Indiana Institute for Working Families
Research and Public Policy
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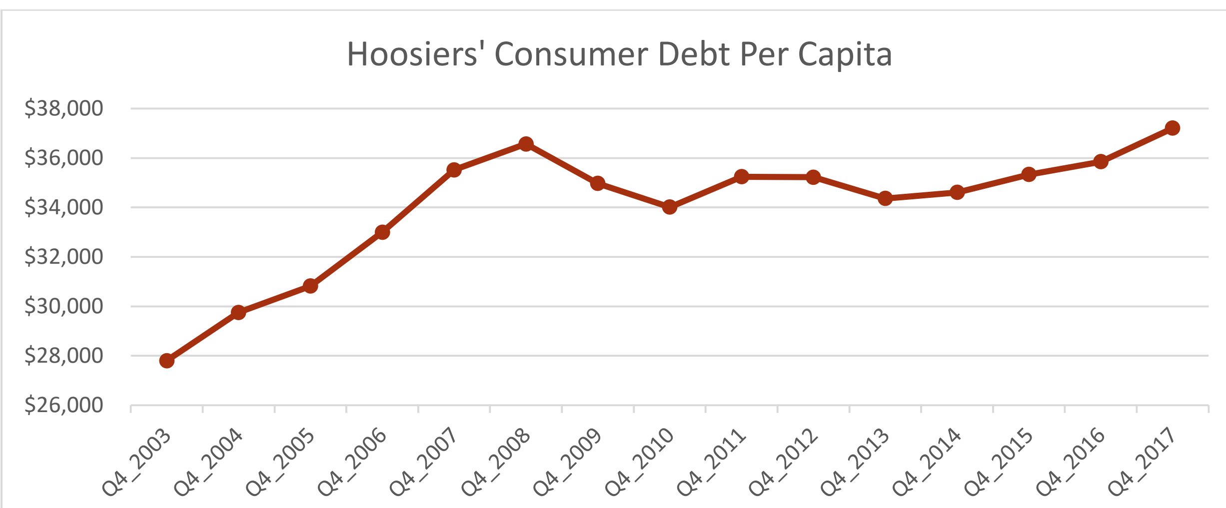
Debt Collection Policies and Practices

With rising consumer debt and many households' inability to cope with even a small financial emergency,[i] debt collectors and debt buyers have become a fixture in American economic life. Debt collection is the pursuit of payment of a debt owed or believed to be owed. Because debt collection can affect an individuals' credit, pull him or her into litigation, and result in wage garnishment or seizure of property, it is critical that federal and state laws promote transparency, accuracy, and fairness in the collection process. **This policy brief demonstrates the widespread nature of debt and debt collection, describes problems with the current collection process, and makes recommendations for policy change.**

Total household debt in the U.S. reached a new peak in the first quarter of 2018, topping out at $13.21 trillion dollars: that figure represents the sum of debts like mortgage balances, student loans, credit cards, and auto loans.[ii] By comparison, in 2004, that figure hovered around $8 trillion. About three in four Hoosiers held some form of debt in 2017.[iii] Taken "per capita", Hoosiers' debt now rests at $37,210 per person. As Figure 1 shows, this is a new peak for Indiana.

