MARK BORN
STATE REPRESENTATIVE • 39TH ASSEMBLY DISTRICT

Testimony on 2015 Assembly Bill 117

Committee on Financial Institutions
September 16th, 2015

Chairman Craig and Financial Institutions Committee members,

Thank you for allowing me to testify in favor of AB 117.

Under current law, consumer credit transactions of $25,000 or less which are entered into for personal, family, or household purposes are generally subject to the Wisconsin Consumer Act (WCA). The WCA includes requirements that must be satisfied by a creditor or merchant in order to enforce rights arising from a consumer credit transaction.

The primary goal of AB 117 is to clarify ambiguities that currently exist in the pleading requirements for complaints filed by creditors in WCA cases. To that end, this legislation contains two key components.

First, the bill changes current statutory references of "creditor" to "merchant". These terms are currently defined in Chapter 421 and are not changing under this bill. Often times, consumer credit card debt is sold by a credit card company to a third party. The third party then attempts to recoup that debt that the consumer still owes. By changing this terminology, we are making it crystal clear that the original creditor that issued the debt, as well as any successors to that debt, are entitled to enforce their rights under the WCA to collect that debt.

Second, AB 117 makes changes to the pleading requirements for complaints filed in consumer credit cases. The bill more clearly defines the information the creditor must provide in regards to the customer's outstanding obligation. Currently, the information creditors are required to provide varies from judge to judge, and based on vague "figures necessary" to determine the obligation. These gray areas have been exploited in order to get out of paying their debts. A specific breakdown of the charges, interest, and payments associated with the alleged obligation would be required under this legislation.

The vast majority of consumers repay their debts. However, the select group of people defaulting and then exploiting ambiguities in our legal system to get off the hook results in costlier credit

(over)

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for everyone. This adversely impacts all the good actors in the credit market, especially the more vulnerable populations who rely on credit on a day-to-day basis.

The changes included in AB 117 will help both merchants and debtors save time and money associated with litigation. Moreover, this bill will help our credit markets function more efficiently, which benefits us all.

Thank you.

My name is Jim Johannes. I am

- Aschenbrenner Chair of Banking at UW-Madison
- Director of the Puelicher Center for Banking Education at UW-Madison

I am a consumer advocate whose objective is to maximize access to credit at the lowest price

- I chaired the Committee to rewrite the Wisconsin Consumer Act
- I was a Director of the UW Credit Union for over 20 years.
- I currently serve on the Funds Management Committee for the UW Credit Union
- I serve on at least 4 non-profit boards

I am not an advocate for abusive banking or collection practices nor am I a shill for the financial industry. I have testified against banks and accounting firms on numerous occasions.

I am here to

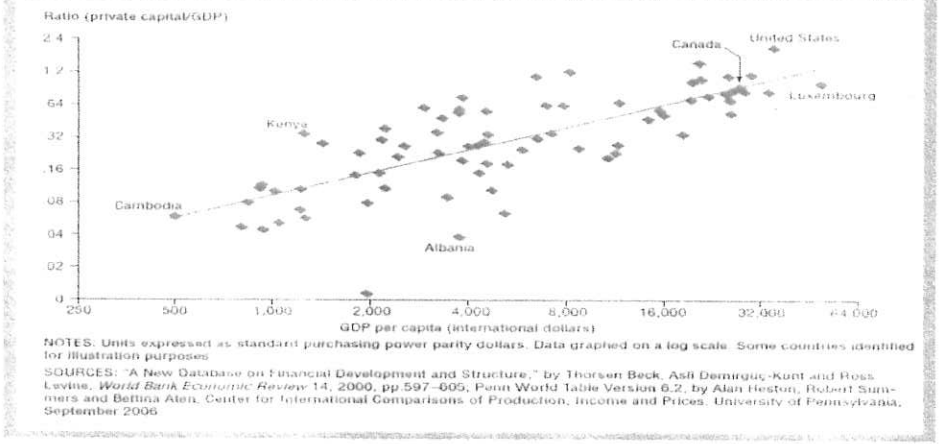
- advocate for inclusion of 3rd party collectors and assignees in our debt collection laws and
- To advocate for clarity in debt in collection activities to help financial markets work more efficiently to the advantage of both lenders and borrowers.

To put my comments in perspective, it is important to understand the economics of credit markets

1. Well-functioning credit markets that allow people to access private credit are important for economic growth and welfare.

