ALERT MEMORANDUM

Key Consumer Finance Issues in the COVID-19 Crisis

March 24, 2020

As the number of diagnosed cases of the COVID-19 virus increases in the United States, and the restrictions on commerce increase in their severity, the crisis is expected to hit working-class Americans who rely on regular paychecks to meet their monthly expenses particularly hard. In a recent study, nearly 20% of respondents reported that someone in their household had either been laid off or had their work hours reduced as a result of COVID-19 containment measures.[1] For many of those families, that is likely to result in either increased reliance on consumer financing, or defaults on existing obligations.

If you have any questions concerning this memorandum, please reach out to your regular firm contacts, the following authors, or our COVID-19 task force by clicking here.

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The federal and state governments have now begun taking action to protect consumers facing economic hardship as a result of COVID-19 and the travel and commerce restrictions imposed to combat it. Many of these measures may also be relevant to companies and institutions that engage in consumer finance lending, servicing or collection. Here we examine measures related to:

- Industry efforts to accommodate consumer financial hardship.
- Regulatory and legislative restrictions on consumer debt collection.
- Efforts to prevent a wave of residential mortgage defaults.
- Enforcement risks related to consumer debt collection arising from COVID-19-related defaults.

[1] NPR/PBS NewsHour/Marist Poll at 21, http://maristpoll.marist.edu/wp-content/uploads/2020/03/NPR_PBS-NewsHour_Marist-Poll_USA-NOS-and-Tables_2003151338.pdf.

Households Face Increasing Financial Pressure From COVID-19 Containment Measures

During the 2007-2009 Financial Crisis, American households were hit with an unprecedented rise in the rate of consumer debt defaults. Between 2006 and 2011, the default rate on residential mortgages rose from 2% to over 11%, and to nearly 30% for sub-prime mortgages.[2] Between 2007 and the second quarter of 2010, the rate of charge-offs on consumer credit cards likewise exploded from 3.85% to 10.97%—a nearly three-fold increase.[3]

If past is prologue, the current situation threatens to place similar pressures on American households. Indeed, it remains to be seen whether the current situation is better or worse than during the recession following the Financial Crisis—while economic fundamentals remain strong in the current environment, the effective shuttering of wide swaths of the American economy threatens to place severe financial strain on low-income and working-class households. For these households, a "liquidity" crunch can quickly cause the domino effect leading to default.

Many who find themselves out of work have no obvious means to make up the lost income. A 2019 Federal Reserve study showed that 40% of American households would be unable to come up with $400 to meet an unexpected expense, and 12% of American households could not do so even through borrowing.[4] With so many expected to be out of work for an extended period of time, and slowed economic activity expected for at least the next two quarters, it is reasonable to expect a marked increase in consumer defaults notwithstanding government efforts to provide relief in the form of direct payments and extensions of unemployment benefits.

Industry Initiatives To Avoid Defaults

The financial services industry has been on the front line in providing relief to borrowers to avoid default. Consumer lenders and financial services companies have announced COVID-19 assistance measures they will offer to eligible affected customers such as waiving account fees, collection forbearance, and payment deferrals. A number of banks have announced the following measures, among other actions by consumer lenders:

- Waivers of monthly account maintenance fees,

[2] Federal Reserve Bank of Minneapolis, Who Defaults on Their Mortgage, and Why? Policy Implications for Reducing Mortgage Default, https://www.minneapolisfed.org/article/2017/who-defaults-on-their-mortgage-and-why-policy-implications-for-reducing-mortgage-default

[3] Federal Reserve Bank of Philadelphia, What Happened to the Revolving Credit Card Balances of 2009?, https://www.philadelphiafed.org/-/media/consumer-finance-institute/payment-cards-center/publications/discussion-papers/2016/dp16-01_what-happened-to-revolving-credit-card-balances-2009.pdf?la=en

[4] Report on the Economic Well-Being of U.S. Households in 2018-May 2019, https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-dealing-with-unexpected-expenses.htm.

- Waivers of penalties for early withdrawal of timed deposits,
- Refunds of bank and loan fees,
- Mortgage and auto loan restructuring and forbearance during periods of income disruption,
- Deferral of small business and consumer loan payments during the period of the COVID-19 crisis, and
- Providing low-rate or zero-rate loans in some cases to qualified customers facing income disruption.[5]

Outside of the banking sector, consumer lenders and debt servicers are broadly engaged in similar actions to address the COVID-19 crises and avoid significant consumer debt defaults.

Proposals To Curtail Private Debt Collection and Limit Negative Credit Reporting

No federal action has yet been taken to formally suspend consumer debt collection, although we anticipate that some legislative measures will be taken in the medium term.