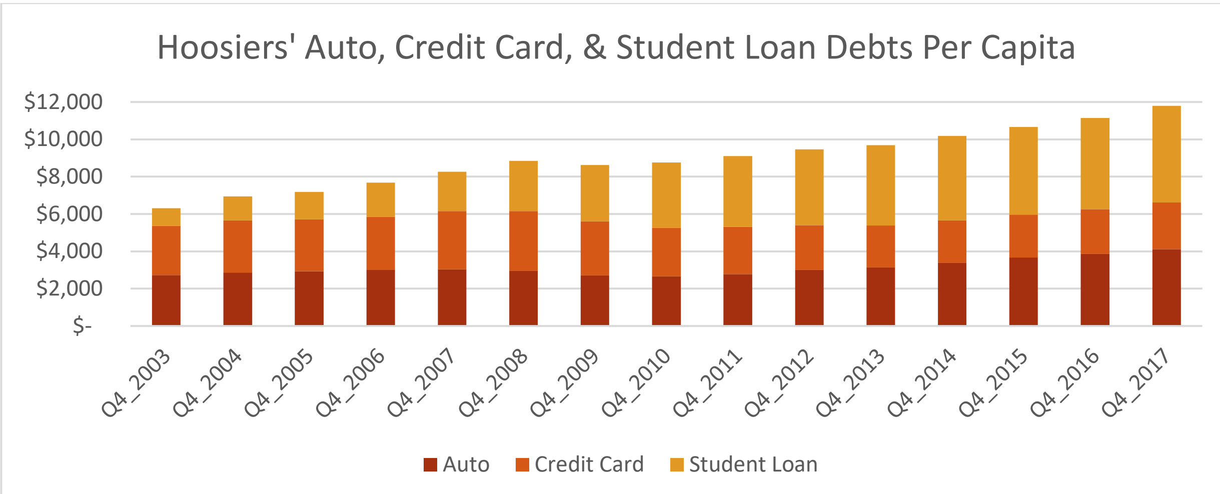
FIGURE 1. Hoosiers' Consumer Debt per Capita



Source: State Level Household Debt Statistics, Federal Reserve Bank of New York, 2017

Non-mortgage debts currently make up a substantial share of the red ink on families' balance sheets. Figure 2 presents per capita auto, credit card, and student loan debts to illustrate the growing range of liabilities Hoosiers must eventually repay.

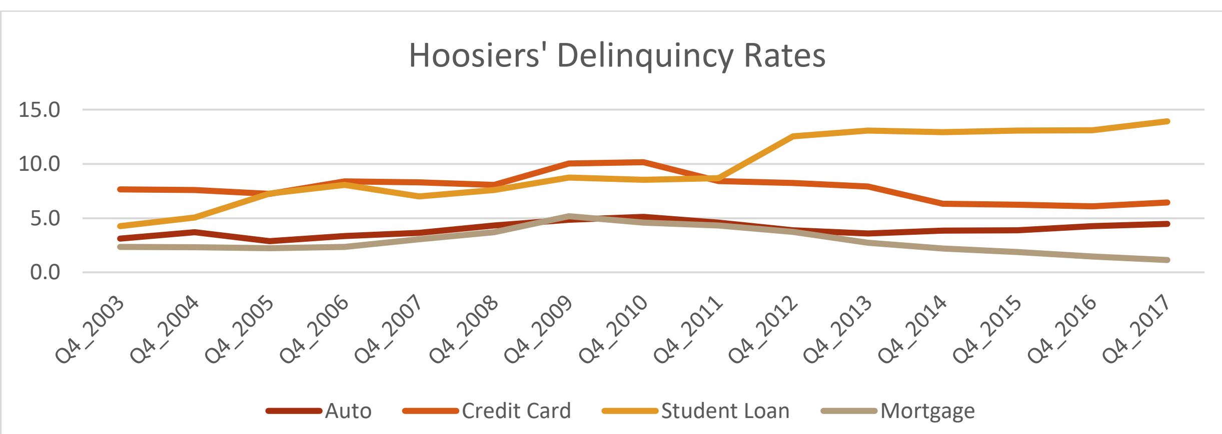
FIGURE 2. Hoosiers' Non-Mortgage Debt per Capita



Source: State Level Household Debt Statistics, Federal Reserve Bank of New York, 2017

Given the mismatch between rapidly rising basic costs and sluggish income growth,[iv] it is not surprising that many families have fallen behind on consumer loan payments and bills. Consumers typically default on bills or debts due to unanticipated hardships like unemployment, illness, or divorce.[v] Delinquency and default is far more common for low-to moderate income families – a full 25% of whom have severely delinquent debt – as compared to 11% of middle-to-upper-income families.[vi] Figure 3 shows the delinquency rates for particular loan types over time.

