



Impact of Collections Call Restrictions on Consumer Delinquencies in Vehicle Finance and Installment Lending

November 2019



Executive Summary

Borrowers benefit by working with creditors

The Consumer Financial Protection Bureau (CFPB) has issued a proposed rule limiting the number of phone attempts third-party debt collectors may make per week in an effort to collect a debt. While the proposed rule would only apply to debt collection agencies, the American Financial Services Association (AFSA)¹ is concerned that borrowers would be harmed if the CFPB or others lumped creditors and debt collectors together and treated them the same way, even though their businesses are very different.

Whereas debt collectors do not have any prospect of having future or ongoing relationships with borrowers and most do not make any attempt to salvage borrowers' credit scores, creditors have an incentive to maintain a relationship with borrowers. Creditors risk losing the relationship, in addition to the entire balance, while borrowers may lose opportunities to work to maintain their financial wellness if they cannot effectively communicate with a borrower. Failing to acknowledge this distinction by applying the proposed call restrictions to creditors would negatively impact borrowers.

AFSA conducted a study with the assistance of the Data Science practice at CenturyLink to estimate the potential negative consequences on borrowers. The results of the study suggest that among those borrowers entering collections (1-29 days past due), restricting the number of call attempts could increase the number of those borrowers who end up 90+ days past due by nearly 70% for installment loans and over 50% for vehicle finance contracts. Because creditors typically charge off and/or repossess at or around 90+ days past due, we would expect the number of charge offs and repossessions to increase at similar rates. The negative impact of a charge off or repossession is obvious, but even in situations where borrowers fall further behind and then get caught up on their loans, they will pay more interest, potentially incur more late charges, and their credit reports will reflect a more serious delinquency, negatively affecting their credit scores.

As a result, AFSA recommends that the CFPB carefully consider any limit on the number of call attempts by creditors. Creditors must have reasonable opportunities to contact their borrowers. More attempts lead to more direct communications with borrowers – referred to in the industry as “Right Party Contact” (RPC). It is only through RPCs that the creditor can help the borrower resolve a missed payment, whether through facilitating a payment or providing other options, such as a loan extension or modification.

¹ Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

Background

Overview of the proposed rule

The CFPB's proposed rule is the first regulation implementing the Fair Debt Collection Practices Act (FDCPA). The CFPB's intention in its rulemaking is to provide borrowers with clear protections against harassment by debt collectors and straightforward options to address or dispute debts. Among other things, the proposed rule would set limits on the number of calls debt collectors may place to reach borrowers on a weekly basis; clarify how collectors may communicate lawfully using newer technologies, such as voicemails, emails, and text messages that have developed since the FDCPA's passage in 1977; and require collectors to provide additional information to borrowers to help them identify debts and respond to collection attempts.

Commissioning the Study

Show impact beyond the hypothetical

AFSA as an organization lacked the direct data to measure the impact of the proposed rule, so it commissioned a study involving several member lending institutions and a third party to conduct the research. The Data Science Team² at CenturyLink® (hereby referred to as the "Consultants") has been conducting predictive analysis for banks and insurance companies since 2009 and has extensive experience with the types of data and analysis required to answer AFSA's hypotheses. The two analysts who executed the study have a combined 35 years of financial services analytic experience. The specific hypotheses to be addressed by the study as jointly formulated by AFSA and CenturyLink are as follows:³

- Reducing the number of attempts by creditors to contact a delinquent borrower would lead to fewer total RPCs for a given time window. Said another way, while some borrowers are never reached regardless of the number of attempts, there are some borrowers who require MANY attempts to contact them for whatever reason and reducing the number of attempts will reduce the number of RPCs for those borrowers.
- Fewer RPCs would lead to fewer payments made and thus increase the number of loans rolling into later stages of delinquency.

² The Data Science Team was originally part of an independent firm named Cognilytics, which was started in 2009 and acquired by CenturyLink in 2014.

³ The analysis was done on open accounts held by creditors, not on charged off accounts held by third-party debt collectors.

