FARLEIGH WADA WITT
Attorneys

CLIENT ALERT

Collection Practices Guidance After the CFPB - Navy Federal Credit Union Consent Order

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On October 11, 2016, the Consumer Financial Protection Bureau (CFPB) released a Consent Order under which Navy Federal Credit Union (Navy Federal) consented to issue $23 million in reimbursements to consumers and to pay an additional $5.5 million in civil money penalties. This action arose from various Navy Federal debt collection practices. While the facts are specific to Navy Federal and are only broadly outlined, the Consent Order offers lessons to all credit unions about various actions that the CFPB found unfair, deceptive or abusive. Although its examination authority is limited to institutions over $10 billion, the CFPB has authority to initiate investigations of smaller institutions and to recommend enforcement actions to the primary regulator. In addition, plaintiff's attorneys may use the CFPB's action to support state unlawful and deceptive practice claims for similar collection practices.

In this Alert, we examine the collection practices that the CFPB found unfair, deceptive or abusive and provide guidance on specific collection practices that may be relevant for credit unions.

Navy Federal Practices Deemed Unfair, Deceptive, or Abusive

The Consent Order is based on 4 specific practices: (i) communications threatening legal action (lawsuits or wage garnishments), (ii) communications threatening to contact a borrower's commanding officer, (iii) communications about the impact of the borrower's failure to pay on the borrower's credit standing; and (iv) suspension of access to electronic services including ATM and debit card transactions and online account access.

Threats of Legal Action

The Consent Order indicates that Navy Federal routinely sent collection letters and made phone calls claiming that legal action "had been recommended" or that the credit union would have "no choice" but to initiate legal action. The CFPB determined that Navy Federal had communicated to borrowers that legal action had been recommended or was likely but Navy Federal only pursued legal action against approximately 3% of members that failed to respond. Also Navy Federal did not actually evaluate or consider whether it was likely to actually file a lawsuit or pursue other legal action before sending letters threatening such actions. The CFPB determined that Navy Federal's threats of legal action with no intent of pursuing such actions were deceptive acts or practices.

Navy Federal also threatened or referred to garnishment of the borrower's wages. Garnishment is not a remedy that is available until the creditor has already obtained a judgment. Therefore, CFPB claims that Navy Federal's representations that garnishment could occur immediately or without first obtaining a judgment were deceptive.

Threats of Contact with Commanding Officer

Navy Federal also sent debt collection letters containing a threat to contact a member's military commanding officer about a loan delinquency. This will not be an issue for most credit unions. However, it does serve as a reminder that most communications with the debtor's employer or other third parties are prohibited. Of greater concern, however, was Navy Federal's support for the member consent to contact commanding officers. The Navy Federal loan or deposit documents apparently included language in which the member purportedly gave permission to Navy Federal to contact the commanding officer. The CFPB found that such consent is ineffective, because it was "buried in fine print, not negotiable, and not bargained for." CFPB's determination raises concerns that it could find other contract terms ineffective for the same reason.

Representations About Credit Standing

Navy Federal's communications to delinquent members included statements that it would be difficult or impossible for the member to obtain credit now or in the future due to the member's unsatisfactory credit rating with Navy Federal. In some cases, the member was informed that they could "repair" their credit by contacting Navy Federal. The CFPB treated these communications as deceptive because Navy Federal did not analyze the borrower's credit to assess whether the borrower would have difficulty in obtaining credit. In addition, the CFPB asserted that the communications created an impression that Navy Federal offered credit repair services when the credit union did not in fact offer such services.

Suspension of Account Access

In addition to Navy Federal's collection communication practices, the CFPB found Navy Federal enforcement actions on related accounts and services of delinquent borrowers unfair. Navy Federal routinely suspended a delinquent borrower's electronic access to accounts and services, including debit card and ATM transactions, online account access, and audio response service. This action effectively prevented the member from conducting any electronic transactions or obtaining any information about the account without contacting the credit union and speaking with a credit union representative. Also this access restriction prevented members from placing travel alerts on their accounts and from having Social Security verification requests processed, which may have delayed determination of the members' eligibility for certain benefits.