Chart 4

Economic and Financial Development by Nation



NOTES: Units expressed as standard purchasing power parity dollars. Data graphed on a log scale. Some countries identified for illustration purposes.

SOURCES: "A New Database on Financial Development and Structure," by Thorsen Beck, Asli Demirguç-Kunt and Ross Levine, *World Bank Economic Review* 14, 2000, pp.597–605; Penn World Table Version 6.2, by Alan Heston, Robert Summers and Bettina Aten, Center for International Comparisons of Production, Income and Prices, University of Pennsylvania, September 2006

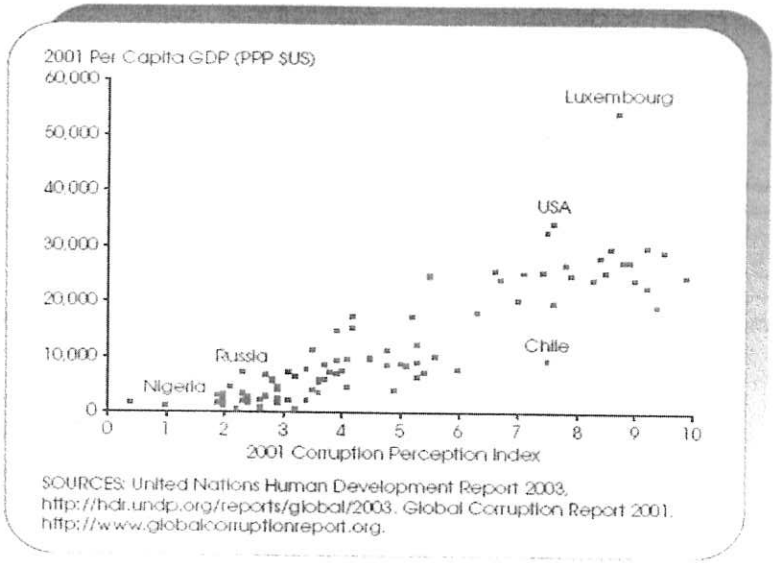
And to consumers who need access to credit to

- Purchase in a convenient manner
- Purchase durables in a cash constrained period
- Finance unanticipated but necessary or emergency goods
- Bridge difficult financial situations without creating undo hardship

2. We cannot have a well-functioning credit market without a well-functioning legal system that supports contracts.

If contracts cannot be enforced, credit markets will fail.

If laws allow abusive activities on the parts of either lenders or borrowers, credit markets will fail



So we need to include all collection activities in our consumer protection laws.

3. Third –party collectors are an important part of a well-functioning and efficient credit market.

As 7th Circuit US Appeals Court Justice Posner wrote in Olivera v Blitt Gaines,

"There is an innocent reason that creditors assign collection to other firms rather than doing it themselves. It is the same reason that most manufacturers sell to consumers through independent distributors and dealers rather than doing their own distribution. Outsourcing phases of the total production process facilitates specialization, with resulting economies. Specialists in debt collection are likely to be better at it than specialists in creating credit card debt in the first place...[Forcing third party collectors out of debt collection]... would not benefit [borrowers]on average, because creditors, being deprived of the assignment option as a practical matter ... would face higher costs of collection and would pass much of the higher expense on to their customers in the form of even higher interest rates."

4. Whoever collects debts, we need well thought out and clear laws to both protect consumers from unscrupulous lenders and collectors but also to allow credit markets to work correctly.

The Consumer Financial Protection Bureau is currently working on regulations to amend the Fair Debt Collection Practices Act to reflect best practices in collections.

5. One key to credit is the cost of providing credit- which depends on several factors:

- Cost of funds used to make loans
- Costs of loan administration (documentation, loan officers, facilities,...)
- Costs of mitigating interest risk (hedging costs, etc)
- Bad debt expense or how much the lender expects to lose

6. **To explain the impact of bad debt expense**, consider two groups of borrowers. One is riskless and everyone in that group will pay back everything they owe (principal and interest) and the other is risky and 90% will pay back what they owe (most people do regardless of risk class) but 10% of the people in that group will not pay back what they owe.

   If we charge the riskless Group 5% to borrow we have to charge the risky Group 16.67%

   risky rate = (1 + riskless rate)/percent recovered

   .90(1.1667) = 1.05

7. This means that all borrowers in the risky group will pay 16.67% (an 11.67% risk premium) even though 90% pay their debts in full.

So the 10% who renege on their debt inflict a large penalty on the other 90% in that risk class.

