

THE CONSUMER FINANCE PODCAST: CFPB ADVISORY OPINION ON TIME-BARRED DEBT COLLECTION**HOST: CHRIS WILLIS****GUESTS: STEFANIE JACKMAN, JOE REILLY, JONATHAN FLOYD****DATE AIRED: AUGUST 3, 2023****Chris Willis:**

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. And today we're going to be talking about a recent CFPB advisory opinion on time-barred debt, or maybe mortgage debt. We'll see once we get into the discussion. But before we jump into that topic, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com, where you'll see all the updates we post about what's going on in the consumer financial services universe.

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Now, as I said, today we're going to be talking about a recent CFPB advisory opinion that talked about the collection of what the CFPB termed as zombie mortgages that were barred by the statute of limitations. And I have three of my colleagues on to talk with me about this today and to share their insights with you, the audience, about it. Two of them have been on the podcast before, Stefanie Jackman and Jonathan Floyd. And then we have a new partner to welcome today, Joe Reilly, who's just joined our firm. He's in our Washington DC office. And he is our resident expert on a lot of things, one of them being mortgage lending. Jonathan, Stefanie, Joe, welcome to the podcast.

Stefanie Jackman:

It's great to be here. Thank you, Chris.

Jonathan Floyd:

Thank you for having us, Chris.

Joe Reilly:

Yes, thank you very much, Chris.

Chris Willis:

What prompted this episode was that the CFPB came out with another of its strongly worded advisory opinions, cautioning debt collectors and others about collecting on time-barred mortgage debt.

And so Stefanie, can you just set the stage for the audience and tell us, what is this advisory opinion about?

Stefanie Jackman:

Yeah, I'm happy to. Last month in April, the CFPB came out with an advisory opinion that I read as reminding us that there are aged second mortgages. The CFPB said a lot of them were packaged up and sold after the last financial crisis of 2008 and 2009. And the CFPB is expressing concern that some of those may still be percolating, may be time-barred, may be, as you noted, Chris, in a zombie status. And taking the opportunity to remind all of us that there are restrictions and things we need to be careful about when collecting on aged debt that is time-barred under state law.

Chris Willis:

Okay. So we'll get into the specifics of the advisory opinion in a minute, but Joe, let me turn to you. You have so much background in the mortgage industry. And in fact, Joe is the author of a very popular American Bankers Association deskbook on the CFPB's Mortgage origination rules. So we're very lucky to have him for his mortgage expertise, among other expertise that he has.

But Joe, can you give the audience a little bit of background about what was going on with second mortgages dating back to before the CFPB's inception of 2006, 2007, before the recession of 2008?

Joe Reilly:

Thanks, Chris. Yes, the background for this advisory opinion does go back to the years prior to the Great Recession when mortgage underwriting standards were not what they are today, they were more lax. And it was not uncommon for mortgage borrowers to put zero money down on a home purchase. They would finance the purchase with two loans, a first-lien mortgage for about 80% of the purchase price, and then a second-lien mortgage for the balance. The balance being approximately 20%. Those second-lien loans were often referred to as piggyback loans.

As real estate prices then declined in the 2005, 2006, 2007 period, those second-lien loans in particular became practically uncollectible. Mortgage borrowers, as the value of the home went down, became what people would call underwater, meaning the value of the home was less than the size of the debt. And that would be particularly true for the second-lien holder who only collects due to foreclosure sale once the first-lien holder has collected in full. So a lot of holders of these second-lien loans effectively gave up any hope of ever collecting on them, and did disappear from the market. Ceased communications with borrowers, charged the loans off, and in many cases, sold the loans to debt buyers for much less than 100 cents on the dollar.

The hook for the CFPB's announcement appears to be some press reports that in more recent years, some of the holders of these second-lien loans have resurfaced after an absence of communication with the borrower for a decade or more. And these second-lien holders are attempting to collect on the debt. I would just point out it's rather common for us to see the CFPB pointing to the Great Recession or events prior to the Great Recession as a hook for an advisory opinion, since the Great Recession, after all is what drove the creation of the CFPB.

But I think overall, the story I just told and the history I just described is really just the hook for a much broader point that the CFPB wants to make about time-barred debt. And we'll hear more on that from Stefanie and Jonathan.

Chris Willis:

Thanks a lot, Joe, for that background. With that, Jonathan, can you just now dive a little further into the specific things that the CFPB is using this advisory opinion to warn the market about? And highlight the point that Joe made, which is, is this really specific to mortgage or not?

Jonathan Floyd:

What I will point out is although this is an advisory opinion, it really doesn't change anything. It's really just highlighting a point that the CFPB wants to make. Regulation F already confirmed for us that a debt collector must not bring or threaten to bring a legal action against a consumer to collect a time-barred debt. What we've seen here though, is the CFPB has found a very specific example of something they don't like, and then they've used that almost as a marketing purpose to remind everyone about this rule. But also to put out something that is ... they're following the press cycle. They're seeing what's in the news, and we're seeing advisory opinions like this all on that issue.

