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Legal Update
September 20, 2017

CFPB: Profit Motive of Loan Purchaser Is Element of Novel "Abusive" Claim

A desire to make a profit by purchasing high-risk student loans is abusive according to a recent filing by the Consumer Financial Protection Bureau ("CFPB" or "Bureau"). Claiming that a loan purchaser is a "covered person" over which it has jurisdiction, on August 17, 2017, the CFPB filed a complaint[1] and proposed settlement[2] related to the role of Aequitas Capital Management, Inc. ("Aequitas") and certain related entities in the private student loan program of Corinthian Colleges, Inc. ("Corinthian"). This appears to be the first time the CFPB has used its authority over "abusive" acts and practices against a third-party loan purchaser.

The CFPB's complaint rests on allegations that Aequitas funded, supported and maintained a private student loan program that was a "sham" designed to ensure Corinthian's access to federal student loans.[3] The complaint alleges that prospective students had little option but to participate in the program and that loans made under the program suffered from high default rates and were subject to above-market fees and interest.[4] The CFPB reached a settlement with Corinthian's successor-in-interest in February 2015, but by that time Corinthian had filed for bankruptcy and liquidated its assets, so it could not pay the judgment entered against it.[5] Aequitas, which is now in receivership, has agreed to the proposed settlement of the claims against it, which needs to be approved by the U.S. District Court for the District of Oregon.[6]

The Complaint

Under federal law, for-profit colleges must receive at least 10 percent of their revenue from sources other than federal student aid in order to have access to that aid (known as the "90/10 Rule").[7] The CFPB's complaint alleges that Corinthian sought to comply with the 90/10 Rule by raising its tuition beyond the maximum amount of federal aid any individual borrower could receive. Because the vast majority of its students could not pay this increased tuition out of pocket, Corinthian initially bridged that funding gap by making direct loans to students.[8]

Changes to federal law later limited the ability of for-profit colleges to make direct loans to student borrowers in order to achieve compliance with the 90/10 Rule.[9] The CFPB alleges that, as a result, Corinthian arranged for Aequitas to purchase certain existing student loan portfolios, in addition to funding and purchasing future private student loans immediately after they were made by unaffiliated bank partners to Corinthian students. This allowed Corinthian to get the loans off of its books and have them count toward the 90/10 Rule.

Under this arrangement, however, Corinthian was required to repurchase from Aequitas any private student loans that became more than 90 days delinquent, meaning that Corinthian solely bore the credit risk of default. The CFPB alleges that the Aequitas funding arrangement was a

loss leader for Corinthian and was created for the exclusive purpose of ensuring that Corinthian would continue to comply with the 90/10 Rule and therefore have access to its largest source of revenue, tuition paid by federal student loans.[10]

The CFPB's complaint alleges that Aequitas engaged in abusive conduct in violation of the Dodd-Frank Act's prohibition against unfair, deceptive, or abusive acts or practices ("UDAAP"). That prohibition only applies to a "covered person" who offers or provides a consumer financial product or service.[11] In what appears to be a first in an enforcement action, the CFPB has alleged that Aequitas is a covered person solely because it acquired or purchased consumer loans. The Dodd-Frank Act defines a financial product or service to include "extending credit and servicing loans, including *acquiring, purchasing*, selling, brokering or other extensions of credit."[12] The clause "acquiring [and] purchasing" is used as an illustrative example of "extending credit," so many believe that a mere loan purchaser that does not make the credit decision does not rise to the level of a "covered person."[13] The CFPB has not previously relied on this characterization in an enforcement action to subject a party to the statute's UDAAP prohibition.