FIGURE 3. Hoosiers' Delinquency Rates



Source: State Level Household Debt Statistics, Federal Reserve Bank of New York, 2017

When families fall behind, creditors may continue to seek payment themselves, hire a third party to collect the debt, or sell the debt to a debt buyer. Debt collection may involve loans or past-due bills, such as medical bills or utility payments. According to the Urban Institute, about **one in three Hoosier borrowers has a debt in collections**, with a median amount owed of $1509.[vii] As Table 1 shows, this is slightly higher than the average for the nation and exceeds the rates for all of our neighbors except Kentucky.

TABLE 1. Percentage of Borrowers with a Debt in Collections by Borrower Type

	US	IN	OH	MI	KY	IL
All borrowers	33%	**34%**	33%	33%	40%	31%
Medical debtors with debt in collections	18%	**22%**	19%	20%	27%	18%
Student loan borrowers with debt in collections	13%	**16%**	15%	16%	17%	12%

Source: Urban Institute, 2017

The law sets up some parameters for the manner in which creditors and collectors can pursue overdue debts, attempting to strike a balance between enabling creditors to seek what they are owed and any additional costs incurred from lack of timely payment, while also ensuring that individuals are not pursued for debts they have paid or do not owe and that borrowers who are struggling with repayment are able to maintain their dignity and work toward fulfillment of their obligations while still meeting their basic needs. However, as the following sections illustrate, these protections are currently insufficient.

The Debt Collection Process & Current Protections

Once a borrower's account becomes delinquent or a bill is overdue, creditors have several options. They can pursue payment on their own, hire a debt collector who works on behalf of the creditor to seek payment, usually for a fee or a share of the amount collected, or they can sell the debt to a debt buyer.

The length of time a bill is delinquent before it is sent to collections may vary. Once in collections, the overdue account is likely to appear on the individual's credit report, damaging the individual's credit score. Debt collection accounts can stay on the individual's credit report for up to seven years, potentially hindering their ability to secure housing, employment, or other forms of credit.[viii] It is therefore concerning that a 2012 FTC report showed that **more than 1 in 5 individuals had material errors on his or her credit reports.**[ix] Credit reporting is also a top complaint category for Hoosiers at the Consumer Financial Protection Bureau.[x]

Creditors, debt collectors, and debt buyers can also seek a judgment against an individual in court. The judgment may allow a creditor to garnish the consumer's bank account or wages. In 2016, while an estimated seven percent of employees had wages garnished nationally, **an estimated one in ten employees had wages garnished in Indiana**. Table 2 shows an estimated breakdown for Indiana and the U.S. by type of garnishment. Garnishment rates are higher for lower-income workers.[xi]

Who's Involved?

Creditor: The entity that made a loan or granted credit

Debt collector: A third party regularly engaged in the pursuit of payment of a debt owed, usually for a fee or share of the payments made.

Debt buyer: A subset of debt collectors, these companies attempt to purchase old debts for pennies on the dollar and keep the proceeds of continued collection attempts.

Repossession or recovery agent: The company or individual hired to take possession of personal property or automobile to satisfy an overdue debt.

TABLE 2. Estimated Percentage of Employees with Wage Garnishments

	Indiana	U.S.
All types of garnishments	10.5%	7.0%
Child support	5.3%	3.4%
Other	5.6%	2.9%

Source: *ADP Research Institute, 2017*

Creditors may also seize financed property – such as a vehicle or other item – and resell it, crediting the consumer with whatever sales price the item garners against the total debt. When this happens, the consumer is likely to have a deficiency balance – the amount of debt still owed after the sales price is subtracted.

