

Data, Media and Chain of Title Management Solution

Opportunity of Partnering Now

Overview of how economics, compliance and security issues are changing the debt buying and selling industries and why now is a good time to partner with Convoke Systems.

Convoke
Systems

Data, Media and Chain of Title Management Application

Opportunity of Partnering Now

Market and governmental changes are taking place that will soon change the process for distributing charge-off account media and the tracking of chain of title information in your charge-off debt selling business. The changes are related to: economics, compliance, and security.

The sale of charge-off debt is an important factor in keeping the credit industry healthy. However, portfolio sales prices have dropped from 10 to 25 percent compared to previous years, due to a larger supply of charge off debt. The credit market is faced with higher volume at a lower price. A key strategy to stabilize and increase liquidation rates, is to improve efficiency and develop ways to make assets (media, payment information, etc.) generate additional long and short term revenue. Convoke Systems has developed an automated solution that will help the industry transition to a new way of doing business, where economic, compliance and security issues will be addressed and managed, through increased efficiency and improved visibility.

Economics

There are many factors that can reduce the value of charge-off debt: the timeliness and availability of media, account data, chain of title information, documentation related to previous collection activity, last form of payment, who the originator is, and state and local collections laws and regulations.

According to the ACA here are some of the items that debt buyers should look at when buying accounts:

- Understand What Debt is Worth: Liquidation curves drive prices—not the other way around. “Something that liquidated at 15 cents will not liquidate at 24 cents just because I paid 8 cents rather than 5 cents,” said Irwin Bernstein, ABD Committee member and managing member of Ravinia Management Company, LLC Bernstein. Debt is only worth the net present value (NPV) of the liquidation



curve. Many debt buyers use a formula-driven approach. They are looking to get back two and a half to three times what they paid for the portfolio. Immediate availability of accurate media, chain of title information and account data are important factors in determining what the debt buyer's return will be. Without this information they will be less willing to pay more for debt upfront.

- **Validate the Chain of Title:** Request and review copies of any and all upstream bills of sale to ensure clear title to the purchased accounts. If unfamiliar with any party in the chain, do your due diligence, request full redacted copies of upstream agreements and proceed carefully. Buyers do not want to take the risk of purchasing something that is already being collected on by another party. Duplicate sales have been a problem within the market. A centralized source to manage this information would provide the necessary visibility.
- **Understand the Characteristics of the Originator:** This is also a very important observation in the process of debt buying and due diligence. Buyers must have a handle on the entity that originated the paper. The paper will be no better than the originator. Buyers must understand the origination process, the servicing process and the collection process to establish a basic comfort level. Buyers must also investigate the unique qualities of the originator regarding how portfolios are packaged for sale. Buyers would rather deal with original creditors that have consistent availability to media, chain of title information and account data. Creditors that provide consistent availability are better positioned to get a premium for charge-off debt.
- **Obtain a Clear Documentation Provision:** Not fully understanding what is included with the documentation can cause serious liquidation ramifications on any purchase. For example, not fully understanding the costs, timeline and whether the documentation provided will be in a hard copy or electronic form could be risky. When possible, buyers need to be aware of the percentage of documentation that is or is not available prior to purchasing portfolios. This will have a significant impact on the ability of the buyer to validate or litigate the



accounts¹. The clear documentation provision can be solved by using a third party to centralize all account media and data. Today buyers have to go through a chain when making these requests, a single source for these requests will speed the debt validation process and improve recovery rates and portfolio values.

By automating the media and chain of title management process, original creditors can reduce the above mentioned concerns and improve portfolio liquidation rates. The original creditor only, is in the position to do this because they can transfer all of the account media to a centralized third-party application at the time of portfolio sale. They can also provide information on who purchased the account first, which allows chain of title tracking to start immediately.

Certain creditors have considered bundling all of the media at the time of portfolio sale, which would make media availability a first line buyer problem. This approach will actually make the problem worse. This would not solve the clear documentation provision that debt buyers are requesting or provide a clear chain of title process. This is just moving the problem to first line buyers, which could reduce the value of the portfolio. This approach will also not provide the security needed to protect consumer information through each sale of the charge-off account. A centralized approach is the best way for the original creditor to retain visibility. Instead of dealing with several buyers requesting account information they will only have to work with a single source to answer requests.

An additional issue with providing media up-front, is that it does not take into account breaks in the sales chain of charge-off debt. After the original creditor sells the debt, the debt can be sold many times. If any one of the debt buyers goes out of business in the sales chain, the last buyer will not have access to the account media because it was not in a third-party centralized solution. Also, debt buyers down the chain will not be willing to pay a premium for an account they know has this associated risk. Therefore, bundling

¹ ACA International, *Ten Sure- Fire Ways to Succeed at Debt Buying*, October 31, 2007



up media at the point of sale could actually reduce the value of your debt throughout the debt selling process.

