CFPB Makes Novel "Abusive" Claims against Student Loan Investor

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On August 17, 2017, the Consumer Financial Protection Bureau filed a complaint against and proposed settlement with Aequitas Capital Management, Inc., and related entities, arising out of Aequitas's involvement in a student lending scheme devised by Corinthian Colleges.

Under federal law, to have access to federal student aid, schools must receive at least 10% of their funding from sources other than federal student aid. The CFPB alleged in its complaint that Corinthian inflated its tuition by 10% beyond what federal student loans would cover so that it would not fall below the threshold for funding that must come from alternative sources. Many of Corinthian's students did not have a way to pay for tuition beyond what federal student aid would cover. As a result, Corinthian first began making loans directly to its students. However, when the federal rules changed to limit institutional lending as a way to provide alternative funding, Corinthian needed a different way to fund the tuition gap. According to the CFPB, that was when Aequitas came into the picture.

The CFPB alleged that Aequitas and Corinthian entered into an arrangement in which Aequitas would purchase existing loans originated by Corinthian and fund new loans originated by Corinthian's bank partner. The arrangement included a recourse provision that required Corinthian to buy back any loans from Aequitas once they became more than 90 days delinquent. Under this arrangement, Corinthian could demonstrate that at least 10% of its funding was coming from an outside source other than federal student aid. The CFPB claimed that Corinthian's increased tuition charge was a "sham tuition charge solely to gain access to [federal student aid] funding." The CFPB further claimed that Corinthian's gap lending program was a loss leader, with extremely high default rates, but "[r]egardless of whether students were able to repay the private student loans, Corinthian would profit from the increased availability of [federal student aid] monies." The CFPB and numerous state attorneys general brought actions against Corinthian not only for its lending scheme, but also for its consumer-facing practices, including collection and marketing practices.

The CFPB went on to allege that Aequitas's role in funding the loans was essential to Corinthian's scheme. The CFPB said that Aequitas's involvement gave the appearance that Corinthian was receiving outside funding, when in fact it was obligated to buy back the loans that Aequitas funded if they fell into default. Further, the CFPB said that Aequitas knew at all times that the purpose of the gap lending program was simply for Corinthian to gain access to federal student aid funds. The CFPB claimed that Aequitas continued investing in the program even after it became aware that the default rates were exceptionally high, Corinthian could not profit from the program, and numerous state attorneys general, the Department of Education, and the CFPB had brought actions against Corinthian for its practices.

The CFPB's lawsuit alleged that Aequitas's actions were abusive because: (1) Aequitas knew but disregarded the consumer harm of Corinthian's scheme, including that students had to repay high-interest, high-fee loans that were really just a "sham" for Corinthian to gain access to federal funding; (2) student borrowers could not protect themselves because they were unaware of the arrangement or the underlying purpose of the loans; (3) Aequitas took advantage of the borrowers' inability to protect themselves "by funding, supporting, and maintaining its purchase of Corinthian student loan portfolios" and continuing to profit from the lending program; and (4) borrowers were harmed by the high fees and interest rates and by their own defaults, which resulted in negative consequences, including bankruptcy. The CFPB also alleged that Aequitas was liable as a "covered person" because it acquired or purchased the loans from Corinthian (rather than acting as a "service provider" or an entity that provided "substantial assistance" to the principal actor).

There are a few key takeaways here. First, the CFPB's abusive claim is novel and shows that the CFPB believes its authority extends to investors and other background players. The CFPB did not target any truly consumer-facing conduct - there were no allegations that Aequitas directly mistreated consumers, for example, by offering high-cost loans, making deceptive marketing claims, or engaging in prohibited abusive debt collection practices. Instead, the claim was that Aequitas facilitated and profited from *Corinthian's* scheme. Second, companies need to pay attention to state attorneys general, who will remain active regardless of who is at the helm of the CFPB. Several state attorneys general have already reached settlement agreements with Aequitas over its involvement in the Corinthian scheme. The CFPB pointed out in its complaint that Aequitas had failed to take seriously the state actions against Corinthian, instead taking Corinthian's word that the claims were meritless.

This alert was prepared by Hudson Cook's Government Investigations, Examinations, and Enforcement Practice Group. For questions, please contact Lucy Morris at lmorris@hudco.com or 202.327.9710.

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