The Fair Debt Collection Practices Act (FDCPA) is a federal law that limits what debt collectors can do to collect a debt. It applies to third-party collectors and debt buyers, but does not cover original creditors. The FDCPA:

- Limits the times and places a collector can contact a consumer, and allows consumers to request that a debt collector stop contacting them;
- Protects individuals from harassment;
- Requires that if a debt collector knows an attorney is representing a consumer, he/she must contact the attorney and not the consumer; and
- Allows individuals to request documentation and dispute debts.

On the federal level, Title III of the Consumer Protection Act also offers some safeguards to garnishees and their families. The weekly amount garnished for consumer debt cannot exceed the lesser of 25% of disposable earnings (earnings minus taxes and certain deductions) or the amount by which disposable earnings are greater than 30 times the federal minimum wage. The rules for child support, bankruptcy payments, and tax garnishments can differ.

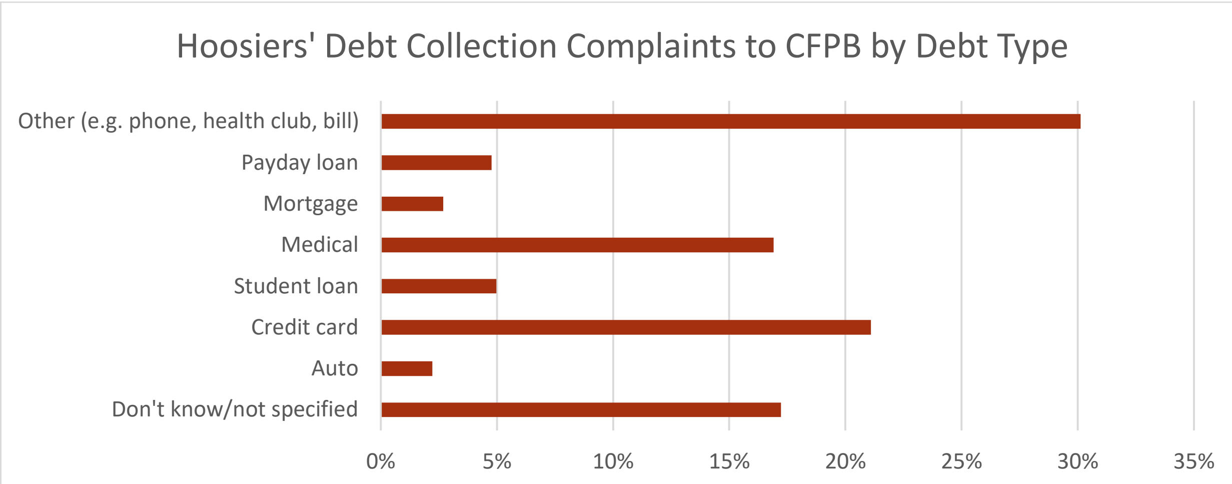
Indiana offers limited additional protections to borrowers relative to other states. For example:

- Unlike some other states, Indiana does not extend the restrictions under the federal Fair Debt Collection and Practices Act to original creditors.
- Compared to other states, Indiana allows relatively little of an individual's assets to be protected from levy. Indiana's homestead exemption – the amount of home equity protected in a judgment – is $19,300. $10,250 in other real estate or tangible property can also be protected (e.g. car equity), as well as $400 in intangible personal property (e.g. cash or bank account balance).[xii]
- Indiana aligns with the floor set by federal wage garnishment limitations, allowing the lesser of 25% of disposable income or amounts above 30 times the federal minimum wage ($217.50) to be garnished for consumer debts. By contrast, some states prohibit wage garnishment outright.

Problems with the Debt Collection Process

Hoosiers have filed a number of complaints against debt collectors. The Consumer Financial Protection has received 5,363 consumer complaints from Hoosiers about debt collection practices, making it the top complaint category for Indiana. Similarly, the Federal Trade Commission (FTC) received more than 8,166 complaints from Hoosiers about debt collection in 2017 alone, again making it the top complaint category for Indiana.[xiii] Debt collection is also a top complaint category nationwide, both at the CFPB[xiv] and the FTC.[xv] As Figure 4 indicates, among Hoosier complaints published by the CFPB, collectors seeking payment for medical debt, credit card balances, and other types of debt like overdue bills receive the most complaints.

