

## 2 Cases May Expand CFPB's Reach On Deceptive Practices

By **John Coleman and Leslie Meredith** (September 27, 2023)

In two separate cases, the Consumer Financial Protection Bureau is asserting a broad interpretation of who is subject to the Consumer Financial Protection Act's prohibition on unfair, deceptive, or abusive acts and practices.

Both cases turn on the question of whether the defendants fall within the scope of covered persons subject to that prohibition because they engage in offering a consumer financial product or service.

Both sets of defendants argued that they did not themselves engage in the underlying conduct, and that their contractual relationship with the third parties who did was not sufficient to make them covered persons. Both sets of defendants have, so far, been unsuccessful.

In *CFPB v. National Collegiate Master Student Loan Trust*, a closely watched case with potentially significant consequences for the consumer credit markets, the U.S. Court of Appeals for the Third Circuit is poised to decide whether the lower court was correct when it concluded that a group of securitization trusts are covered persons, potentially responsible for the UDAAPs of servicers and debt collectors simply because they had contracted with the servicers to collect the debts.

While the industry awaits this ruling, another recent decision in *CFPB v. Manseth* has gone largely unnoticed. In this case, the U.S. District Court for the Western District of New York held last month that the defendants, a group of consumer debt brokers, were covered persons who were engaged in the collection of consumer debt simply by selling the debt to, or placing the debt with, debt collectors.

Perhaps more troubling for those concerned with the potential regulatory liability of securitization trusts, the New York district court reached an issue not before the Third Circuit, but of significant long-term importance.

It held that the CFPB's complaint sufficiently alleged facts under which the defendants could be held vicariously liable for the UDAAPs of the third-party debt collectors.

Together, the two cases raise complex questions about the scope of the CFPB's UDAAP enforcement authority, and what an expansion of that authority might mean for the consumer credit markets.

### **The Significance of Being a Covered Person**

Who is a covered person under the CFPB is a key jurisdictional question for invoking the CFPB's broad and potent UDAAP authority.

The CFPB empowers the bureau to bring enforcement actions only against covered persons and their service providers for "committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a



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consumer financial product or service, or the offering of a consumer financial product or service." [1]

The CFPB defines "covered person" to mean "any person that engages in offering or providing a consumer financial product or service" along with any affiliates that act as a service provider to the covered person. [2]

In both these recent cases, the key question is whether the defendants were engaged in offering or providing a consumer financial product or service even though neither set of defendants directly interacted with consumers in the conduct at issue.

### **CFPB v. National Collegiate Master Student Loan Trust**

The defendants in CFPB v. National Collegiate Master Student Loan Trust are a group of 15 Delaware statutory trusts that were created to hold title to pools of private student loans and issue notes to investors that are secured by the loans. [3]

Commonly referred to as securitization trusts, these special purpose entities are essential to the secondary market for consumer debt. Securitization trusts typically have no employees and must enter into contracts with various service providers to carry out all necessary activities.

Most often, all of these contracts are finalized when the trust is created, so that the trust does literally nothing during the course of existence.

For most securitization trusts, including the defendants in National Collegiate, this included hiring servicers to carry out servicing and collection of the underlying loans.

The CFPB alleges that the defendants' servicers violated the CFPB by filing lawsuits to collect on defaulted loans that were time-barred or not supported by sufficient evidence to establish that the trusts owned the loans.

In late 2021, U.S. Circuit Judge Stephanos Bibas of the Third Circuit, sitting by designation in the U.S. District Court for the District of Delaware, denied the defendants' motion to dismiss.

In doing so, he ruled that the trust defendants were "covered persons" under the CFPB because they were "engaged in" offering a consumer financial service or product by "servicing loans and collecting debt through their contractors," the loan servicers.

The court rejected the trusts' argument that they were merely passive entities who took no action themselves and cannot be held liable for the actions of the servicers whom they characterized as "independent contractors."

The definition of the word "engage" is broad enough, Circuit Judge Bibas found, to "encompass actions taken on a person's behalf by another, at least where that action is central to his enterprise."

He noted that the allegedly deceptive conduct at issue arose from collection suits filed on behalf of the trusts, and that the trusts "have a powerful incentive to ensure that students do not miss their loan payments."

Given that the issue is "novel" and dispositive to the case overall, he certified an

interlocutory appeal to the Third Circuit, which that court agreed to hear.

At the oral argument this May, the panel was openly skeptical of the trusts' position. Judge McKee called it "remarkably weak," and suggested that there would be little left of the consumer financial protection laws if the trusts' arguments were accepted.[4]

It is important to note that the issue before the Third Circuit is simply whether the trusts are subject to the UDAAP prohibition.

Circuit Judge Bibas did not resolve the question of whether the trusts would be liable for the UDAAPs if the bureau could prove its allegations, and that question is not before the Third Circuit.

Given the possibility of further review and the glacial pace of this litigation to date — the case was filed in 2017 — it may be many years before we know the answer to that question, if it is ever answered.

In the meantime, a recent decision from another district court shows how the question of liability might be decided and demonstrates the potential breadth of those who might be subject to the CFPB's authority to enforce the UDAAP prohibition.

