

'Robo' Credit Card Suits Menace Banks

by Jeff Horwitz

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Last year JPMorgan Chase & Co took New York resident Shady Gergis to court over a few thousand dollars in allegedly unpaid credit card debt.

The facts of the suit were banal, but Chase's case landed in the courtroom of Noach Dear, a Brooklyn, New York civil court judge with a reputation for being tough on collections efforts. Taking no chances, Chase hired pricey white-shoe law firm Alston & Bird to face off against the self-represented Gergis.



In June, Judge Dear threw Chase's suit out. The judge described as "robo testimony" the statements of the bank's document custodian — a 17-year Chase veteran — and made it clear that he believed Chase had failed to present evidence to support the accuracy of its own records.

The case received little attention and ultimately could prove to be merely a populist fluke. Of course, that's what many observers first said when judges began dismissing home foreclosure suits over problems with affidavits and recordkeeping — a trend that eventually mushroomed into the nationwide robo-signing mortgage scandal.

Now, a growing number of judges, state attorneys general, federal agencies, consumer attorneys and academics are concluding that banks may be susceptible to similar claims in other areas of consumer lending, including the credit card market. If banks prove unsuccessful in defending themselves from claims that their records are shoddy, they run the risk of inviting a new regulatory crackdown and legal battles over the validity of claims involving tens of billions of dollars in unsecured debt.

Under normal circumstances, the handling of delinquent consumer loans is fairly straightforward. When consumers fail to pay off such debts, banks write down the balance and try to recoup

whatever they can by bringing collections suits against debtors themselves or by selling rights to the debt to specialized collection agencies. The individual debts amount to only a few thousand dollars per consumer on average, but the total sums at issue are large; last year, market leaders Bank of America and Chase each charged off \$7 billion in credit card debt.

One silver lining for banks is that they have not been the main focus of documentation dispute so far. Instead, consumer advocates and courts have directed their harshest barbs at the third parties who acquire rights to delinquent credit card accounts and then seek to turn a profit collecting from consumers.

The risks that brand-name banks will themselves get caught up in the dispute appear to be rising, however. As American Banker reported earlier this month, JPMorgan Chase stopped filing collection suits last April amid growing evidence of internal documentation problems. With the template for challenging collection procedures already established in the mortgage market, a broad attack on banks' debt collection practices in other areas of consumer lending could expand rapidly.

"If I were a collector of consumer debt, I'd look at my entire process from start to finish for whether there's an argument to be made that the process is not verifiable," says Christopher Willis, an Atlanta attorney for Ballard Spahr LLP, which specializes in defending banks in consumer lending cases. "I think there is substantial danger."

For banks, the documentation issues pose threats on several fronts. If consumer advocates manage to hobble the ability of collections agencies to win court judgments against consumers, it would likely reduce what they're willing to pay banks for defaulted receivables. Such bum debt typically sells for only pennies on the dollar, but those pennies add up to billions of dollars.

More aggressive defenses in court and more rigorous rules regarding unscrupulous practices in the second-hand debt market could also complicate and raise the cost of banks' own debt-collection efforts. Another risk is that highly publicized cases of poor documentation and plaintiffs' victories in court could encourage other borrowers to pose legal challenges or simply stop paying.

Missing Records, Unprovable Cases

Willis emphasizes that for banks reviewing documentation practices is purely a prudent risk-management measure; there is no reason to believe the courts will find that substantive documentation failings are widespread, he says.

Consumer advocates argue otherwise, at least for outside debt collection agencies. When banks sell delinquent loans to such firms, its transfer is accompanied by proof of how the debt was created, critics say.

"Banks actually keep pretty crummy records," says Peter Holland, a University of Maryland law school professor who focuses on consumer debt.

