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STRUCTURED FINANCE AND SECURITIZATION ADVISORY

Third Circuit Says Statutory Trusts are ‘Covered Persons’ Under Consumer Financial Protection Act

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In a ruling long anticipated in the securitization industry, the US Court of Appeals for the Third Circuit on March 19 issued its opinion in *Consumer Financial Protection Bureau v. National Collegiate Master Student Loan Trust et al*. The case has had a tortuous litigation history beginning in 2014 with a Consumer Financial Protection Bureau (CFPB) investigation of a series of student loan collection lawsuits[1] brought against borrowers by the defendant trusts (the “Trusts”).[2] The Third Circuit agreed with the legal arguments advanced by the CFPB in the lower court. The issues presented to the Third Circuit turned on two legal questions: (i) whether a trust is a “covered person” under the federal Consumer Financial Protection Act (CFPA)[3] because it *engages* in consumer financial products or services (the so-called “statutory question”), and (ii) whether the CFPB was required to ratify the underlying action given issues related to the appointment of the agency’s director (the so-called “constitutional question”).

The Trusts in issue used the typical structure for securitizing consumer obligations. Specifically, the Trusts had no employees but instead contracted with “administrators” to provide operating support and “servicers” to service the Trusts’ assets. In connection with the servicing of the Trusts’ assets, the CFPB took the position that the Trusts (notwithstanding their lack of direct, consumer-facing contact and engagement) were “covered persons” *under the CFPA* ***because the Trusts engaged in consumer debt collection***.

In considering the statutory question, the court made quick review of the statutory language and the facts in issue, holding that “Congress’s intent is clear: the Trusts were to be included as ‘persons’ under the CFPA, [and that a] similarly inevitable conclusion is reached when defining ‘consumer financial product[s and] service[s].’” Notably, with respect to the second definitional issue, the court pointed out that such a determination was easy because the Trusts themselves stated in their opening brief that they “‘were formed to acquire a pool of private student loans, to issue securitized notes on those loans, and to provide for the servicing of the loans and the distribution to noteholders of the loan payments made by borrowers.’” The final question for the court’s consideration on this point, however, was whether the Trusts “engage” in offering or providing a consumer financial product or service as required in the CFPA’s definition of “covered person.” In assessing this point, the court considered both definitional resources as well as legal precedent to find that the “Trust Agreement’s purpose indicates that the Trusts *engage* in both student loan servicing and debt collection.”[4]

With respect to the constitutional question, the Trusts argued that, even if the definitional requirements for a “covered person” were satisfied, the director of the CFPB wasn’t authorized to pursue the suit against the Trusts

[1] According to the court’s opinion, the National Collegiate Student Loan Trusts, a collection of 15 pre-2008 trusts, “amassed collectively over eight hundred thousand private student loans.”

[2] At one point, the parties had reached a settlement on the matter but the US District Court refused to accept the settlement.

[3] The term “covered person” is defined in relevant part in the CFPA as “any person that engages in offering or providing a consumer financial product or service.” 12 USC § 5481(6)(A).

[4] Emphasis added.

because the director acted after the expiration of the statute of limitations applicable to the cited laws. The court dismissed this claim in light of recent US Supreme Court decisions concerning the status and authority of the director of the CFPB (the "removal provision"). The Third Circuit determined that actions taken by the director of the CFPB are not "void" and do not need to be "ratified" unless a plaintiff can show actual harm from the removal provision. "In other words, if there is no harm derived from the President's inability to remove the agency head, then the agency action will not be unwound." In this case, the court found that the Trusts didn't demonstrate a sufficient "link" between the removal provision and the Trusts' case.

Notable Analyses

First, it is important to note that this ruling is controlling precedent only in the Third Circuit (comprised of Pennsylvania, Delaware, and New Jersey). Further, the case is far from over. The Third Circuit has sent the case back to the US District Court for the District of Delaware for further consideration in light of the appellate court's interpretive decision. The case can also be appealed to the full Third Circuit (an en banc review) or to the US Supreme Court.

From a regulatory perspective, trust counsel and securitization counsel should review each securitization trust's organizational documents and legal requirements related to debt collection registration, licensing, and bonding. The holding in this case may provide a basis for plaintiffs' counsel to bring actions related to the failure of securitization trusts to hold the licenses or registrations required of debt collectors. In addition, the CFPB, the states, and potentially private plaintiffs may now use this case as leverage in connection with claims against securitization trusts for various consumer-focused complaints.

Finally, this case serves as an instructive reminder that litigation is not "over until it is over." As noted above, the parties in this case reached a settlement *seven years ago*, but the US District Court judge rejected it, causing the parties to move forward with the case. This nuance is a detail that should not be lost on parties that are challenging the CFPB's position regarding the scope of the agency's jurisdiction.

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