8. Therefore, to help the borrowers who do pay back their loans in any risk class, lenders need to minimize, NOT MAXIMIZE, the losses created by the 10% which means we need collections to be effective.

9. To minimize the losses we therefore want to maximize collections subject to responsible and ethical collections laws. We do not want to create loopholes for defaulting debtors to jump through! If we create such a law, two things will happen.

    1. The cost of credit will increase as demonstrated above.
    2. We will encourage reckless use of credit and over-borrowing by consumers which is not in the best interest of society.

10. We have such a loophole in Wisconsin's pleading requirement. Our law reads

"The actual or estimated amount... that the creditor alleges he or she is entitled to recover and the figures *necessary* for computation of the amount, including any amount received from the sale of any collateral [emphasis added]."

The words "*figures necessary*" at a minimum is vague and introduces unnecessary uncertainty and interpretation into the law and at a maximum creates a huge loophole.

- The necessary figures might no longer exist as the current debt would depend on what happened in an account 5,7,10 years ago. Nobody has that data.
- This puts the burden to prove the debt solely on the back of the creditor and creates a situation where the borrower has NO incentive to cooperate.
- It creates an impossible, **vague** standard that goes way beyond "adequate" or "sufficient" that Attorneys for Debtors can exploit. For example see "You Can Beat Credit Card Collectors",

a quote form the article

"[request] that they produce all of the receipts for every transaction that you engaged in during the entire life of the use of that credit card. You have requested that they show what you purchased in each of those transactions, and you have requested that they produce your payment record. All of this is legal, and all of it is required in order for them to properly enter the court. Guess what? They do not have this documentation."

It is also inconsistent with the "reasonableness" being written into debt collection laws everywhere else at the National and State level that call for sufficient information to prove the debt

For example,

- the standard used by CFPB auditors (Consumer Finance protection Bureau) is the following: "Consider in particular whether the entity received information ***sufficient*** to determine the consumer's identity, the amount due, whether any fees charged were permitted by contract, and the original creditor." (emphasis see CFPB Examination Procedures Debt Collection, page 7) or

- or the standard in the Fair Debt Collection Act for debt validation reads that says " ... unless the consumer, within thirty days after receipt of the notice, disputes the validity of the debt, or any portion thereof, the debt **will be assumed to be valid** by the debt collector..."

- or the new California law:" If the claim is based on debt for which no signed contract or agreement exists, the debt buyer shall have access to a copy of a document provided to the debtor while the account was active, demonstrating that the debt was incurred by the debtor. For a revolving credit account, the most recent monthly statement recording a purchase transaction, last payment, or balance transfer shall be deemed ***sufficient*** to satisfy this requirement."

Which suggests that a recent bill and activity on the account since that bill is sufficient especially at the pleading stage.

Which by the way is exactly what is called for by the Consumer Group called the Center for Responsible Lending which is a nonprofit, non-partisan organization that works to protect homeownership and family wealth by fighting predatory lending practices.

This group wants lawmakers to "Require more detailed and accurate evidence when debt buyers file lawsuits".

"State legislatures should adopt legislation or state court systems should establish statewide court rules that require debt buyers to possess more detailed and accurate information and evidence when they sue to collect on the debts...documentation establishing the debt, such as the original contract or credit application and recent billing statements"*

*Debt Collection & Debt Bbuying
The State of Lending in America & Its Impact on U.S. Households
Lisa Stifler and Leslie Parrish
April 2014

11. This loophole in the current Wisconsin Statutes is flawed and minimizes collections and therefore maximizes the rate "good" borrowers pay for credit.

12. The economics literature is pretty clear on the impact of inefficient collection practices

A recent study, for example, at the Federal Reserve Bank of Philadelphia . ("Debt Collection Agencies and the Supply of Consumer Credit", Working Paper No. 13-38) highlights the costs to society in terms of higher interest rates and less access to credit that result from higher collection costs or laws that make it harder to collect on bad debts.

The follow-up empirical study (Paper 15-23) to that paper by the Philadelphia Fed supports the results of the first study. Laws that make it harder to collect debts lower access to credit and raise the price of credit.

So if your goal is to reduce access to credit and to raise the cost of that credit to all borrowers then leave the law as it stands.

But, if your goal is to

- **increase RESPONSIBLE access to credit**
- **decrease irresponsible borrowing**
- **lower the rate responsible borrowers in all risk classes pay for credit and**
- **preserve the integrity of the financial system**

Then you need to rewrite the law to clarify the exact documentation required at the pleading stage to adequately validate a legitimate debt outstanding that is to be collected.