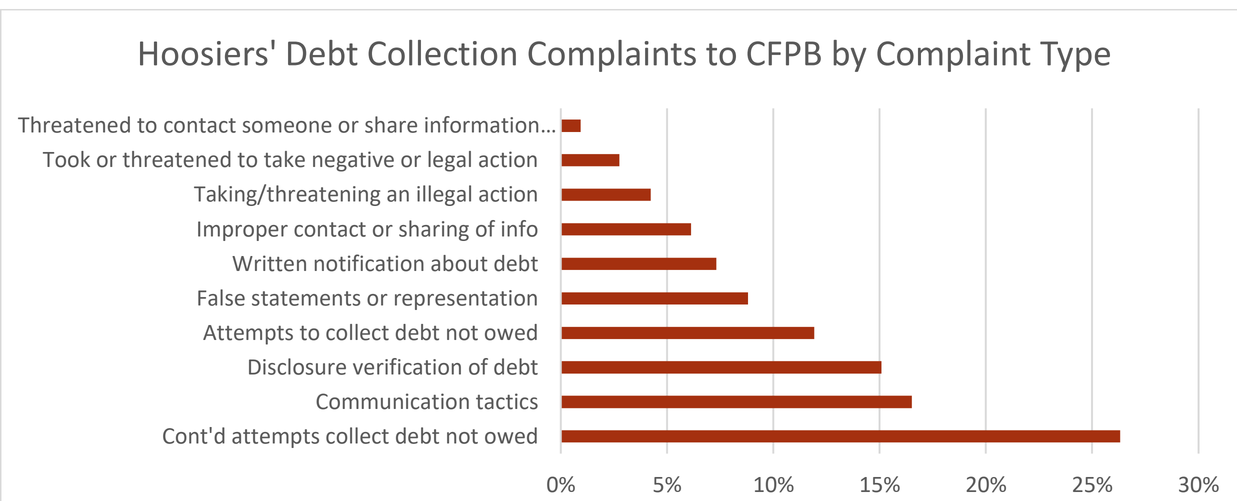
FIGURE 4. Hoosiers' Debt Collection Complaints to CFPB by Debt Type



Source: Author's Analysis of Consumer Financial Protection Bureau Complaint Data, 2018[xvi]

As Figure 5 shows, by far the most frequent complaint to the CFPB was about continued attempts to collect a debt not owed, which, when combined with "attempts to collect debt not owed," accounted for 38% of Hoosiers' complaints to the CFPB. This mirrors national data suggesting that more than fifty percent of all consumers contacted by debt collectors are subjected to collection efforts based on inaccurate or insufficient documentation.[xvii] Communication tactics, which includes frequent or repeated calls, calls outside 8am-9pm, continued calls after written requests to stop calling, and obscene or abusive language, was the second highest complaint category.

FIGURE 5. Hoosiers' Debt Collection Complaints to CFPB by Complaint Type



Source: Author's Calculations Based on Consumer Financial Protection Bureau Complaint Data, 2018

When collection attempts move through the judicial system, individuals rarely appear for hearings. In a survey of American consumers, the Consumer Financial Protection Bureau found that fifteen percent of consumers who were contacted about a debt in collections reported having been sued by a creditor or debt collector in the preceding year. Of those, only about one in four attended the court hearing. Lower-income consumers are more likely to be sued to collect a debt.[xviii]

These statistics – as well as consumer survey data[xix] - suggest that the notice requirements for hearings and availability of low- or no-cost legal services are inadequate. If notice is not reaching borrowers - either at all or with sufficient time to dispute claims, negotiate settlements, or respond to requests - default judgments may be issued against consumers for an amount they do not owe or additional court fees will be added to an overdue debt. Consumers may also be subjected to wage garnishment.