No less than the Association of Credit and Collection Officials, an industry trade group, has admitted as much. "[D]ocumentation is often unattainable for a variety of reasons, the most important of which is the creditor no longer has the information or did not have it when selling an account," the association wrote in a 2011 letter to the rules committee of Maryland's Court of Appeals. "Greater discussion is needed to identify the type of proof sufficient to seek a judgment."

Without access to the original creditor's business records and procedures, collections agents cannot truthfully attest to the validity of the debt they're seeking to collect. What's more, unlike in the case of home, when the original amount borrowed is rarely in dispute, there are numerous instances in the public record of debt collectors filing suits involving bogus claims for other types of consumer debt.

"The person [filing an affidavit] doesn't have personal knowledge of the records, even though he says he does," says Charles Debaulm, an attorney for the National Consumer Law Center who has litigated robo-signing involving mortgages and other types of consumer debt. When challenged by a competent consumer defense attorney, "the debt [collections agency] buyer will simply dismiss the suit."

What has worked in the favor of creditors is the fact that defendants rarely show up in court, enabling creditors to win default judgments in most circumstances. However, when lawyers have put up a defense in such suits, they boast of winning the overwhelming majority of even contested cases.

Michelle Weinberg, a Supervisory Attorney at the Legal Assistance Foundation of Metropolitan Chicago, says she's taken on nearly 100 consumer debt cases over the last decade and lost only one.

"Debt buyers know they cannot prove [their claims] if there's someone making proper legal objections on the other side," she says.

Similarly, law students at the University of Maryland's consumer protection clinic claim a nearly undefeated record defending debt collection suits, says Holland, the law professor there who manages their efforts. The clinic's only loss was in a case in which it opposed Chase directly rather than a collections agency.

"Getting judges to focus on the lack of proof in debt buyer cases has taken awhile," Holland says. "But often the exact same kinds of problems exist in the original creditor cases."

Holland and other consumer advocates have been making a market lately defending such cases in important venues. Missouri's Supreme Court threw out a credit card debt judgment Jan. 17. In doing so it sided with the defendant, who argued debt collector CACH LLC could not claim as its own business records originally created by now defunct Washington Mutual. The ruling appears to indicate that debt buyers will have a much harder time making cases in the courts in Missouri. Appellate courts in Texas, Pennsylvania, Illinois, and Wisconsin have raised similar objections over the past few years.

ACA, the trade association for the collections industry, concedes that there may be room for improvement in legal documentation. "We've always said that the debt buying industry is relatively new," says David Cherner, head of the group's state lobbying efforts. "A lot of banks and credit card companies are beginning to make documents digital so they can transfer. I think over time this problem is going to resolve itself."

A Template for Bank Trouble

False documentation has already gotten third-party collectors of credit card debt into legal trouble

that is reminiscent of bank's robo-signing woes. An employee for Asta funding testified that she churned out affidavits every 13 seconds. An employee at Collect America (now known as SquareTwo Financial) stated in a deposition that if a debtor's file said the moon was made out of green cheese he would formally vouch for it. A third firm, Portfolio Recovery Associates, had to promise it would stop using affidavits signed by Martha Kunkle, a woman who had been dead 15 years. Amazingly, it was subsequently caught using Kunkle's name again.

"What was true with mortgage foreclosures is true here," says Thomas Donnelly, a law professor at Chicago's Loyola University and a part-time Cook County judge. "The system itself, the way it's set up, is rife with the possibility that things could go wrong."

Some consumer advocates, says Ballard Spahr's Willis, would like to "put personal knowledge and review requirements on affidavits that would make it essentially impossible to do any large volume of collection activity ... The possibility that consumer attorneys or regulators will hold banks responsible for third-party collection failures may be a greater danger."

In an untested but plausible worst-case legal scenario for banks, they could be forced to defend themselves against charges that they knowingly sold poorly documented accounts to outside agencies and are therefore responsible for their worst abuses, attorneys say. One theory laid out in the Oklahoma Bar Journal last month has banks facing civil or criminal charges under the Racketeer Influenced and Corrupt Organizations Act for selling dubious accounts to entities that file false documentation.