So although they've used these second mortgages as an example of this, this is a widespread advisory opinion that touches anyone who may be a debt collector under the FDCPA. It's not limited just to the mortgage situations, which Joe just described to us. And further, although it's not directly referenced in the body of the advisory opinion itself, the word zombie debt is included in a footnote. They make reference to an Associated Press article within the advisory opinion, and then the press release that goes with it talks a lot about this zombie debt even though this isn't technically zombie debt. But yes, this is the CFPB, what I would consider being more aggressive in essentially marketing efforts here.

Chris Willis:

Very interesting insight, Jonathan. Thank you for that. Stefanie, I want to give you an opportunity to come back and tell the audience what you think some of the points of significance or takeaways from this advisory opinion are.

Stefanie Jackman:

Jonathan makes some really good points about what it's doing, what it's not doing. But some things to remember, first, yes, debt collectors that are subject to the FDCPA are squarely subject to and within the scope of the advisory opinion, FDCPA case law, et cetera. But remember, number one, it's not limited just to debt collectors. The FDCPA is, but the CFPB has put out previously Bulletin 2013-07, where it said it would apply a non-exclusive list of FDCPA requirements to creditors collecting their own debt through UDAAP. Then the CFPB in Reg F, both in the proposed rule and then in finalizing it, the CFPB made remarks about finding the efforts or threats, if you will, to collect a time-barred debt to be something they think is an unfair practice. That's the U in UDAAP. So they're telegraphing right there, it's not much of a leap.

There are some state laws also that come into play here that can impact creditors. First, you have Mississippi and Wisconsin, and if it's purchased debt, North Carolina, that prohibit any type of collection activity on a time-barred debt. There's no exception for a mortgage or a certain type of debt. If it's passed the date of the statute of limitations under that applicable law, it's as if that debt never came into existence and it's not collectible. Other states require disclosures, and some of those are applicable to creditors in collection communications. So that's the first thing to think about. This isn't just a defaulted debt collector issue.

The CFPB reminded us on page six that even if you're doing just a non-judicial foreclosure, like something that's allowed here in Georgia where I live, you're still subject to the provision of the FDCPA and then any state analogs that apply more broadly ... to my prior point. Section 1692f(6) that say you can't threaten to take an action that you don't have a legal right to do. So you can't threaten to sue on an account where it's time-barred. That's interesting when you start thinking about it in the mortgage context, because if the consumer's still in possession of the property, are they getting to keep security for a loan? It can get tricky, but it's something to think about and discuss with counsel.

CFPB also put, basically a roadmap, of all the ways consumers can attack efforts to collect, even if done in a way that doesn't threaten legal action that is not allowed because it's time-barred, a roadmap of ways to bring litigation. They've reminded everybody of all the other sections of the FDCPA that can apply, dealing with ... you can't make false statements. You need to answer questions accurately. You have to deal with disputes. And a whole host of other sections that could fit to certain activity. They reminded everybody, this is strict liability, that we don't get a mulligan, if you will. Whether that's fair or not to creditors and collectors is a different discussion, but the reality is it's a strict liability standard, especially under Reg F. If the debt is time-barred, you may not threaten to sue or try to sue on it or take legal action on it.

Oh, and by the way, the CFPB was clear to say one more thing that consumers should recognize may have been done wrong over the last decade or whatever while these loans have been sitting there aging. Is whether or not the servicers, if they qualify as mortgage servicers, have been providing monthly periodic statements because RESPA and the CFPB's mortgage servicing rules may apply. So I read it as just a whole host of ways to make it difficult if you are actually an owner or servicer of some of these really aged second mortgages to do anything about them.

Chris Willis:

Stefanie, thanks for that. It sounds like there's a lot packed into this advisory opinion in the way of reminders. A lot of which is applicable to all kinds of debt, not just these second mortgages.

But Jonathan, let me turn to you. What do you think the practical takeaways for the industry are, writ large, from the advisory opinion?

Jonathan Floyd:

Chris, I think some of the practical takeaways are, when communicating with consumers about older debt, very likely debt collectors should be prepared for when consumers have no idea what they're talking about. Which leads to a high percentage of requests for validation, which leads to disputes. Which ultimately, could lead to litigation. And we've even seen litigation in this context even when debt collectors have done the right thing.

There's famously a case out of the seventh circuit where the debt collector used the time-barred debt language, but they used it in a letter that also included an offer to settle the account. And the consumer filed a lawsuit saying, "The use of the word, settle, made me think about lawsuits, but your letter said the debt was time-barred, so I'm confused." And the seventh circuit upheld that, and the entity who had been sued there was under a consent decree. They said, "Well, this is what we agreed to say for time-barred debt language in our consent decree." The seventh circuit said, "That may be good enough for your consent decree, but that's not good enough for us."

So debt collectors should be prepared. The CFPB has put a target on your back, particularly as it relates to this type of debt. And anytime you're communicating with consumers about older debts, be prepared. Disputes are going to be high, validation requests are going to be high, and litigation is going to be more likely from your efforts.

Stefanie Jackman:

I think those are really great points, Jonathan. I don't have anything else to add. It's just the time for caution and attention to these issues. And the CFPB is kindly reminding us if we weren't already thinking about it.

Chris Willis:

We have been suitably warned, then. So Joe, Jonathan, Stefanie, thanks for being on the podcast today. And thanks, of course, to our listeners for tuning in as well.

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