Navy Federal's practice of suspending electronic account/service access operated on a fairly aggressive schedule. The timing of the suspension was based on Navy Federal's risk profile for the member in question. In the accounts reviewed by the CFPB, 36,000 service suspensions occurred between 1 and 5 days delinquency; 480,000 suspensions occurred between 6 and 16 days delinquency; and 180,000 occurred at greater than 17 days delinquency. Also Navy Federal did not make any special exception or arrangements for accounts that had direct deposit of federally protected benefits such as social security or veterans' benefits. The CFPB determined that Navy Federal did not

provide adequate notice of this practice to members at account opening, inception of the loan, or before the suspension of services occurred.

The CFPB's legal claim was not that Navy Federal acted deceptively in suspending electronic services, but that the practice of freezing electronic access was inherently unfair. Under the Dodd Frank Act, an action is "unfair" if it is likely to cause substantial injury to the consumer, and the injury is not reasonably avoidable by the consumer. The CFPB reasoned that Navy Federal members could not reasonably avoid the harm caused by suspension of electronic services because they were not adequately warned that such suspensions could occur. It is also worth noting that the Consent Order deals only with Navy's practice of freezing electronic services. It did not include any discussion of any use of setoff rights or the statutory lien to actually apply funds from member accounts to pay delinquent loans.

How and Why the CFPB's Order Impacts Your Credit Union

Credit unions may ask whether this Consent Order has any direct impact on them. The Consent Order is not a finding by a Court. It represents a settlement of the CFPB's claims against Navy Federal based on a specific set of facts, and it is not binding on any credit union other than Navy Federal. The CFPB only has direct examination authority over credit unions that exceed $10 billion in assets. However, credit unions would be wise to reexamine their collection practices in light of this order for several reasons.

The Navy Federal Consent Order was based on the unlawful and deceptive or abusive acts and practices (UDAAP) provisions of the Dodd Frank Act. The CFPB has broad authority to launch investigations and to recommend enforcement actions for UDAAP violations. While the CFPB may not directly examine credit unions with less than $10 billion in assets, the CFPB may undertake an investigation (including issuance of subpoenas, taking depositions, etc.) for UDAAP violations. A pattern of complaints against a particular credit union via the CFPB's portal could provide the CFPB (or NCUA or a state agency) with the basis to investigate a credit union. Finally, most states have similar laws prohibiting unfair or deceptive acts and practices (Washington's Consumer Protection Act, Oregon's Unlawful Trade Practices Act and Idaho's Consumer Protection Act are examples). Attorneys representing borrowers may view the Consent Order as articulating standards that should also be applied under state UDAP laws.

Guidance for Reviewing Your Collection Practices & Communications

Credit unions need to examine their own collection practices in light of the CFPB's order. In particular, credit unions should review practices and documents for the following issues:

<u>Collection Letters</u>

> **Communication about legal remedies must be real not threats**. Credit unions should carefully tailor collection letters and verbal communications about legal remedies to ensure that they are not misleading. Certainly the credit union should not represent that a lawsuit or other legal action is imminent, likely, or recommended if no action is reasonably intended (likely, not just an idle threat.) If the credit union has made a decision to file a lawsuit if the member does not respond, it is fine to say so. Otherwise, credit unions need to be extremely

cautious in referring to potential legal actions. Similarly, any reference to garnishment or any other post-judgment remedy should be avoided with early collection letters as the credit union cannot take these actions before filing a lawsuit and obtaining judgment.

Communication about impact on credit standing must be accurate. It is reasonable to remind the borrower that the credit union will report the status and history of the borrower's obligations to credit reporting agencies. But credit unions should be careful not to overstate this point. Similarly, any discussion of the positive impact that contacting the credit union or repaying the credit union obligation must be carefully crafted. Members should understand that if they bring their loan current or pay it off, the credit union will accurately report that to the credit reporting agencies. These payments may (or may not) have a positive impact on credit score or on the member's overall credit profile, so the credit union should not make speculative representations about such effects.