Given that a basic needs budget is well above $218 per week for even a single adult in Indiana,[xx] Indiana's wage garnishment laws are likely putting some Hoosiers at risk of eviction, job loss, hunger. At current levels of income, approximately one in three Hoosiers struggles to afford a basic-needs budget.[xxi] The high number of consumers in Indiana with wage garnishments (more than one in ten) and the relatively large percentage of wages that can be garnished suggest that garnishments may affect Hoosiers' abilities to meet their basic needs. High wage garnishment rates are correlated with high bankruptcy rates,[xxii] which may help to explain why Indiana's bankruptcy rate is 8th highest in the nation.[xxiii]

Finally, laws and practices surrounding repossession, especially when it involves a vehicle, require additional safeguards. Vehicles in particular are often critical to a family's ability to continue working, making a right to cure a delinquency a valuable tool to promote self-sufficiency. Furthermore, with few regulations in place, self-help repossession can put both property owners and repossession agents at risk if and when untrained and plains-clothed agents attempt to seize property. [xxiv] Finally, upon repossession, borrowers should be credited fairly for the value of repossessed property.

Policy Solutions

To preserve the rights, well-being, and dignity of consumers, there are several ways to improve the debt collection process:

Prevent predatory lending practices. Allowing products and services by which creditors can turn a profit whether or not the borrower is successful in repaying the loan sets too many families up for failure. Indiana should incentivize responsible lending through caps on interest and fees as well as limits on the manner and circumstances in which a creditor or lender can seize property or access to a borrower's wages or bank account.

Improve delinquency notice adequacy, accuracy, and timeliness. The number of complaints about inaccurate debt collection attempts suggests that more must be done to ensure that adequate notice is reaching consumers. Collectors should provide timely and accurate documentation of debts, and consumers must have access to support in challenging mistakes. No judgment should be permitted without evidence that a consumer received timely and adequate notice, and, given the negative consequences of a poor credit score, more must be done to ensure that creditors and collection agencies report accurately to credit bureaus.

Reduce harassment. Hoosiers' complaints about communication tactics – as well as national data about the frequency of collection calls - suggest that more needs to be done to curb harassment. Folding original creditors into the protections already offered may reduce these complaints.

Ensure basic needs are met when wages are garnished. While there are some provisions in place to reduce the amount of wage garnishment available to a creditor when a borrower has low income, these adjustments are insufficient to ensure that borrowers with garnished wages are still able to meet their basic needs. In fact, garnishing more than a borrower can afford to give up may actually be counterproductive if the borrower then loses housing, transportation, or utilities. The Indiana Self-Sufficiency Standard could be used to develop ability-to-pay guidelines that are specific to a particular county and family type.

Promote fairness & transparency in repossession. Indiana should consider additional protections for consumers facing repossession, including additional time to catch up on payments, notification of both the date and time of property auctions and the calculations of deficiency balances, and otherwise strengthening requirements for what constitutes "commercially reasonable" sales. For vehicles, the state might consider requiring dealers to grant the auctioned value or some percentage of a standardized value, whichever is greater, to prevent the incentive to sell at an unreasonably low rates.

Bolster financial literacy for youth and adults. To complement strong consumer protections, Indiana can and should bolster current and future consumers' financial literacy. Beyond basics like budgeting, ensuring that consumers understand and can evaluate credit products as well as their rights and obligations when signing contracts might enable more consumers to successfully navigate complex financial marketplaces.

Ultimately, a successful financial marketplace helps Hoosiers meet their financial goals successfully and provides a transparent, safe, and fair process for the collection of debts. It will take further work to get there.

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[ii] Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit, accessed June 22, 2018 from https://www.newyorkfed.org/microeconomics/databank.html

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[vi] Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit.

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[xvi] Note: not all complaints are made public. This data represents publicly available complaint data.

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