Early Legal Trouble

Even if RICO suits are not forthcoming, the decades-long tussle between consumer advocates and the collections industry appears to be tilting in favor of the former.

Ballard Spahr's Michael Waldron, who has spent several years trying to contain the regulatory fallout from mortgage robo-signing, says that the industry needs to adjust to an environment of regulatory and judicial skepticism.

"Gone are the days when the collector or the servicer was given deference," Waldron says. "I'd hang my reputation on there being several iterations of this in asset classes besides mortgages. The issue is how consumers are treated as assets are serviced and what the process looks like once the consumer goes into default and the stakes are higher."

A review of New York state cases indicates a vanguard of judges has become increasingly wary about documentation issues. In *Chase v. Cardello*, Rochester County Judge Philip Straniere lambasted Chase in 2010 for trying to execute the "bulk" transfer of credit card debt to "an unlicensed, out of state debt collector" without attempting to notify borrowers.

In a separate ruling the same year, Straniere found problems extended to Chase's own collection efforts and dismissed 150 Chase collection cases that relied on dubious affidavits. The documents "appeared to be signed in large numbers by only a few individuals," the judge wrote in an opinion first cited last year by the *Wall Street Journal*.

Other judges in the state have cited Straniere's rulings in Chase cases.

If there is a bright side to consumer debt documentation concerns it's that banks have a relatively straightforward way address them, says Waldron. It involves getting their systems for handling defaulted credit cards up to the standards regulators are now demanding for mortgages.

"At the end of the day, the mortgage industry is the most heavily regulated out there," Waldron says. "There's always been more stringent requirements around collecting money for someone's home."

Upgrades would no doubt increase costs, but based on the changes Waldron's seen in the mortgage market, they're bearable, he says.

"It's a different number crunch than what the industry has historically been used to but people will figure it out," says Waldron.



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Bank of America Sold Card Debts to Collectors Despite Faulty Records

by Jeff Horwitz

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Bank of America has sold collections agencies rights to sue over credit card debts that it has privately noted were potentially inaccurate or already repaid.

In a series of 2009 and 2010 transactions, Bank of America sold credit card receivables to an outfit called CACH LLC, based in Denver, Co. Each month CACH bought debts with a face value of as much as \$65 million for 1.8 cents on the dollar. At least a portion of the debts were legacy accounts acquired from MBNA, which Bank of America purchased in 2006.



The pricing reflected the accounts' questionable quality, but what is notable is that the bank could get anything at all for them. B of A was not making "any representations, warranties, promises, covenants, agreements, or guaranties of any kind or character whatsoever" about the accuracy or completeness of the debts' records, according to a 2010 credit card sales agreement submitted to a California state court in a civil suit involving debt that B of A had sold to CACH.

In the "as is" documents Bank of America has drawn up for such sales, it warned that it would initially provide no records to support the amounts it said are owed and might be unable to produce them. It also stated that some of the claims it sold might already have been extinguished in bankruptcy court. B of A has additionally cautioned that it might be selling loans whose balances are "approximate" or that consumers have already paid back in full. Maryland resident Karen Stevens was the victim of one such sale, which resulted in a three-year legal battle (see related story).

Bank of America declined requests to comment for this story, other than to say through

spokeswoman Betty Riess that it works with credit card customers to try to resolve delinquent debt issues. CACH did not respond to several phone and email messages seeking comment on the terms of its purchases.

Some industry observers said that the language in Bank of America's sales documents should be regarded as standard legalese intended to protect it against a disgruntled buyer's legal claims. And even though Bank of America refused to stand behind the accuracy of the records it sold, debt buyers are the ones who make the call to sue.

"The buyer has the primary responsibility to test the ... quality of what they're buying," says Samuel Golden, a former OCC ombudsman who is a managing director at consulting firm Alvarez & Marsal in Houston, Texas.

