fewer than approximately 30 consumer reporting firms, or less than 7% of all market participants. However, these entities together would comprise more than 94% of the industry's total receipts. The Proposal defends this position by remarking that this low-level threshold is necessary to reach consumers which might not have files at the largest reporting agencies or "otherwise participate in mainstream financial activities." The Proposal seeks comment on whether an even lower dollar threshold (e.g., $5 million) may be appropriate for the consumer reporting market to include other "entities that could reasonably be described as larger participants."[11]

Bolstering support for its $7 million threshold for the consumer reporting market, the Proposal analyzes the average price for various consumer reporting products. Noting that prices for consumer reporting transactions range from a few cents for prescreening products to several dollars for specialty reports, the CFPB concludes that “a company with more than $7 million in annual receipts would likely impact several million consumers.”

Projected Impact and Effect of the Proposal

While the Proposal is intended to implement the authority for the CFPB to conduct supervisory activities with respect to larger participants pursuant to the agency’s nonbank supervisory program, it is important to highlight that the CFPB is not *required* to undertake any such activities with respect to any nonbank covered person. In this regard, the CFPB stresses in the Proposal that it intends to exercise its supervisory authority over larger participants consistent with criteria set by Congress to focus on risks to consumers. In particular, the Proposal notes that the CFPB is “required to exercise its authority under its nonbank supervision program in a manner that is based on the assessment by the [CFPB] of the risks posed to consumers in the relevant product markets and geographic markets.”[12] Among the factors that the CFPB may take into consideration in assessing its supervisory response to the activities of a covered person under its nonbank supervision program are: (i) asset size of the covered person, (ii) volume of transactions involving consumer financial products and services conducted by a covered person, (iii) the extent of the risks to consumers, (iv) existing state oversight of the activities in question, and (v) any other factors the CFPB deems relevant.[13]

Another important aspect of the CFPB’s jurisdiction with respect to larger participants is that, similar to the Federal banking agency’s exercise of supervisory authority over service providers of insured depository institutions, the CFPB will have the ability to exercise its nonbank supervisory authority over service providers of nonbank larger participants. Thus, the Proposal could extend to firms such as “data aggregators, law firms, data and record suppliers, account maintenance services, call centers, software providers, and developers of credit scoring algorithms.”[14]

Request for Comments

The CFPB seeks comments on all aspects of the Proposal, including:

- the definitions set forth in the Proposal, and whether any definitions should be modified to be consistent with other existing regulatory requirements;
- the scope of ‘‘consumer debt collection’’ and ‘‘consumer reporting’’ in the Proposal;
- whether the definition of ‘‘affiliated company’’ is appropriate for purposes of the aggregation requirement set forth in the Proposal;
- the proposed criterion and annual receipts thresholds for measuring larger participants in the consumer debt collection and consumer reporting markets;
- methods for apportioning amounts that count toward the annual receipts threshold (for consumer reporting or consumer debt collection) for entities that generate annual receipts from multiple lines of business;
- the appropriateness of a two-year supervision period for entities deemed larger participants;
- the proposed process for allowing a person to rebut a “larger participant” designation;
- which other markets for consumer financial products or services should be covered by future proposed rules to define larger participants; and
- the proposed effective date of a final rule.

Comments on the Proposal are due April 17, 2012.

Action Plan — Review Proposal and Provide Comments to Address Particular Areas of Concern

The Proposal provides market participants with considerable insight and direction on the CFPB's nonbank supervision program. In defining the consumer debt collection and consumer reporting markets, the CFPB has chosen to treat each as a unified market encompassing somewhat diverse market participants. Further, the CFPB has proposed a single, low-dollar annual receipts threshold in each market to identify the scope of its supervision over the "larger," and not just the "largest," participants of each market. As part of its mission to assess compliance and identify and assess risks associated with consumer financial products and services, the CFPB appears to be marking off a fairly wide playing field for its nonbank supervision program. In this sense, the Proposal serves as an important illustration of the extent of the CFPB's supervisory reach over non-depository covered persons.

The Proposal provides an important opportunity for financial services providers to participate in the CFPB's larger participant rulemaking process. Market participants in the two markets covered by the Proposal, in particular, should take advantage of this opportunity to address areas of concern and issues raised by the Proposal. Market participants impacted by the Proposal should use their first-hand knowledge of the subject consumer products and understanding of trends and how products are likely to evolve in the future to inform the CFPB regarding aspects of the Proposal that may require clarification, modification, and/or a different approach.

Key steps that a consumer financial services provider should consider in assessing how to provide meaningful and effective input to the CFPB on the Proposal include the following:

- Review existing product lines affected by the Proposal and assess the projected impact on your operations, as well as the impact and coverage of the Proposal on your competitors.
- Review and understand how the definitions in the Proposal will apply to your business operations, and the broader implications and impact on your company and other market participants.
- Review the delivery channels for your products affected by the Proposal, and consider whether the proposed annual receipts threshold appropriately captures the "larger participants" in the relevant markets in which you operate.
- Assess the potential impact on innovation in your product market(s) and identify possible improvements and alternatives to reduce the overall impact of the Proposal.
- Identify potential unintended consequences and how regulatory requirements may be modified to avoid adverse impacts on market participants and/or consumers.
- Assess existing data collection requirements and other available information that may provide a better measure for defining the larger participants in the relevant product market(s) covered by the Proposal.
- Identify and collect data, research, or other evidence to assist the CFPB in analyzing the impact of the Proposal, including the associated costs and benefits of any recommended changes on both providers and consumers.
- Advise the CFPB regarding other areas of concern, issues, and any other important considerations raised by the Proposal and its potential impact on your business operations and customer base.

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If you have any questions concerning the Proposal, or if you are interested in working with Paul Hastings lawyers to provide comments to the CFPB on the Proposal, please do not hesitate to contact any of the following:

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[1] 76 Fed. Reg. 38059 (June 29, 2011).

[2] 77 Fed. Reg. 9592 (February 17, 2012).

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (enacted July 21, 2010).

[4] DFA § 1024(a)(1)(B).

[5] Pursuant to DFA § 1024(a), persons/entities specifically covered by the program include (i) nonbank mortgage companies, (ii) payday lenders, and (iii) private education lenders.

[6] 77 Fed. Reg. 9597.

[7] 77 Fed. Reg. 9599.

[8] *Id.*

[9] *Id.*

[10] Proposed 12 CFR § 1090.101(i). *See* 77 Fed. Reg. 9607.

[11] 77 Fed. Reg. 9601, note 53.

[12] 77 Fed. Reg. 9604, note 67.

[13] *Id.*

[14] 77 Fed. Reg. 9593, note 4.