Such a change will not lessen the law when it comes to prohibiting abusive collection practices but will add clarity to the law which will remove ambiguity, remove a loophole and allow financial markets allocate credit more effectively and efficiently..

Three states have actually lowered the evidentiary requirement AZ, ARK and TN

UNIVERSITY of WISCONSIN LAW SCHOOL

Testimony of Stephen J. Fozard, Staff
University of Wisconsin Law School Consumer Law Clinic
Before the Assembly Committee on Financial Institutions
Regarding 2015 Assembly Bill 117
September 16, 2015

Mr. Chairman and members of the Committee, thank you for the opportunity to speak with you today. My name is Stephen Fozard. I am a third-year law student and I am Mrs. Orr's Project Assistant at the University of Wisconsin Law School's Consumer Law Clinic. I have worked for Mrs. Orr at the Clinic for the past year and a half. Mrs. Orr has already explained the mission of the Clinic, so I will not belabor the point. Prior to attending the University of Wisconsin-Milwaukee for my Bachelors Degree in Criminal Justice, I served in the Marine Corps as an infantryman from 2005 to 2009. In that time, I deployed to Iraq for combat missions on three separate occasions. I decided to join the Marine Corps and to continue my education into law school for one simple reason. I believe it is my natural-born duty to be a protector. That is what we are here to talk about today. And in that regard, I oppose Assembly Bill 117.

Let me be clear. The Wisconsin Consumer Act is vitally important to the legitimacy of the State's power and the financial health of our consumers. In many respects, it puts ordinary people on a level playing field with some of the most sophisticated business entities in one of the most complex business markets imaginable. In the financial and legal realm, information is undoubtedly power. And when one of those sophisticated entities sues one of our citizens in one of our courts, we must be sure that we have all the information necessary to determine the validity of that lawsuit. Because, essentially, those entities are asking the State to exercise its awesome power and give them access to our citizens' paychecks, bank accounts, or any other property they might seek to satisfy a judgment. And to ensure that awesome power is not abused by fraudsters, or other unsavory businesses, this legislature enacted the pleading requirements in section 425.109.

Those pleading requirements supply the very basic information that would be necessary to receive a judgment in any other context. The only difference is that the information must be provided up-front, rather than relying on a lengthy and expensive discovery process. This is necessary in the consumer context because most consumers do not have the funds to pay for a lawyer, and they do not know enough about their legal rights to demand the information on their own. Without that very basic information on the front-end, a consumer will probably have no idea what the lawsuit is about. Consumers may have lost paperwork, forgot who they had a loan with, have no idea that their loan has been sold to a different company, or the lawsuit may be entirely improper because it is past the statute of limitations. This is exactly the type of disadvantage that fraudsters use every day to extort money from our citizens. The pleading requirements also serve several advantages to our courts. It saves court resources, so that lengthy and expensive discovery battles do not clog the docket, and so judges can rest assured that they have entered a judgment against the proper defendant, for the proper plaintiff, and for the proper amount.

What's more, is that there is simply no good excuse for a Plaintiff not to have this very basic information. These Plaintiffs know at the time they acquire the right to payment that this information will be necessary if they must use the courts. For a Plaintiff to file a lawsuit without this information would be utterly frivolous.

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So why are we here today? Why has this Bill been proposed? Because the current statute lacks clarity? Because the pleading requirements are too onerous? Absolutely not. The current statute has worked to ensure consumer understanding and creditor compliance for over forty years. We are here because out-of-State businesses want our laws to cater to their broken business model. We are here because those businesses want to increase their profit margins at the expense of the legitimacy of the judicial system, and the financial safety of our consumers. They will tell you that they are compromising with consumers. They will say that they have expanded the types of businesses who must comply with the statutory requirements. And, in a sense that is true. But this Bill also entirely eradicates the reason those businesses might actually comply with those requirements. That is unacceptable. You would not pass a law for the safety of your citizens without a penalty for breaking it. You would not have a speed limit on our State highways without giving the police a way to enforce it. So we must not allow the same absurdity in the consumer context.

Do not amend Wisconsin Statute Section 425.109 until the Bill on the table is one that furthers the goals of the Wisconsin Consumer Act, not a Bill that undermines its necessary and vital protections.

Ladies and gentlemen of the Committee, Mr. Chairman, I thank you for your time here today.

