Clients&FriendsMemo

Federal Court Holds That Student Loan Trusts Are Subject to CFPB Enforcement Authority: What This Means for Consumer Securitizations and Other Whole Loan Buyers

December 15, 2021

On December 13, 2021, Judge Stephanos Bibas, visiting judge in the U.S. District Court for the District Delaware from the U.S. Court of Appeals for the Third Circuit, denied a motion to dismiss a lawsuit brought by the Consumer Financial Protection Bureau ("CFPB" or the "Bureau") in *Consumer Financial Protection Bureau v. The National Collegiate Master Student Loan Trusts*,[1] allowing the enforcement action to proceed directly against The National Collegiate Student Loan Trusts (the "Trusts"). In allowing the action to proceed, the Court ruled that the Trusts were "covered persons" under the Consumer Financial Protection Act ("CFPA") despite having no employees and contracting with special servicers and subservicers to service and collect on the student loans. As discussed below, this holding has wide-reaching implications for the secondary market in consumer loans, including securitizations and other whole loan buyers.

Background

The Trusts hold more than 800,000 private student loans through 15 different Delaware statutory trusts created between 2001 and 2007, totaling approximately $12 billion. The loans originally were made to students by private banks. The Trusts provided financing for the student loans by selling notes to investors in securitization transactions. The Trusts also provided for the servicing of and collection on those student loans by engaging third-party servicers. However, the Trusts themselves are passive special-purpose entities lacking employees or internal management. Instead, to operate, the Trusts relied on various interlocking trust-related agreements with multiple third-party service providers to—among other things—administer each of the Trusts, determine the relative priority of economic interests in the Trusts, and service the Trusts' loans.

On September 18, 2017, the CFPB filed suit against the Trusts in Delaware federal court, alleging that the Trusts had violated the CFPA by engaging in unfair and deceptive practices in connection with the servicing and collection of student loans. Although the CFPB acknowledged that the alleged

[1] No. 17-1323, ECF No. 380 (D. Del. Dec. 13, 2021).

misconduct resulted from actions taken by the Trusts' servicers and sub-servicers in the course of their debt collection activities—rather than any actions taken by the Trusts themselves—the CFPB nonetheless named only the Trusts as defendants.

The Court Allows the CFPB's Case to Proceed

The CFPB's action against the Trusts has been pending in federal court in Delaware since 2017.[2] After granting initial motions to dismiss the case, the Court permitted the CFPB to file an amended complaint. The Trusts and various intervenors in the action moved to dismiss the amended complaint, arguing that the Trusts are not "covered persons" under the CFPA because they are "passive securitization vehicles that take no action related to the servicing of student loans or collecting debt" and, thus, are not subject to the CFPB's enforcement authority.[3]

Under the CFPA, the Bureau may bring an enforcement action "to prevent a *covered person* or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice."[4] A "covered person" is defined by the CFPA as:

> "(A) any person that engages in offering or providing a consumer financial product or service; and
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> (B) any affiliate of a person described in subparagraph (A) if such affiliate acts as a service provider to such person."[5]

On December 13, 2021, the Court denied the motion to dismiss the amended complaint.[6] The Court framed the legal question before it as: "Does a person 'engage' in an activity if he contracts with a

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[2] To read further about this history, *see* Ellen Holloman *et al.*, *CFPB Suit Against Student Loan Trusts Dismissed*, CADWALADER, WICKERSHAM & TAFT LLP (Apr. 1, 2021), https://www.cadwalader.com/resources/clients-friends-memos/cfpb-suit-against-student-loan-trusts-dismissed#_ftnref7; Ellen Holloman *et al.*, *Forward Movement in the Bureau of Consumer Financial Protection's Student Loan Litigation: What This Means for Securitization*, CADWALADER, WICKERSHAM & TAFT LLP (Nov. 2, 2018), https://www.cadwalader.com/resources/clients-friends-memos/forward-movement-in-the-bureau-of-consumer-financial-protections-student-loan-litigation-what-this-means-for-securitization.

[3] *Nat'l Collegiate Master Student Loan Trust*, No. 17-1323, ECF No. 380 (D. Del. Dec. 13, 2021) ("Order") at 8.

[4] 15 U.S.C. § 5531(a) (emphasis added).

[5] 12 U.S.C. § 5481(6).

[6] Order at 8–10. The intervenors also argued that the action was untimely. *Id.* at 5-6. They argued that the CFPB failed to ratify the suit before the statute of limitations expired, rendering the action time-barred. *Id.*

Addressing this argument, the Court concluded that ratification of the litigation was unnecessary under the Supreme Court's June 23, 2021, ruling in *Collins v. Yellen*, which held that an unconstitutional removal restriction does not invalidate an agency action and, thus, does not require ratification. *Id.* at 5 (citing *Collins v. Yellen*, 141 S. Ct. 1761, 1788 (2021)). Because the CFPB's litigation action did not require ratification, the Court held that this suit was timely because it was filed third party to do that activity on his behalf?"[7] Turning first to the plain meaning of the word "engage," the Court reasoned that "'engage' means 'to embark in any business' or to 'enter upon or employ oneself in an action.'"[8] The Court concluded that the "definition is broad enough to encompass actions taken on a person's behalf by another, at least where that action is central to his enterprise."[9] For example, "if a dairy farmer contracts with a farmhand to milk his cows and never does that job himself, he is still employed in or in the business of milking cows."[10] Thus, the Trusts also "'embarked in the business' of collecting debt and servicing loans when they contracted with the servicers and subservicers to collect their debt and service their loans."[11] As such, the Court held that the Trusts themselves were "covered persons" under the CFPA and the CFPB's claims against them could proceed.[12]

Key Takeaways

The Court's ruling that a securitization trust is a "covered person" under the CFPA is noteworthy. Under the CFPA, a covered person may not "offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law," "violat[e] Federal consumer financial law," or "engage in any unfair, deceptive, or abusive act or practice."[13] The CFPA authorizes the CFPB and state Attorneys General to bring lawsuits against covered persons for violating federal consumer financial law and to seek damages, restitution, injunctions, and civil money penalties of up to $1,000,000 for each day a violation continues. The Court's ruling thus creates a new line of potential exposure for entities, like securitization trusts and other whole loan buyers, that acquire consumer loans either on a servicing retained basis or enter into a servicing agreement with a third-party servicer acting as an independent contractor.

However, it is important to note the limits of the Court's ruling as well. The Court did not address to what extent and under what legal theories the Trusts may be *liable* for the unlawful acts of the servicer under the CFPA. Specifically, the Court acknowledged that its ruling did not decide whether

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within three years of the date on which the CFPB discovered the alleged violations, as is required by CFPA. *Id.* at 6; *see also* 12 U.S.C. § 5564(g)(1).

[7] Order at 8 (quoting Oxford English Dictionary (2d ed. 2000)).

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id* at 8-9.

[12] *Id.* at 10.

[13] 12 U.S.C. § 5536.

common-law principles of vicarious liability are available under the CFPA to attribute the acts of the servicer to a covered person.[14]

We will continue to monitor this action and others for important legal developments under the CFPA affecting the secondary market.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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[14] Order at 10.