Compliance

As stated by Peggy Twohig, Federal Trade Commission (FTC) Associate Director, here are five predictions about the credit and collection industry:

- Consumer financial issues will be in the spotlight like never before. “The spotlight will move from just mortgages to other areas, including credit and collections.”
- The FTC will be shining the spotlight on the problems in the credit and collection industry along with possible solutions. Much of this will be the result of last October's FTC Debt Collection Workshop.
- Data integrity and verification will be a major focus of FTC policy and enforcement. “Debt collectors should have access to information to ensure they are contacting the correct consumer.”
- Record-setting enforcement activity is on the horizon. In addition to holding companies responsible for their actions, the FTC will also seek to hold individuals responsible.”
- The more the credit and collection industry can police itself, the less need there will be for legislative solutions. “To be effective, [self-regulation] has to have teeth, which can be a challenge,” she said. “I can't emphasize enough how much self-regulation can provide relief².”

² Peggy Twohig, FTC Associate Director, ACA Convention, July 28, 2008



Federal Concerns

The FTC has stated that self-regulation will be critical if the financial services and accounts receivable management industries want to keep congress from creating laws that will further regulate them in order to foster better compliance. Much of the focus has been on data integrity and compliance. A centralized solution will help the industry better track chain of title information, account data, and provide documented proof of the debt sales chain and provide the data and information immediately. A centralized solution will also help to move the industry to a Self Regulation Organization (SRO) approach. An SRO was crucial in the success of the U.S. futures industry. This will build confidence and stability within the credit market. A centralized solution will be a key element in the process.

“The FTC encourages industries to undertake self-regulatory initiatives to address consumer protection concerns. Self-regulation can encourage voluntarily compliance with the law through the adoption of industry standards that meet or exceed legal requirements and educating industry members as to what must be done to comply with these standards, which are especially important in an industry experiencing rapid growth,” says FTC Chairman Deborah Platt Majoras.

According to The Office of the Comptroller of the Currency, the FACT Act, section 623(a)(8) of the FCRA directs the Agencies to jointly prescribe regulations that identify the circumstances under which a furnisher is required to reinvestigate a dispute concerning the accuracy of information contained in a consumer report on the consumer, based on a direct request by the consumer.

Consumer groups reported that sales of consumer accounts to collection agencies also result in accounts being “re-aged,” meaning that a debt receives a new origination date when the collection account is opened, resulting in the debt being included on a



consumer's credit file longer than legally permissible³. Proper chain of title information and documentation will help the industry to regulate this problem.

Some of the recommendations presented to FTC:

1. Enforce accuracy and Integrity of Consumer FACT Act.
2. Prohibit credit reporting unless a debt can be verified.
3. Require notice on the consumer's credit report if the debt is in dispute.
4. Ensure that any subsequent buyers of the debt receive past dispute information.
5. Conduct a real investigation to verify debts disputed by the consumer and prohibit collection activity without such proof.
6. Give consumers important information about the debt up front, such as the original creditor, date of the delinquency and a breakdown of the original amount, interest and fees.

The original creditor only, is in the position to solve this problem. The risk associated with doing nothing is high. Identity theft is on the rise. So, the need to protect consumer information is critical.

State Concerns

Many states have started to act on the industry not providing the proof necessary to validate consumer debts. There are also laws related to identity theft.

Minnesota

Minnesota Attorney General Lori Swanson announced Tuesday, July 15, 2008, that her office had filed a lawsuit against a collection agency she says failed to “adequately verify the validity of debts” the company was collecting. One of the companies, Allied Interstate Inc., allegedly relied too heavily on relentless telephone calling and failed to

³ Federal Register, Vol. 72, No. 239, Thursday, December 13, 2007, Proposed Rules



tell consumers that they had to dispute debts in writing, according to one of the law suits.

Massachusetts

Under the Massachusetts Attorney General's Debt Collection Regulation, 940 CMR: It shall constitute an unfair or deceptive act or practice for a creditor to fail to allow a debtor or an attorney for a debtor to inspect and copy the following materials regarding a debt during normal business hours of the creditor and upon notice given to such creditor of not less than five business days preceding the scheduled inspection:

1. All papers or copies of papers in the possession of the creditor which bear the signature of the debtor and which concern the debt being collected.
2. A ledger, account card, or similar record in the possession of a creditor which reflects the date and amount of payments, credits and charges concerning the debt.

California

Creditor cannot sell a debt to a debt collector once the individual has reported to the credit bureau that the debt resulted from fraud. California Civil Code § 1785.16.2

Victim of identity theft may seek an injunction against a creditor or debt collector who pursues payment from the victim of a debt incurred by a thief. California Civil Code §§ 1798.92-97

Debt collector must stop temporarily collecting a debt after written certification by the consumer that an identity thief incurred the debt. Collection may resume only if the collector makes a good faith determination that the information provided does not establish that the consumer does not owe the debt (confusing). California Civil Code § 1788.18, AB 1294, effective January 1, 2004



Judicial Concerns

Federal, State and District courts are starting to make their own rules relating to documentation needed to prove ownership and validation of debt. The courts are accommodating the drive toward change by assembling the different constituencies involved in the lawsuits and working with them to hash out what alterations to the system will work. The current judicial system can not handle the current volume of cases. As charge-off debt increases, specifically credit card debt, the current system will not have the ability to supply the necessary documentation (media) and chain of title information necessary to satisfy the proof that is required by the judicial system. This will cause the value of charge-off debt from the original creditor to go down. However, those original creditors that have implemented solutions like Convoke Systems would meet the demands of the market.