Study Approach

Leverage data from a sample of ASFA's members

AFSA asked its member organizations for volunteers willing to provide anonymous data from their past collections activity, including frequency of call attempts and outcomes of said attempts. AFSA sought information for both vehicle financing as well as installment lending to ensure that the study captured potential borrower behavioral differences depending on the type of credit.

AFSA member organizations provided their data to CenturyLink. To avoid data security concerns and to expedite the process, the files did not contain any of the borrowers' personally identifiable information (PII). Rather, each creditor was assigned an anonymous key so the Consultants could aggregate the data. The data will be destroyed once all of the study materials are turned over to AFSA by the Consultants.

The key information used in the study includes the following:

- When the loan/finance contract became delinquent,
- A record of each attempt to contact the borrower and the outcome of that call attempt,
- Any payments received after the account went delinquent,
- The final status of the account (current, delinquent, default, repossession),
- The type of credit (vehicle finance or installment loan), and
- The credit score at the time the loan/finance contract was originated (in case we needed to separate prime from subprime loans).

The period of the data ranged from June 2018 through May 2019. Some participants were able to provide their entire collections history and others provided samples. To reduce bias between the samples, we evaluated each creditor's data individually before combining the data, giving each creditor equal weight in the study.

Study Results

1. Impact of call attempt restrictions on RPCs

While the proposed rule deals with weekly limits on call restrictions, we looked at monthly data, in part to accommodate the roll rate analysis later. We translated a seven attempt per week limit as an average of “1 attempt per day” or “30 attempts per month.”

While some borrowers were reached with very few attempts, others were not reached at all. We found that up to 20% of borrowers required at least 30 attempts to achieve the first RPC in a given month. Figure 1 shows the distribution of RPCs by number of attempts for vehicle financing. It should be noted that a very significant number of the population requires more than seven calls before an RPC is made. Approximately 11% of vehicle finance borrowers require more than 49 attempts. Figure 2 shows the corresponding information for installment lending.

Figure 1: Number of Attempts Required to Obtain First RPC (Vehicle Financing)