Respectfully Submitted,

Stephen J. Fozard

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WISCONSIN CREDITORS RIGHTS ASSOCIATION

LAW FIRMS PROVIDING LEGAL AND LEGISLATIVE SUPPORT TO
WISCONSIN CREDITORS AND COLLECTORS

Matthew J. Richburg, President
Robert I. Dorf, Vice President
Rob E. Potrzebowski, Treasurer
Robert Hornik, Secretary

Chapter 425 Revisions

WHO WE ARE

The Wisconsin Creditors' Rights Association (WCRA) consists of members of Wisconsin law firms that represent nationally recognized debt buyers and mainstream creditors such as Bank of America, Capital One, Citibank, Discover, Target, and others.

WCRA members are the collectors of last resort, dealing with debt that has usually gone through collection efforts by the original creditor, and a collection agency. WCRA members do not pursue debts that have been discharged in bankruptcy or are beyond the statute of limitations for collection. We maintain rigorous safeguards in our practices and procedures to insure that we do not attempt to collect any such debt.

Our Country's system of issuing credit is based on the premise that those debts will be paid. Credit would and could not be issued to consumers if creditors did not have a system to collect unpaid debt – which includes an effective, viable legal process. This is an important factor in keeping the cost of borrowing at a reasonable rate for all consumers. The WCRA assists in preserving the integrity of the credit system by holding individuals accountable for their lawful debt in an ethical and fair manner using the litigation process.

PROPOSED LEGISLATION

The WCRA recommends making a change to Chapter 425 of the Wisconsin Statutes to bring consistency and clarity to the debt collection process by amending §425.109 to clarify various ambiguities in the pleading requirements for consumer credit debt collection that exist as a result of a Wisconsin Court of Appeals decision.

§425.109 is ambiguous and excludes assignees of consumer credit debt

§425.109 of the Wisconsin Statutes is a special pleadings statute that requires more information in a complaint than the information required in the General Rules of Pleadings under §802.01.

Unfortunately, the current language of §425.109 excludes from its coverage *assignees* who are not the original creditor but who have purchased – i.e., have been *assigned* – the debt. It is also ambiguous and unclear regarding the proof it requires an assignee of debt to produce in court in its pleadings.

§425.109 does not include any reference to assignees and states that a complaint in a consumer credit collection lawsuit must include:

> *"The actual or estimated amount of U.S. dollars or of a named foreign currency that the creditor alleges he or she is entitled to recover and the figures necessary for computation of the amount, including any amount received from the sale of any collateral."*

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The problem with this language is two-fold: (1) It fails to even acknowledge the existence of assignees of debt as a creditor, even though they have purchased the debt and completely assumed the risk; and (2) It fails to indicate what "figures" a debtor would need to determine the balance due; and this ambiguity causes our court system as well as creditors and debtors to waste unnecessary time and resources arguing and litigating what "figures" are necessary to comply with the statute

The result is the undermining of the integrity of our credit system and inefficiency in our court system. Various circuit courts currently apply vastly different definitions and standards, ranging from requiring only an allegation of the total amount due, to the extreme of attaching copies of every monthly account statement from the time the account was opened.

An amendment would clarify and give guidance to courts, creditors, and debtors as to what information must be provided. Specifically, an amendment should require a complaint to supply the customer with the account balance on a statement previously sent to the customer, so the information on the complaint will conform to information the customer has already seen. An amendment should also require a listing of all activity following such date of the statement identified in the complaint.

Finally, the statute should be amended to expressly include assignees of consumer credit debt in order to eliminate any concern that assignees have a lesser pleading burden than original creditors. In 2006, based in part on the ambiguity and incompleteness of §425.109, the Wisconsin Court of Appeals ruled in *RISDUE* v. Michaud that only original creditors were covered by the statute because a "creditor" is defined as an entity that extends credit, and the assignee of a consumer credit debt does not typically do that.

421.301(16)

(16) "Creditor" means a merchant who regularly engages in consumer credit transactions or in arranging for the extension of consumer credit by or procuring consumer credit from 3rd persons.

421.301(25)

(25) "Merchant" means a person who regularly advertises, distributes, offers, supplies or deals in real or personal property, services, money or credit in a manner which directly or indirectly results in or is intended or designed to result in, lead to or induce a consumer transaction. The term includes but is not limited to a seller, lessor, manufacturer, creditor, arranger of credit and any assignee of or successor to such person. The term also includes a person who by his or her occupation holds himself or herself out as having knowledge or skill peculiar to such practices or to whom such knowledge or skill may be attributed by his or her employment as an agent, broker or other intermediary.