On March 23, 2020, Congressional Democrats proposed expansive legislative that would affect consumer lending and collection activities on a variety of fronts. Among other measures, the proposed "Financial Protections and Assistance for America's Consumers, States, Businesses and Vulnerable Populations Act" would prohibit:

- Any collection of a consumer, non-profit or small business debt by any creditor during the period of the currently-declared emergency period,
- Capitalizing or adding extra interest or fees,
- Suing or threatening to sue to collect a debt, or continuing litigation to collect a debt,
- Enforcing a security interest to collect a debt, or
- Reporting a past-due debt to a consumer credit reporting agency.

Notably, the definition of a "debt collector" under the proposed legislation includes "a creditor and any person or entity that engages in the collection of debt (including the Federal or a State government)." It would therefore be considerably broader than the definition of a debt collector or collection agency under existing federal or state law, which is typically limited to businesses that are primarily engaged in the business of debt collection (as distinguished from lenders).

Amendments to the proposed legislation should be expected as it progresses through the House of Representatives, and the fate of the bill in the Senate is uncertain.

[5] *See, e.g.*, American Bankers Association letter to Maxine Waters, https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/aba-response-to-chairwoman-waters-re-covid19-03202020.pdf?rev=d155085609fe419980580b90fdf5328a.

On the senate side, proposed legislation has been less expansive. On March 17, 2020, U.S. Senators Brian Schatz (D-Hawai'i) and Sherrod Brown (D-Ohio) introduced a bill that would would provide for an immediate four-month moratorium on all negative credit reporting and free, unlimited credit reports and credit scores for a year after the pandemic.[6]

On March 23, 2020, U.S. Senators Chris Van Hollen (D-Maryland) and Sherrod Brown announced legislation to temporarily cap consumer lending rates at 36 percent during the Covid-19 outbreak. New legislative proposals are expected as pressure mounts for a quick and decisive response by Congress.

At the state level, no state has yet imposed a formal moratorium on debt collection activities. On March 19, 2020, the Deputy Commissioner of the Nevada Department of Business and Industry recommended that collection agencies in the state cease operations for 30 days, although that guidance does not carry the force of law. As a practical matter, however, the effective closure of small claims courts across the country will limit the ability of collection agencies to obtain judgments on defaulted debt. On March 21, 2020, New York Governor Andrew Cuomo issued an executive order mandating that financial services firms grant forbearance to any debtor that requests it and has suffered financial hardship as a result of the COVID-19 outbreak.[7]

Outside the United States, other countries in Europe and elsewhere are either looking at restrictions on debt collection or have enacted them. Among the first to act was Greece, which announced on March 19, 2020 that it is suspending the operation of debt collecting for the duration of the state of emergency.[8]

As governments grapple to respond to the immediate crisis, financial institutions and lenders are also grappling with the impact of potentially significant consumer debt restructuring and forbearance, including the implicit obligation to take on greater credit risk over time with respect to borrowers who may be more likely to default than when credit was first extended. While avoiding defaults may prevent the sort of cascading market impact experienced as a result of the sub-prime crisis during the Financial Crisis, the impact on credit portfolios held by financial institutions and lenders remains to be seen. On March 22, 2020, the federal bank supervisors issued interagency guidance encouraging financial institutions to work with borrowers to avoid defaults, stating that supervised institutions will not be criticized for doing so and will not be required to categorize all COVID-19 related loan modifications as troubled debt restructurings—potentially avoiding the need

[6] https://www.schatz.senate.gov/press-releases/schatz-brown-introduce-new-bill-to-protect-peoples-credit-scores-suspend-negative-credit-reporting-during-coronavirus-outbreak.

[7] https://www.governor.ny.gov/news/no-2029-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency.

[8] https://www.thenationalherald.com/292658/new-democracy-suspends-debt-collectors-over-covid-19/.

to recognize accounting impairments as a result of modifications.[9]

Official and Unofficial Moratoria On Foreclosures and Evictions

On March 18, 2020, President Trump announced a nationwide moratorium on foreclosures and evictions. The policy applies directly to approximately 60% of all mortgage debt, which represents the amount attributable to agency-backed mortgages.[10]

In response, the Federal Housing Finance Agency ("FHFA"), which controls lenders Fannie Mae and Freddie Mac, has taken steps to provide forbearance on mortgage payments and to prevent evictions and foreclosures arising from the COVID-19 crisis. In early March, Fannie and Freddie issued guidance to mortgage lenders directing that payment forbearance of up to 12 months be afforded to borrowers impacted by COVID-19. An extended period of mass forbearance could make it more difficult for lenders to manage credit risk, which could also implicate supervisory concerns. On March 18, 2020, FHFA directed the suspension of foreclosures and evictions for Enterprise-backed mortgages for 60 days.

The Federal Housing Administration ("FHA"), which is part of the Department of Housing and Urban Development ("HUD"), likewise announced on March 18, 2020 a 60-day moratorium on foreclosures and evictions.