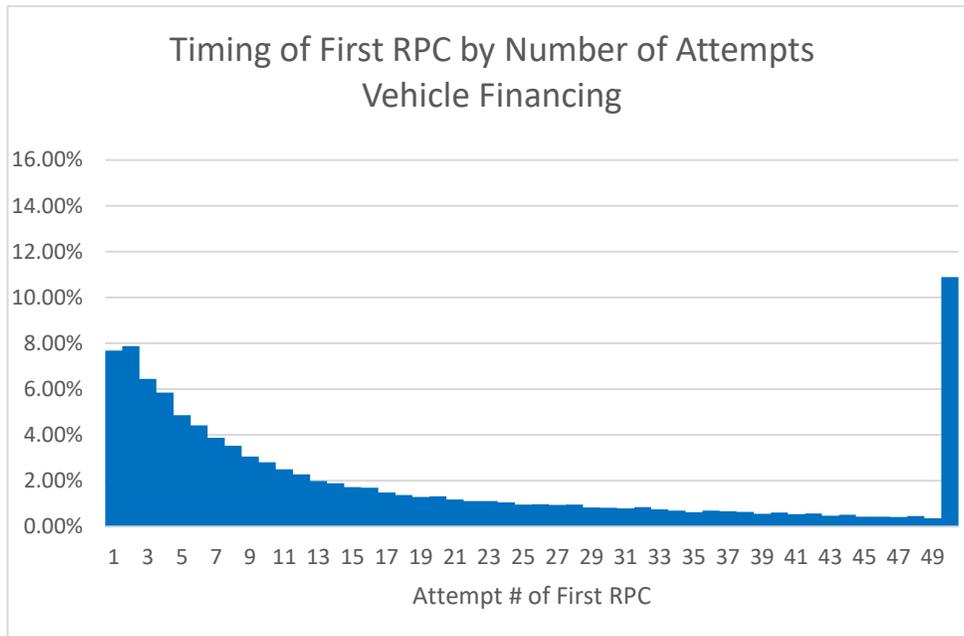
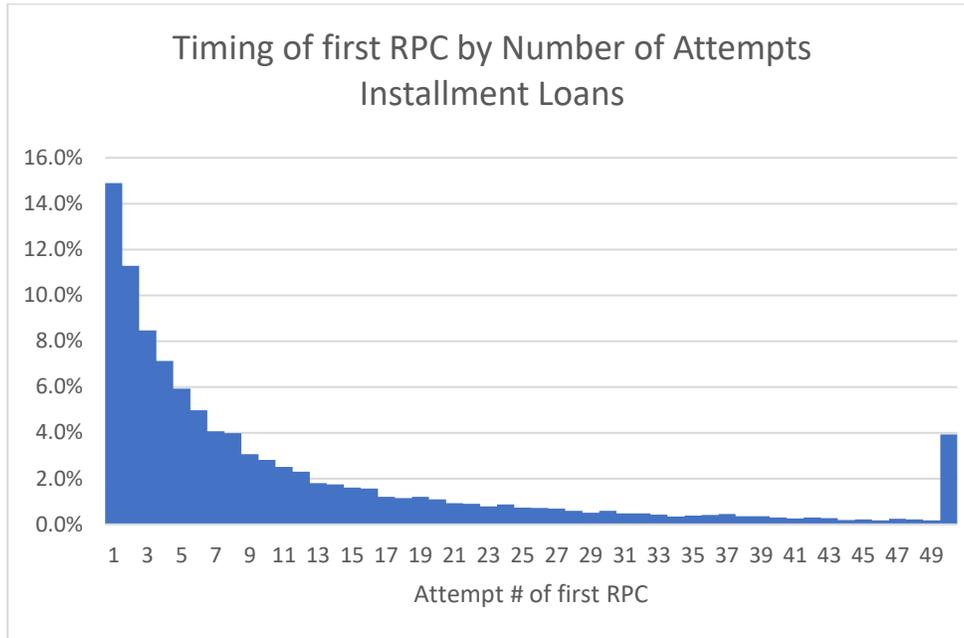


Figure 2: Number of Attempts Required to Obtain First RPC (Installment Loans)



While there are over 55% of borrowers who are not reached even without call limitations, we are concerned that many more borrowers would not be reached if the proposed rule were applied to creditors. While these borrowers may still have received letters and/or email notifications regarding their past due status, our hypothesis was that borrowers who were not contacted telephonically would be less likely to make payments. Each additional RPC is an opportunity to work with borrowers and reach acceptable resolutions for their accounts. Rather than assume all non-RPCs roll to the next delinquency bucket, we evaluated that metric directly.

2. Impact of call attempt restrictions on roll rates

We then looked at the relationship between call attempts and roll rates. Within this industry, an account is said to “roll” when its delinquency status shifts from one 30-day window to the next 30-day window. Put another way, each time a borrower rolls, that borrower is one additional payment past due on her loan and one month closer to charge off (and repossession for vehicle finance contracts).

While the borrowers most likely to make a payment tended to respond with fewer attempts, limiting the number of calls did negatively affect the roll rates. Figures 3 and 4 show the roll rates for vehicle finance contracts and installment loans at various stages of delinquency.

Figure 3: Change in Roll Rates for Vehicle Financing by Restricting Call Attempts