The creditors' lawyers say that judges across a state often have different standards for what documents are required for reaching a judgment. For instance, the number of account statements detailing a defendant's history of debts, and current funds, etc. that are necessary.

While some judges might require the entire history of a given account, others might call only for the most recent statement. Likewise, some judges may insist on seeing the debtor defendant's original application for credit while others do not.

"Each judge has his or her idea on what it takes to prove a case and it would be so nice if that was the same in every court," said David Wright, an attorney at Fort Wayne, Indiana based Wright and Lerch.

In Iowa, Charlie Litow of Litow Law Office in Cedar Rapids, said "there are a handful of judges across the state that require an attorney to drive five hours to court to enter an appearance in a case while others do not require a face-to-face encounter."

Some judges require a plaintiff to fly in witnesses, such as bank representatives, from another state to make the case against a debtor while others do not.



In Florida, Indiana, Iowa and Pennsylvania, creditors' attorneys have created or revived state creditor bar associations this year to press for court changes with encouragement from the National Association of Retail Collection Attorneys.

"We cannot and will not attempt to say one size fits all, so we therefore encourage local attorneys to work within their own individual systems," said Bob Markoff, who is president of the national association.

In Illinois and Michigan, creditors' attorneys are serving on committees with court officials and consumer advocates to consider the creation of a standard complaint for filing debt collection lawsuits and clearer instructions for banks on which accounts can be garnished to pay outstanding debts and which are exempt.

"I want to create an expedited disclosure so that banks are required to show that record within 24 hours," said Michael H.R. Buckles, who, with his wife, leads Beverly Hills, Michigan based Buckles & Buckles, a collections law firm with 20 counsel lawyers around the state.

California led the way last year in issuing court rule changes that allow special handling of debt collection actions for less than \$25,000.

The state's judicial council convened judges, creditors' attorneys and consumer advocates to study the system. It issued new rules last July that standardize procedures to require plaintiffs across the state to serve debtors with lawsuits within 60 days after they are filed. The rules require parties to make the necessary filings to reach a court judgment within six months if there is not an earlier settlement. The rules also allow for automatic continuances that cut down on the need for attorneys to appear in court.

"For 95 percent of the cases, this was a tremendous savings of court time and resources," said Bill Goldsmith, a creditors' attorney at Los Angeles-based Goldsmith & Hull who is president of the California Creditors Bar Association.



Later this year, the California court system will bring together a new committee to tackle the issue of standardizing the documentation required to reach default judgments, Goldsmith said.

Security

Many originators have stated they will just bundle up account media and send it to the first line buyer. There are problems with this strategy: lack of visibility, breaks in the sales chain, and compliance with data security standards like PCI.

Lack of Visibility: Once a charge-off account is sold and associated media attached, the original creditor no longer has visibility into what has happened to that account.

Documents are out there being transferred and copied multiple times, by people that may be using it for reasons not related to collection of the account. This lack of visibility increases the potential for identity theft and fraud. It also poses a liability risk to the original credit.

The FBI calls identity theft one of the fastest growing crimes in the United States and estimates that 500,000 to 700,000 Americans become identity theft victims each year. Identity theft is a federal crime. It occurs when one person's identification (which can include name, social security number, or any account number) is used or transferred by another person for unlawful activities.

Although the original creditor is transferring consumer information for lawful purposes, without total visibility they cannot tell who is using the information, thus it increases their potential exposure to litigation.

Breaks in the sales chain: Once the original creditor sells the debt to the first line buyer, they no longer have any visibility into who has access to the consumer information they collected (social security number, etc.). The Social Security Misuse Prevention Act was introduced to the House on February 6, 2008. The act amends the federal criminal code to prohibit the display, sale or purchase of Social Security numbers without the affirmatively expressed consent of the individual, except in specified circumstances. The



act directs the Attorney General to study and report to Congress on all the uses of Social Security numbers permitted, required, authorized, or accepted under any federal law, including the impact of such uses on privacy and data security. When there are breaks in the sales chain it is almost impossible to tell who has accessed the consumer information (social security number, etc.) which could increase the litigation risk for the original creditor.

PCI

Compliance with the Payment Card Industry (PCI) Data Security Standard (DSS) is one way that businesses can improve the safety of their customers' valuable information and protect the trust they have established in their brands. Original creditors have subscribed to these standards, however as debt is sold further down the chain, PCI standards are not subscribed to. This poses a great risk to both the consumer and the original creditor. By centralizing media and chain of title information PCI standards can be met. It also makes it easier to implement new PCI related standards.

When reviewing the existing manual, unsecure, slow process for managing data, account media, and chain of title, the time is right to embrace a solution like the one Convoke Systems has already developed and is currently implementing.