Collectors' responsibilities aside, other banks' sales agreements suggest Bank of America's standards are emblematic of wider industry practice that raises risk management concerns. For less than \$1.2 million a month — a rounding error on B of A's income statement — the company sold CACH accounts that raise regulatory and reputational questions about the accuracy of its records and its disclosures to courts.

Industry Practice

As the originators of credit card loans, banks are at the headwaters of the rivers of bad debt that flow into the collections industry. Over the last two years, Bank of America has charged off \$20 billion in delinquent card debt. The bank settles or collects a portion of that itself and retires other accounts when borrowers go bankrupt or die. An undisclosed portion of the delinquent debt gets passed along to collectors. Once sold, rights to such accounts are often resold within the industry multiple times over several years.

Bank of America's caution that its card records may be incomplete or inaccurate suggests that documentation and accuracy problems may originate at the debt's source. Other banks' debt sale contracts acknowledge potentially large holes in their records as well.

One such example involves a 2009 U.S. Bancorp forward flow agreement, which outlines plans to sell a certain volume of delinquent accounts in the future. U.S. Bancorp's agreement states that it may have failed to credit borrowers for some payments and only guarantees the accuracy of account balances within a 10% margin of error.

Teri Charest, a spokeswoman for the bank, noted that the contract had expired and said that, regardless of such past contractual language, the bank scrubs its card data and that the claims it sells are accurate.

JPMorgan Chase, meanwhile, drafted an agreement to sell \$200 million of credit card debt to Palisades Collection in 2008, even though records proving the debt might be unavailable for close to half the claims. "Seller represents and warrants that documentation is available for no less than 50% of the Charged-off Accounts," JPMorgan Chase's sales agreement stated.

The bank declined to comment. Palisades' chief counsel Seth Berman says the company has not bought Chase card debt in several years, but that its standards were always high.

The U.S. Office of the Comptroller of the Currency is already investigating JPMorgan Chase's handling of credit card debt records, as reported by *American Banker* earlier this month. A group of current and former employees described at the time how the bank had sold card accounts previously deemed "toxic waste" and which suffered from errors in the amounts being claimed.

CACHing In

At Bank of America, records declared unreliable yet sold to CACH were used to file thousands of lawsuits against consumers, according to a review of hundreds of cases in the state courts where collection suits are typically filed. The overwhelming majority of cases end in default judgments, which are awarded to creditors when borrowers don't show up to contest the claims made against them.

In cases where debtors do challenge collections demands in court, the original bank-creditor must testify about the documentation supporting the claims. In several such instances, people identified as Bank of America employees have submitted affidavits attesting to the validity of debts sold by the bank to collections firms.

Even though Bank of America previously disavowed "the accuracy of the sums shown as the current balance," the sworn statements vouch for the borrowers' debts down to the penny and declare that the bank's "computerized and hard copy records" back the claims. There are other possible discrepancies, as well: the affidavits state that B of A "has no further interest in this account for any purpose," while the sales contracts reference a "revenue sharing plan."

The prospect that B of A was selling unreliable credit card debts did not deter CACH from buying them. A subsidiary of SquareTwo Financial, CACH does not collect debts itself. Instead, it operates like a restaurant franchiser, acquiring rights to the delinquent debts that are the raw materials of the collections business. It then works with law firms around the country that do the actual collections work, providing them with debt files, court witnesses and other services.

In thousands of cases in state courts, CACH has appended a single page from its purchase agreements with Bank of America attesting to its ownership of delinquent credit card debt. CACH has omitted from many such filings the more than 30 additional pages where Bank of America disclaims the accuracy of its debt records. Even so, attorneys affiliated with CACH have cited the reliability of Bank of America's records as the foundation for their collections lawsuits.