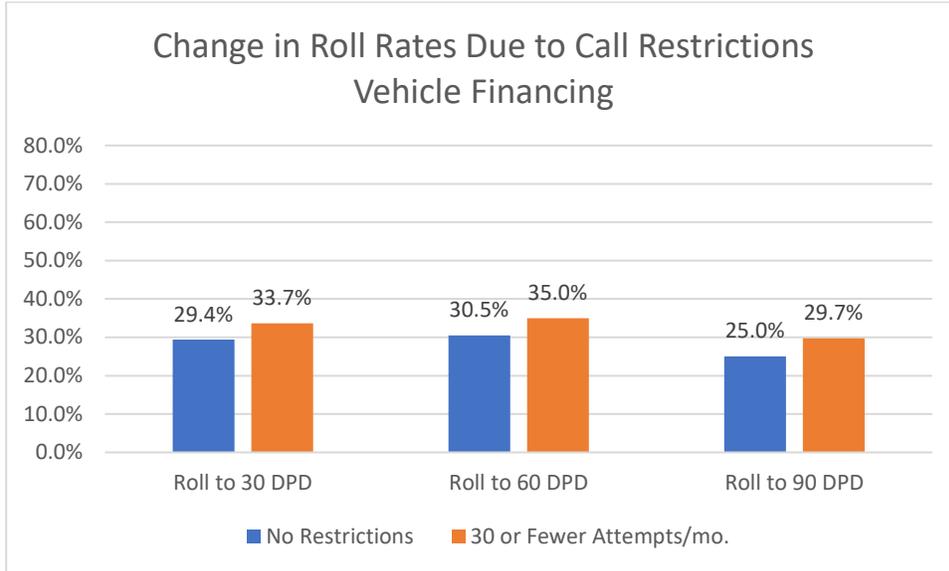
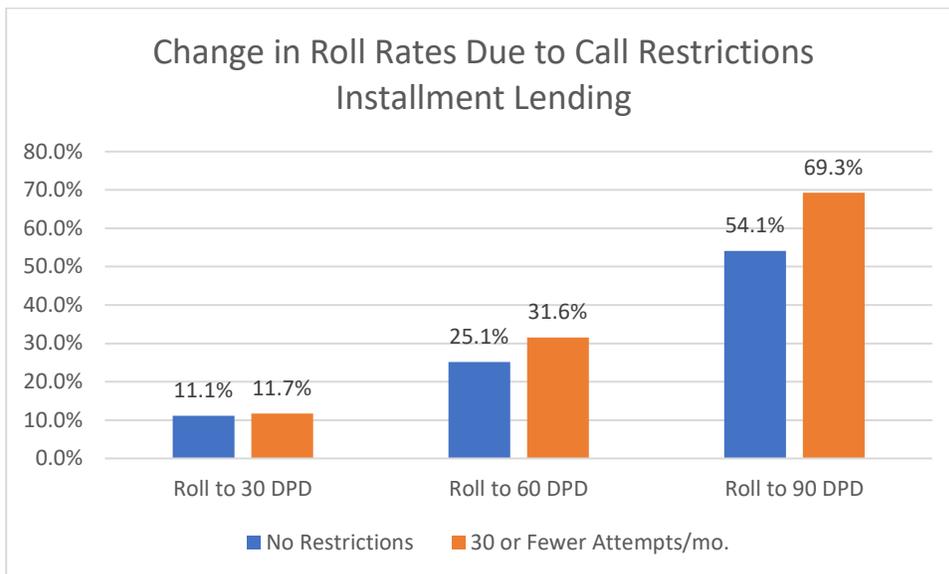


Figure 4: Change in Roll Rates for Installment Lending Due to Call Restrictions



The impact to roll rates becomes more pronounced as the days past due accumulate. In vehicle financing, while the difference relative to roll rates due to call restrictions status is just a few percentage points higher each month than current roll rates, those increases compound month-over-month, resulting in a material increase of the number of accounts that end up 90+ days delinquent (see Figure 5 below). This effect of lower contact rates in installment loans tends to be bigger for the later stages of delinquency.

Figure 5 shows the cumulative impact of our scenario. Borrowers for both credit types would see a sharp increase in loans in collection that subsequently end up severely delinquent. The cumulative effect of the call restriction scenario would lead to a 56% increase in vehicle finance accounts entering collections that end up 90+ days past due and a 69% increase for installment loans. This, of course, would lead to higher losses for the creditors. However, we will focus on the negative impact on borrowers.