Collection Enforcement Practices

Suspension of electronic account/service access – requires notice. First and foremost, if a credit union engages in a practice of suspending a delinquent borrower's access to accounts or services, the member should be informed of that possibility before it occurs. Suspension of electronic access (including debit cards, online banking, mobile banking, audio response, etc.) is a much broader action than exercising the credit union's statutory lien, security interest, or right of offset. As the Consent Order observes, suspension of electronic access may impact the member's ability to make deposits or conduct other activity that would have no negative impact on the delinquent loan. Contractual references to the right to offset or apply funds alone do not adequately address or describe other enforcement actions the credit union may take. For that reason the delinquent borrowers need to be clearly informed.

Loan/Deposit Agreement Support. If a credit union blocks electronic account or service access as a result of a loan delinquency or default, the credit union should confirm (or update) that its documentation explicitly provides the contractual right and the conditions when the credit union may exercise that right. For existing loan and deposit documents, where permissible, a contractual change in terms notice is advisable. Of course recognize that such provisions in loan and account documents are not immune from challenge. After all, the CFPB viewed similar provisions as not negotiated or bargained for. However, the absence of such support leaves the credit union in a weaker position to sustain any challenge. If your loan documents are supplied by an outside vendor, you should check with the vendor to determine if the vendor is implementing forms changes in the near future. Alternatively, the credit union should consult with legal counsel to prepare the necessary changes.

Notice to Delinquent Borrowers. Including information about electronic account or service suspension practices in deposit and loan documentation may not be sufficient. Unless circumstances dictate otherwise, we recommend the credit union notify the member before taking any suspension action. If a credit union routinely takes these actions, the credit union should include a notice about suspension of any account/service access in a 10-day or 15-day delinquency

notice. The notice should accurately address the scope of suspended accounts/services and the timing of any freeze. We also recommend that the credit union provide a reasonable "courtesy period" before routinely cutting off services and inform borrowers of the conditions for any service resumption.

Exceptions for Protected Funds. Credit unions should make appropriate exceptions to any suspension policy for accounts that are subject to direct deposit of protected benefits such as social security, disability payments, or other protected benefits. In addition, credit unions should ensure that other activities (such as responses to government inquiries for benefit eligibility purposes) are not affected by suspension of account/service access.

Denial of Service and Collection Policies.

As with most legal and compliance matters, it is critical that the credit union's policies accurately reflect the practices it routinely takes. Denial of service policies should be reviewed to ensure they articulate the credit union's account/service suspension practices related to loan delinquencies or contractual breaches and not just abusive behavior or actual losses to the credit union. Similarly collection policies should reflect the credit union's notice practices and exceptions for protected funds.

Compliance Management.

As a matter of prudent compliance management the credit union needs to ensure its member response management, training and auditing functions are updated to accurately address its collection practices and communications. The credit union must provide training to the relevant personnel (collections staff, branch staff, back office) to ensure that they are aware of the credit union's policies and procedures. Finally, the credit union should include these issues in its internal audit process to ensure that the policies and procedures are actually followed.

We can help you ensure that your credit union's letters, policies, procedures, loan documents and deposit documents support your practices and put your credit union in the best position possible to avoid the problems found by CFPB in the consent order. If you would like assistance in assessing and minimizing your credit union's exposure in this area, you can contact Kelley Washburn, Hal Scoggins, or Brian Witt. We can all be reached at 503-228-6044, or by email at:

kwashburn@fwwlaw.com
hscoggins@fwwlaw.com
bwitt@fwwlaw.com

Hal Scoggins
Brian Witt
Kelley Washburn

In collaboration with the credit union attorneys at Moore, Brewer, Wolfe, Jones, Tyler & North, Howard and Howard, and Williams Gautier.