### **CFPB v. Manseth**

On Aug. 22, U.S. District Judge Lawrence J. Vilaro of the Western District of New York denied the defendants' motion to dismiss in CFPB v. Manseth, another case involving who can be liable for debt collectors' alleged misconduct.[5]

The CFPB's complaint alleges that the defendants, which include both companies and related individuals, purchased portfolios of defaulted consumer debt that they placed with third party companies to collect on their behalf, and received a portion of the amounts collected in return.

The collection companies allegedly engaged in widespread violations of the Fair Debt Collection Practices Act and made deceptive statements to consumers.

Citing Circuit Judge Bibas' decision in *National Collegiate*, the court found that defendants were "covered persons" under the CFPB because they were "engaged in" collecting consumer debts.

The court followed Circuit Judge Bibas' textual approach, examining the definition of the word "engage," and concluding that "[i]t would strain ordinary understanding to say that a company is not engaged in collecting debt when it purchases defaulted debt, places that debt with other companies for collection, and then receives some of the money recovered by those debt collectors."

The court found it unnecessary to consider the defendants' argument that the CFPB's legislative history indicates that Congress intended to exempt investors from the definition of covered person.

Nonetheless, the court noted that the defendants were "alleged to be far more than mere 'investors,'" perhaps distinguishing the Manseth defendants from the securitization trust defendants in *National Collegiate*.

Next, the court turned to the defendants' argument that vicarious liability was not a viable theory under the CFPB and FDCPA.

The court rejected this argument as well, finding that vicarious liability is a viable path and that the CFPB sufficiently alleged the defendants exercised actual authority over the third-party debt collectors, which may make imposing vicarious liability appropriate.

In reaching this result, the court found it significant that the defendants issued written guidelines to the collection companies that required them to meet certain standards and to report on their performance, instructed them on how to handle consumer complaints, and retained the authority to remove accounts from the collection companies.

The court also relied on the CFPB's allegations that the defendants knew of the debt collectors' allegedly unlawful conduct because they received complaints from consumers about it but nonetheless continued to place debts with the collection companies without taking any steps to address the issues, and even attempted to conceal their relationship with the offending collection companies.

### **Why This Matters**

The market for asset backed securities depends on clear understandings regarding the allocation of risk, including credit risk, but also including regulatory risk.

In the case of securitized consumer credit receivables, the servicer agrees to perform the task of collecting payments on the underlying loans in material compliance with regulatory requirements.

Accordingly, the market's expectation has been that while investors in the securitization will bear credit risk, only the servicer would be liable for any regulatory violations, including potential consumer redress and civil money penalties.

Indeed, the CFPB settled a separate enforcement action against the loan servicers allegedly responsible for alleged violations at issue in the case.[6]

Should the Third Circuit hold that the trusts are also even potentially liable for the actions of the servicers, it raises the prospect that a monetary judgment against the trusts could diminish investors' expected returns.

This concern could become particularly acute if the servicers are not contractually obligated to indemnify the trusts for any regulatory judgment or are otherwise not able to indemnify the trusts. This is not a speculative risk.

A proposed consent order that the district court ultimately declined to enter would have imposed a \$7.8 million civil money penalty on the trusts and prohibited them from seeking "indemnification from any source." [7]

Of course, being a covered person — the only issue pending in the Third Circuit — does not lead to automatic liability.

You must still commit unfair and deceptive practices or — and this is where Manseth comes in — be held vicariously liable for the acts of your agents.

In this respect, the decision in Manseth could be both another cause for concern and

perhaps a cause for hope for the securitization markets.

It is a cause for concern not only because it adopted Circuit Judge Bibas' broad interpretation of covered person, but also because it held that vicarious liability is available under the CFPB — and further, that the CFPB had adequately pleaded facts that, if taken as true, would give rise to such liability.

It is a cause for hope because, as Judge Vilaro noted, the Manseth defendants were, according to the CFPB's allegations, much more involved in the underlying violations than a typical securitization trust.

Even if the CFPB prevails in the Third Circuit appeal, Manseth may indicate that it would have a long road before it can actually persuade the court to impose liability on the trusts.

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[1] 12 USC 5531(a); see also 12 U.S.C. 5536(a)(1)(B).

[2] 12 USC 5481.

[3] Consumer Fin. Prot. Bureau v. Nat'l Collegiate Master Student Loan Tr., 1:17-cv-1323-SB, 2022 WL 548123, (D. Del. Feb. 11, 2022).

[4] See <https://www2.ca3.uscourts.gov/oralargument/audio/22-1864ConsumerFinancialProtectionBureauv.NationalCollegiateMasterStudentLoanTrustetal.mp3>.

[5] Consumer Financial Protection Bureau v. Manseth, No. 22-CV-29-LJV, 2023 WL 5400235, at \*1 (W.D.N.Y. Aug. 22, 2023).

[6] <https://www.consumerfinance.gov/enforcement/actions/transworld-systems-inc/>.

[7] [https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201709\\_cfpb\\_national-collegiate-student-loan-trusts\\_proposed-consent-judgment.pdf](https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201709_cfpb_national-collegiate-student-loan-trusts_proposed-consent-judgment.pdf).