Figure 5: Percent of Loan Balances That Enter Collections That Ultimately End Up 90 Days Past Due

	No Restrictions	30 or Fewer Attempts/mo.	% Increase
Vehicle Financing	2.2%	3.5%	56%
Installment Loans	1.5%	2.6%	69%

Vehicle financing is a \$1.25 trillion business. Industry sources report that as of June 2019, approximately 4.18% of vehicle finance debt is delinquent. A 56% increase in severe delinquencies would yield an additional \$29 billion in severely delinquent vehicle finance contracts. Applying similar logic to the over 53 million vehicle finance contracts in the U.S., one could expect an additional 1.37 million borrowers to end up significantly behind on their accounts because their creditors would not be able to reach them.

While installment loans represent a much smaller pool of loans in aggregate, the industry average delinquency rate is around 10%, which could increase to close to 17% should attempts to contact borrowers be significantly restricted.

Potential Consumer Impact

Credit reports/scores are worse

Consumer credit reports and scores are playing an increasingly important role in the economic mobility of consumers today. Most obviously, low credit scores have an adverse effect on consumers' ability to obtain mortgages, credit cards, vehicle financing, small business loans, and various other types of credit. Without providing the exact details, FICO® reports that 35% of its score is related to the payment history of the borrower. A credit report having an account reported as 90+ days past due would have long-term effects, first by lowering the consumer's credit score, and then by making it more difficult for the consumer to qualify for other types of credit at the lowest possible rates.

Although a low credit score may not prevent a consumer from qualifying for a loan, it can result in increased borrowing costs through higher interest rates and larger down payments. A consumer's score dropping by even 25 points can lead to a significant increase in the cost of credit for that consumer. If consumers with low credit scores qualify for credit, they may be faced with smaller credit limits in addition to a higher interest rate.

Most creditors begin to report consumers as delinquent when they reach at least 30 days past due, which means not only will there be an increase in severe delinquencies in consumer files, there will be more people in general reported as past due. And while the effect of the negative information does decrease as the date of the negative behavior becomes older, the actual record of delinquency won't completely disappear for up to seven years.

But credit reports and scores affect more than a consumers' ability to get the affordable credit they may need. Low credit scores can translate to higher premiums for property and auto insurance, as insurers claim a correlation between low credit scores and high claims. Credit reports and scores also can affect consumers' ability to get jobs and rent housing.

Vehicle repossessions would increase

Creditors typically pursue repossession of a vehicle once the account is 90 days past due. If creditors are severely limited in contacting borrowers, the number of situations where borrowers have their vehicles repossessed without ever speaking to someone could dramatically increase. While under the proposed rule creditors could still send letters and emails, the ability to speak to the consumer to obtain payment or another satisfactory arrangement, such as an extension, is paramount to collecting on the debt. In some cases, creditors may be able to arrange alternate terms for consumers facing a hardship. Still, such terms cannot be discussed unless the creditor and the borrower talk to each other, making the need to reach the consumer via phone so critical.

Recommendations

Limit call restrictions to third-party debt collectors

Third-party debt collectors differ greatly from creditors collecting their own debt. The two have completely different business models with very different incentives. Efficient, expeditious resolution by creditors benefits their borrowers. As a result, if call restrictions are implemented, they should be clearly and expressly limited to those whose business model is less aligned with resolving a borrower's specific situation and solely focused on immediately collecting as much money as possible.

CFPB study to understand unintended consequences

We recommend that prior to applying any such restriction on creditors collecting from their borrowers, the CFPB conduct further research to identify the unintended consequences of limiting how a creditor can contact a delinquent borrower. The assumption made by the CFPB that increased call attempts are a nuisance to the borrower may be flawed in light of the opportunity an RPC presents a creditor and a borrower. Creditors have more options available to resolve problems and would prefer to work out a solution in many cases with their borrowers and avoid the losses and costs associated with defaults and repossessions. Use of extensions or loan modifications, for example, also provides much more beneficial outcomes for borrowers.