The Dodd-Frank Act defines abusive conduct as including an act or practice that "takes unreasonable advantage of … the inability of the consumer to protect [their] interests . . . in selecting or using a consumer financial product or service."[14] In articulating the abusiveness claim, the CFPB's complaint alleges that Aequitas participated in the loan program in order to earn a profit (it is not clear what this fact has to do with an allegation of abusiveness) and that Aequitas knew about the high fees and above-market interest rates charged to borrowers and the high default rates associated with Corinthian's loans but disregarded the harm suffered by those consumers.[15]

With respect to the statutory elements of an abusiveness claim, the complaint alleges that Aequitas took unreasonable advantage of student borrowers' inability to protect their interests by funding, supporting and maintaining the loan program and continuing to profit from it (i.e., the loan funding and purchase itself, coupled with making a profit, constituted taking "unreasonable advantage" of the situation) while consumers were unaware that the program was "a ruse designed to generate Title IV federal loan revenue for Corinthian" and "did not have other options to pay for Corinthian's artificially-inflated tuition."[16]

Although the CFPB's complaint repeatedly rehashes its allegations against Corinthian related to deceptive marketing and job placement rates, which formed the basis of the CFPB's claims against Corinthian itself, there do not appear to be any allegations that Aequitas knew about these practices.

Proposed Settlement Agreement

Under the proposed settlement agreement, Aequitas' receiver would forgive all defaulted loans made under the private student loan program and halt collection activity related to loans that are not in default. It would also reduce the principal amount owed on each eligible loan by 55 percent and discharge and cancel any principal and accrued and unpaid interest, fees and charges that are 30 days or more past due as of the settlement's record date.[17] As touted by the CFPB, this totals more than $183 million in relief, although the proposed consent order does not require the payment of any civil money penalties.

Implications

The unique circumstances here make it hard to predict whether this action will have a major impact on other entities that participate in the secondary market for consumer loans. Nevertheless, the CFPB's complaint is particularly notable for a number of reasons:

- This appears to be the first time the CFPB has used its UDAAP authority or alleged "abusiveness" against a third-party loan purchaser in the enforcement context. This new assertion of the Bureau's enforcement authority may indicate an attempt to broaden its authority and calls into question whether the CFPB will seek to exercise such authority over investors in risky or politically sensitive loan portfolios in the future. On one hand, the CFPB's complaint here could significantly broaden the CFPB's "abusiveness" authority by applying it directly to secondary market participants. Alternatively, Aequitas' unique situation may indicate a limited expansion of the CFPB's authority. For instance, Aequitas' assets are in receivership and the CFPB did not bring any claims against former personnel, so Aequitas' willingness to settle may have been driven by a desire to avoid the costs that would have been borne by a potential investigation or litigation. Moreover, as discussed below, the settlement itself is relatively painless for Aequitas. At the same time, Aequitas' financial position may have encouraged the CFPB to seek a larger settlement than they otherwise would have obtained.
- Allegedly, Aequitas actually knew of the issues with Corinthian's private student loan program and did not participate in the loan portfolio's downside risk. The fact that Corinthian as the seller entirely bore the credit risk of default calls into question whether the purported sales of the loans were "true sales." Also potentially important is the fact that Aequitas purchased the loans, according to the complaint, immediately after the making of the loans, which presumably was the basis for the CFPB to claim that Aequitas had funded the loans. The CFPB may be less willing to claim that a loan purchaser who does not indirectly fund the initial loans to the students and bears the credit risk of default is a "covered person." Similarly, it is not clear how much a loan purchaser's knowledge of a loan's high risk of default might impact a claim brought by the CFPB.
- The fact that the claim of abusiveness is predicated in part on the purchaser's desire to make a profit is sure to fuel the CFPB's opponents' criticism that the Bureau may have gone too far. Similarly, the use of its abusiveness authority to attack a loan purchaser's willingness to acquire loans with high risks of default certainly makes one wonder about the downside risks of the CFPB's foray into the capital markets.
- Although Aequitas arguably played merely a supporting role in Corinthian's scheme, the CFPB brought a direct claim rather than relying on its power to sanction those who provide substantial assistance to a violation, given its allegations that Aequitas actually knew of the violations by Corinthian, which arguably could not have occurred absent the funds provided through purchases by Aequitas.
- The complaint notes that Aequitas regularly monitored the status of various state investigations concerning Corinthian's student lending practices, among other things, but continued to participate in the private student loan program. It also notes that Aequitas took Corinthian's assertions about its marketing and representations to students at face value rather than performing meaningful due diligence into them. Not all governmental investigations are public knowledge, and, even if they were, a mere investigation does not mean guilt. The CFPB would impose quite a chill on the market if it were to claim that mere knowledge of a government investigation is enough to put a potential counterparty at risk of liability if it were to proceed with a contemplated transaction.
- A number of state attorneys general have brought separate actions against Aequitas, with many of them entering into settlement agreements.[18] Given the relative uncertainty surrounding the CFPB's future, this serves as a reminder that state actions will remain important no matter what happens at the federal level.