In both cases, the moratoriums will primarily affect mortgages that were already in default when the crisis commenced, and it will allow borrowers to remain in their homes during the period of the national emergency. While it is expected that efforts will be made to prevent a wave of foreclosures and evictions following the emergency, it seems likely that many borrowers already in default are likely to fall even further behind during this time.

At the state level, a number of states have either formally announced that eviction and foreclosure cases will not proceed through the court system, or that is the effective result of more generally applicable administrative orders:

- On March 20, 2020, New York Governor Andrew Cuomo issued an Executive Order that, among other measures, (a) tolled all deadlines in civil cases until April 19, 2020, and (b) suspended eviction or foreclosure on residential or commercial property for 90 days.[11]

[9] https://files.consumerfinance.gov/f/documents/cfpb_interagency-statement_payment-obligations-covid19.pdf; https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200309a.htm.

[10] Housing Finance at a Glance at 6, https://www.urban.org/sites/default/files/publication/101766/february20chartbook202020.pdf.

[11] https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency.

- A March 16, 2020 executive order from California Governor Gavin Newsom prevents foreclosures and evictions in California through May 31, 2020. The Executive Order covers not only mortgage foreclosures but also evictions of renters.[12]

- On March 18, 2020, Maryland's Chief Judge entered an administrative order staying until further notice all residential property foreclosure cases.[13]

A number of other states have either taken or are considering taking similar measures. At the federal level, House Democrats have called for banning all evictions and foreclosures during the pandemic in the Financial Protections and Assistance for America's Consumers, States, Businesses and Vulnerable Populations Act.

Suspension of Government Collections

While U.S. federal and state agencies have not yet proposed restrictions on private debt collection, a number of states and municipalities have announced that they will temporarily suspend the collection of debts owed to the government during the period of the crisis:

- On March 17, the New York State Attorney General's office halted the collection of medical and student debt owed to the state and has permitted others to petition for the temporary suspension of other debts owed to the state.[14]

- On March 18, Chicago mayor Lori Lightfoot announced the suspension of all debt collection efforts for debts owed to her city.[15]

Outside of New York and Chicago, it is unlikely that collection of government debts is proceeding in light of more general containment measures, but in the absence of a more formalized suspension of collection, borrowers still risk incurring fines or penalties for delayed payment. It is reasonable to expect that additional relief may be enacted, including retroactively.

Extension of Notice Period For Proposed Consumer Financial Regulations

COVID-19 has also impacted rulemaking processes that were already underway. On March 17, 2020, the Ranking Member of the Senate Committee on Banking, Housing and Urban Affairs, Sherrod Brown, wrote to agencies within that Committee's jurisdiction, including the Consumer Financial Protection Bureau ("CFPB"), HUD, and the federal banking agencies, requesting

[12] https://www.gov.ca.gov/wp-content/uploads/2020/03/3.16.20-Executive-Order.pdf.

[13] https://www.courts.state.md.us/sites/default/files/admin-orders/20200318suspensionofforeclosuresevictions.pdf.

[14] https://www.governor.ny.gov/news/governor-cuomo-and-attorney-general-james-temporarily-suspend-state-debt-collection-response.

[15] https://www.chicago.gov/city/en/depts/mayor/press_room/press_releases/2020/march/SuspensionTicketingDebtCollection.html.

an extension of all non-COVID-19-related rulemaking processes.[16]

On March 20, 2020, the CFPB announced the extension of the comment period for proposed amendments to CFPB Regulation F. The proposed amendments would require debt collectors to make specific disclosures when seeking to collect consumer debts that are time-barred under an applicable statute of limitations.[17] The comment period, which was set to close on May 4, 2020, is now extended to June 5, 2020.[18]

While other agencies are expected to grant extensions of regulatory comment periods that would otherwise expire during the COVID-19 crisis, none have yet announced extensions relevant to consumer finance issues.

Enhanced Enforcement Risk

In the current environment, federal and state law enforcement agencies can be expected to be particularly motivated to bring cases based on conduct identified as taking advantage of—or not being sufficiently responsive to—the COVID-19 crisis. In a March 16, 2020 memorandum to all United States Attorneys, Attorney General William Barr directed that cases related to the pandemic be prioritized, writing:

> *The pandemic is dangerous enough without wrongdoers seeking to profit from public panic and this sort of conduct cannot be tolerated. Every U.S. Attorney's Office is thus hereby directed to prioritize the detection, investigation, and prosecution of all criminal conduct related to the current pandemic.*

At the state level, consumer protection legislation in most states is enforced by attorneys general who are likely to find themselves under significant public pressure to bring cases related to COVID-19.

