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RESEARCH SUMMARY

THE LAW AND ECONOMICS OF CONSUMER DEBT COLLECTION AND ITS REGULATION

Effective legal rules governing debt collection are essential to the efficient operation of the consumer credit economy. If creditors are unable to effectively collect debts, they will be reluctant to lend. If borrowers feel oppressed by unfair debt collection practices, they will be reluctant to borrow. Maintaining a modern, flexible system of rules for debt collection is essential in order for both borrowers and lenders to have confidence that contracts will be enforced and that the terms of those contracts will be fair and transparent.

In light of the announcement by the Consumer Financial Protection Bureau (CFPB) that it is considering new regulation for consumer debt collection, it is important for policymakers to understand the potential consequences of such regulation. A new paper for the Mercatus Center at George Mason University reviews the law and economics of consumer debt collection and its regulation and concludes that the CFPB should consider all the potential consequences of new regulation—both intended and unintended—to ensure that it will benefit consumers.

To read the paper in its entirety and learn more about its author, Mercatus senior research fellow Todd J. Zywicki, see "The Law and Economics of Consumer Debt Collection and Its Regulation."

GOVERNMENT RESTRICTIONS ON DEBT COLLECTION WILL BURDEN CONSUMERS

Before imposing new regulations, the CFPB should consider the following factors, which will adversely affect consumers of credit.

Consumer Debt Collection Is Already Subject to Extensive Regulation

- Since the 1970s, consumer debt collection has been subject to extensive regulation at both the federal and state levels.
- Most questionable debt collection practices have previously been outlawed or restricted. Concerning existing practices, it is challenging to discern whether further restrictions would create any new benefits for borrowers that would exceed their additional costs.

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While Good Regulation Can Improve Economic Welfare, Bad Regulation Can Injure Consumers and the Economy

- Restricting creditor remedies raises the risk of loss and the loss rate for lenders, leading to higher prices for loans and a reduction in supply. On the other hand, restricting creditor remedies reduces the total cost of borrowing for consumers, producing an increase in the demand for loans.
- As a result, restrictions on collections simultaneously reduce supply and increase demand. It is unclear whether restrictions would actually increase or decrease quantity.

Riskier Consumers Tend to Be Injured the Most by Restrictions on Debt Collection Practices

- Restrictions on debt collection may benefit consumers who are actually subject to the collection process, but this will come at the expense of other consumers who have to pay more for credit and gain less access to credit.
- Because riskier borrowers are predicted to be the most likely to default, they will also bear a greater proportion of the cost of regulation than other borrowers, even though in most cases they repay their debts.
- Restrictions on collections tend to adversely affect credit card lending relative to other types of lending. Higher-income consumers will be able to avoid some of these negative effects by making greater use of secured debt (such as home equity lines of credit), whereas lower-income users will be forced to turn to products such as payday lending and auto title loans.

Third-Party Debt Collectors and Debt Buyers Play a Unique Role in the Consumer Collections System

- Third-party collection agencies provide liquidity and expertise in collection practices that reduce losses and increase efficiency for consumer lenders.
- This reduction in losses may be particularly valuable to some types of creditors compared to others and may be useful for creditors that otherwise might be overly lenient in their collection efforts and pass on the costs to their other customers.

Regulation of Particular Collection Practices Can Have Unintended Consequences

- Debt collection practices tend to follow a sliding scale of intensity, beginning with low-expense practices such as letters and phone calls and escalating to higher-intensity practices such as lawsuits.
- Restricting the use of less-intense practices can interrupt this important economic calculation, leading to swifter invocation of more-intensive practices, such as lawsuits.

Regulation Should Not Disproportionately Burden Small Debt Collection Firms and Stifle Competition

- Compliance with Dodd-Frank and other regulations enacted since the financial crisis is disproportionately costly for smaller firms in the financial services industry, including the debt collection and debt buying industries.
- Smaller firms, however, have traditionally played an important role in the debt collection industry by providing knowledge of local economic conditions and promoting competition that can benefit consumers.
- Regulation that disproportionately burdens small businesses with unnecessary regulatory compliance costs will promote unnecessary consolidation of the debt collection industry.

ACCURATE COST-BENEFIT ANALYSIS IS NECESSARY

Many Restrictions on Collections Do Not Benefit Consumers

- Even if restrictions on collection practices raise prices, consumers will still benefit if they value the ability to avoid those practices more than the creditor values the ability to exercise them.
- In practice, however, many restrictions fail cost-benefit analysis, because consumers place less value on avoiding particular remedies in the case of default than the increase in price they would have to pay the lender to offset the loss of the remedy.

Regulations Should Be Based on Careful Cost-Benefit Analysis and Consideration of Changing Consumer Lifestyles and Communications Technology

- Given the likelihood of unintended consequences arising from new collections regulations, the CFPB should conduct careful cost-benefit analysis before it imposes new regulations on debt collection.
- The CFPB should consider consumers' growing reliance on technologies such as cell phones, email, and text messaging, and modernize its rules to allow more flexible contact using those technologies while at the same time protecting consumers from intrusions on their privacy.

CONCLUSION

From its inception, the CFPB has described itself as a "data-driven agency" that applies sound economic and empirical analysis to craft consumer protection policies. The CFPB should seek to follow this goal for consumer debt collection rules and consider rules that can be shown to protect consumers from overreaching creditor behavior, ensure access to credit at competitive prices, and avoid burdening consumers with unnecessary restrictions and compliance costs.