- The CFPB's on-paper penalty is likely much larger than the amount that will actually be paid out by Aequitas' receiver. The terms of the proposed settlement primarily consist of principal and interest reductions on performing loans and forgiveness for those loans that are in default. Much of the forgiven debt is unlikely to have ever been paid, meaning the "cost" to Aequitas is likely substantially lower than the $183 million touted by the CFPB. There are no monetary penalties beyond these debt forgiveness provisions.
- As Mayer Brown has described previously, the CFPB has been particularly aggressive in taking action against for-profit colleges.[19] This complaint demonstrates the CFPB's continued willingness to use novel legal theories to seek to punish those who finance industries and markets that the CFPB does not otherwise have authority over.

Conclusion

It is hard to believe that this case is anything more than an aberration given the fact that Aequitas is in receivership. The notion that the CFPB believes that it has authority to go after bona fide loan purchasers who—shockingly—intend to make a profit by purchasing high-risk loans precisely is why there is so much controversy about the role of the CFPB. The facts in this case might be particularly unique in light of the seller's complete retention of the credit risk of default. The alternative, that the capital markets have to worry that the CFPB will seek to police profit in the secondary market, is not likely to survive the current CFPB leadership.

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Endnotes

1 Compl., *CFPB v. Aequitas Capital Management Inc.* ("Compl."), No. 17-1278 (D. Or. Aug. 17, 2017).
2 Proposed Stipulated Final Jgmt. and Order, *CFPB v. Aequitas Capital Management, Inc.* ("Proposed Settlement"), No. 17-1278 (D. Or. Aug. 17, 2017).
3 Compl. ¶ 1, 3.
4 Compl. ¶ 3, 59.
5 Default Jgmt. and Order, *CFPB v. Corinthian*, No. 14-7194 (N.D. Ill. Oct. 27, 2015).
6 Proposed Settlement at *3.
7 34 C.F.R. § 668.14(b)(16).
8 Compl. ¶ 1, 3.
9 34 C.F.R. § 668.28.
10 Compl. ¶ 45-79.
11 12 U.S.C. § 5531(a); 12 U.S.C. § 5481(6).
12 12 U.S.C. § 5481(15)(A)(i).
13 *See id.*
14 12 U.S.C. § 5531(d)(2)(B).
15 Compl. ¶ 121.
16 Compl. ¶ 151.
17 Proposed Settlement ¶ 32.
18 *See, e.g., A.G. Schneiderman Announces Settlement That Will Provide $2.4 Million In Loan Forgiveness And Debt Relief For 350 Rochester-Area Students Victimized By Corinthian College Loan Provider,* N.Y. State Office of the Attorney Gen. (Aug 17, 2017), https://ag.ny.gov/press-release/ag-schneiderman-announces-settlement-will-provide-24-million-loan-forgiveness-and-debt.
19 *Another Aggressive CFPB Position Leads To DC Circ. Rebuke*, Mayer Brown LLP (Apr. 25, 2017), https://www.mayerbrown.com/files/Publication/0e2488c0-5e84-4421-aff0-242ab63619b9/Presentation/PublicationAttachment/16df3fed-2118-4f22-9441-28f63781b705/170425-UPDATE-CFS.pdf.

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