Companies and institutions engaged in the enforcement or collection of consumer debts should be particularly mindful of the risk that actions that may be interpreted as taking advantage of the COVID-19 crisis may lead to enhanced enforcement risks. Businesses that either collect debts on behalf of others, or that have a principal business purposes of engaging in debt collection should be mindful of their obligations under the federal Fair Debt Collection Practices Act ("FDCPA"),[19] and comparable state legislation enacted in many states. While many states impose additional restrictions, the FDCPA imposes a variety of restrictions including:

- Prohibiting harassment or abuse of debtors,

[16] https://www.banking.senate.gov/newsroom/minority/brown-demands-hud-and-independent-financial-regulators-cease-non-coronavirus-related-rulemaking-during-this-public-health-emergency.

[17] 85 Fed. Reg. 12672.

[18] https://www.consumerfinance.gov/policy-compliance/rulemaking/rules-under-development/debt-collection-practices-regulation-f-supplemental-proposal-time-barred-debt/.

[19] 15 U.S.C. § 1692 et seq.

- Prohibiting false or misleading representations, including false or misleading representations concerning the legal status of a debt or the ability to collect it,

- Engaging in a range of unfair practices, including accepting post-dated checks[20] or taking or threatening to take extrajudicial action to effect dispossession of property under various circumstances.

Under Dodd-Frank the CFPB is also empowered to take steps to curb what it deems unfair, deceptive, or abusive acts or practices by financial institutions.

In the current environment, particular attention should be paid to whether business practices that otherwise would reflect the ordinary course of business may be rendered unfair or misleading in light of any government action to suspend collection activities or in light of the tolling of limitations periods for civil enforcement actions.

Licensed consumer lenders should also be mindful of avoiding changes to lending terms or interest rates that may be perceived as taking advantage of the COVID-19 crisis. At least one state regulatory agency has published guidance that increasing interest rates and otherwise treating consumers unfairly may reflect negatively on qualification for licensure. March 18, 2020 guidance from the Wisconsin Department of Financial Institutions to the Payday and Licensed Lender industry reads:

> *Businesses with character recognize that this is a time for shared sacrifice, not financial exploitation. We recognize that the statutes that govern your businesses set no maximum limit on the interest you can charge, even when many are facing sudden financial distress. But fundamental human decency does. Therefore, effective immediately, this Department shall deem it an essential failure of your character and fitness if you increase your customary interest rates, fees, or any costs of borrowing in response to this crisis. We further urge you to reduce your rates and fees as low as operational expenses and sound lending practices allow.*[21]

Businesses and institutions that are not in the business of consumer debt collection or licensed lending and that may therefore fall outside the scope of laws and regulations governing those industries, should nonetheless be mindful that general consumer protection legislation affords broad jurisdiction for state and federal agencies to investigate and take action against unfair trade practices, potentially including those related to consumer debt collection. These include:

- The Federal Trade Commission ("FTC") Act establishes, as a matter of federal law

[20] This restriction is subject to exceptions where sufficient notice is given to the debtor prior to deposit of the instrument.

[21] http://www.wdfi.org/_resources/indexed/site/fi/banks/20200318_EmergencyGuidance-PaydayAndLicensedLenders.pdf.

that, "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."[22]

- In New York, General Business Law § 349 broadly prohibits "Deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service," and New York City's Consumer Protection Law prohibits any "deceptive or unconscionable trade practice in the sale, lease, rental, or loan or in the offering for sale, lease, rental, or loan of any consumer goods or services, or in the collection of consumer debts."[23]

- Massachusetts General Law Ch. 93A § 2 provides that "Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful."

- California Business and Professions Code § 17200 et seq., prohibits "unfair competition" defined broadly to include any "unlawful, unfair or fraudulent business act or practice."

Most other states have enacted similar legislation, although the breadth and elements of each state's laws may vary. Generally, however, such legislation may provide sufficiently broad authority for state attorneys general, federal agencies, or other law enforcement to investigate and bring action against—among other conduct—consumer finance-related practices deemed to be unfair or deceptive.

Given the heightened state of awareness about these issues, licensed consumer lenders and other businesses engaged in consumer finance should be proactive in ensuring compliance with existing regulations, as well as preparing to withstand heightened scrutiny of regulators. They should review all relevant policies and procedures related to consumer-facing lending, collection, and related notices. They should also prepare and distribute to all of their consumer-facing employees—as well as any third-party agents and contractors—guidance regarding the company's current stance with respect to collection efforts in light of the COVID-19 outbreak, any exceptions enacted in response to the outbreak, and assurances regarding how management is monitoring and responding to the fast-changing dynamics of the outbreak.

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For more information regarding other coronavirus-related topics please visit Cleary's online COVID-19 resource center, here. If you have any questions or would like to discuss this, or other topics relating to the COVID-19 outbreak, further, please do not hesitate to reach out to your regular contacts or contact our COVID-19 task force directly by clicking here.

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[22] 15 U.S.C. § 45(a)(1).

[23] N.Y.C. Admin. Code § 20-700.