In the case involving CACH in Duval County, Florida, a person described as B of A "Bank Officer" Michelle Samse swore in an affidavit that "There is due and payable from WENDY CODY as of 9/18/2009 the sum of \$12266.83." The Samse affidavit, typical of many others, went on to say "The statements made in this affidavit are based on the computerized and hard copy books and records of Bank of America, which are maintained in the ordinary course of business." Attempts to contact Samse and Cody through Bank of America switchboards and public records searches were unsuccessful.

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The degree of precision attested to regarding Cody's debt is curious, considering that Bank of America declared it was unable to produce records to back it up. "[T]he original contract in this

matter has been destroyed, or is no longer accessible," Samse's affidavit states. "This affidavit is to be treated as the original document for all purposes."

The affiliate representing CACH in the Cody case was Collect \$outheast, which uses the phrase "Let us show you the MONEY!" in company promotions. Collect \$outheast and Florida attorneys representing CACH in other cases did not respond to requests for comment.

Taras Rudnitsky, a consumer defense attorney in Lake Mary, Florida has regularly defended consumers against lawsuits filed by CACH affiliates in Duval County. He says he regularly demands that debt buyers file banks' sales agreements with the court and invariably runs into stiff opposition.

"In every single case I have involving a debt buyer, they refuse to produce a forward flow agreement," he says, referring to the term for sales contracts under which banks agree to sell a specific number of delinquent accounts in the future. "When push comes to shove, the case disappears."

Weak Link

For individual clients, dismissal of such a case is a victory, but such outcomes are the exception. In the vast majority of collections suits, consumers fail to respond to card payment demands and become liable for default judgments, says Peter Holland, who runs the University of Maryland Law School's Consumer Defense clinic and has collected some of the forward flow agreements. As a result, the questionable reliability of second-hand debt claims is failing to receive the attention it deserves, he says.

"The [terms of] forward flows are being hidden from the public and from the courts," says Holland. "When the banks say explicitly that they don't have the documentation, that's something courts need to know. When a bank says a balance is 'approximate,' that's something courts and consumers need to know."

To date, it is debt collectors who have been the main focus of complaints and lawsuits alleging wrongdoing. In the past year alone, collections firms have paid out a number of multi-million dollar settlements over allegations they robo-signed affidavits, failed to produce evidence to support payment demands and sued consumers over debts that were no longer owed.

According to a trade organization for the collections industry, much of the criticism of collectors' records stems from banks' failure to provide adequate documentation of debts.

"We're not getting what we need from the seller," says Mark Schiffman, a spokesman for the American Collections Association, which wants to see better recordkeeping and more documentation included in debt sales. "Consumer groups want to see original contracts and original documentation. That would make a lot of these debts disappear because a lot of that documentation may not exist."

Regulatory Interest

Washington regulators are beginning to look at what responsibility banks have for wrongful collections activity. But questions about jurisdiction and whether banks will get roped in remain open.

"Not enough information [is] flowing through to debt collectors," says Tom Pahl, an assistant director in the Federal Trade Commission's division of financial practices. Despite its concern, the FTC lacks the authority to regulate financial institutions

"We can't reach the banks to say 'Thou shalt file the following pieces of information with the loans,'" Pahl says. "We're trying to do most of this through either law enforcement, which is case-by-case, or by jawboning the industry."

The Consumer Financial Protection Bureau has jurisdiction over credit cards and last month announced plans to take a close look at the collections industry. The bureau's interest has been heightened by revelations of abuses by mortgage servicers, including robo-signing of affidavits, according to spokeswoman Jennifer Howard.

The CFPB is "very concerned that the same shortcuts and violations may be occurring with other kinds of debt collection," she says.

The OCC, which likewise oversees banks, declined to comment on specific institutions' sales of credit card receivables. However, it expects banks to adhere to high standards regarding account records, especially in cases where institutions attest under oath to their accuracy, according to OCC spokesman Bryan Hubbard.

"There may be reasons it's hard to do. Large portfolios being bought. Systems integration. But banks are still accountable for maintaining accurate records," says Hubbard.



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AMERICAN BANKER

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State AGs Probing Sales of Credit Card Debt

By Jeff Horwitz

A group of state attorneys general is investigating how major banks process and sell delinquent credit card accounts.

Attorneys representing Mississippi Attorney General Jim Hood have contacted former JPMorgan Chase (JPM) employees about possible procedural shortfalls or outright errors in defaulted credit card account records that the bank sold to third-party debt collectors. Attorneys general in other states are also involved in the probe and are scrutinizing the practices at other banks as well, says another ex-Chase employee contacted by investigators.

The alleged practices under scrutiny are similar to the mortgage documentation problems that plagued banks' foreclosure proceedings before a national settlement was reached with state AGs.

At issue is whether JPMorgan and other banks were unloading delinquent accounts before they could actually confirm past-due balances. Consumer advocates fear that banks are selling unreliable or in some cases extinguished accounts to debt buyers, who then turn around and sue consumers without disclosing doubts about the accounts' veracity.

Asked about the investigation, JPMorgan Chase declined to comment. A spokeswoman for Hood's office said it was not policy to confirm or deny the existence of investigations, though the office "has been and remains concerned" about consumer finance issues.

In a series of articles earlier this year, seven current and former Chase employees told *American Banker* that the managers of a credit card processing facility in San Antonio ordered its employees to robo-sign affidavits attesting to the accuracy of debts owed by Chase customers. These process failures were material, numerous Chase employees said, because the bank relied on a patchwork of antiquated computer systems that sometimes disagreed about how much customers owed.

In an interview last week, one of those employees, Carole McGinn, said that she had been contacted by the Mississippi AG's office. "We had a lengthy conversation [on]... the robo-signing of those affidavits," said McGinn, a retired Chase employee who worked with her husband Mac in the bank's Frederick, Md., and San Antonio credit card debt processing facilities.

Mac McGinn previously told *American Banker* that he had supervised teams of robo-signers in Frederick who were responsible for gathering records and affirming account balances for debt buyers. Even before a flood of defaults hit the bank's credit card operation, he and others were uncomfortable with its processes, which left insufficient time to confirm accounts' accuracy.

"You're not going to go through 150 to 200 affidavits an hour; it's just not possible," he said last week.

The alleged problems at Chase were first publicly aired in a wrongful termination suit by Linda Almonte, a former team manager who claimed she was fired for flagging procedural lapses and dubious accounts in the sale of \$200

million in legal judgments. Following her allegations, Chase shuttered its in-house card debt litigation operation and ceased filing new lawsuits on its own behalf in jurisdictions across the country. The Office of the Comptroller of the Currency dispatched investigators to inspect the San Antonio facility, and in February a person familiar with the regulator's actions said that it was taking the matter very seriously.

The OCC declined to comment on the status of any review, though people familiar with Chase's San Antonio credit card facility said that significant numbers of employees still remain employed but idle.

Chase is still sending accounts to debt buyers, however. Lawsuits filed in Florida's Duval County Civil Court, which provides an unusual level of online access to low-dollar collection cases, show that third-party collectors are suing on Chase accounts that defaulted as recently as January.

Though the McGinns said that they have only heard from the Mississippi AG's office, Almonte said that other states are also involved. The ex-Chase employees also said that investigators appear to be broadly interested in collection practices at other banks besides Chase.

Consumer defense attorneys have argued that there are widespread inaccuracies and documentation shortfalls in accounts sold to debt buyers. According to contracts filed in state courts and reported on by American Banker, Bank of America (BAC) sold hundreds of millions of defaulted credit card debts under agreements that warned that the amounts owed were "approximate" and might, in some cases, already have been paid. Despite these reservations, a company called Cach, a subsidiary of Square Two Financial, bought the accounts and then sued upon them, filing affidavits stating that the amounts owed were reliable.

Cach officials have not responded to interview requests, and Bank of America would not comment.



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