STUDENT BORROWER PROTECTION CENTER

MEMORANDUM

June 14, 2021

TO:	The Consumer Financial Protection Bureau State Attorneys General State Banking Departments and Financial Regulators
FROM:	Ben Roesch, Senior Fellow Ben Kaufman, Head of Investigations & Senior Policy Advisor
RE:	**Unfair, Deceptive, and Abusive Acts and Practices in the Servicing of Void and Unenforceable ISAs**

I. Introduction

The companies and schools that market and issue Income-Sharing Agreements, or "ISAs," have been the subject of significant attention from consumer advocates, who have detailed—among other things—deceptive methods used to market ISAs,[1] the fair lending risks that appear to be inherent in the structure of many ISA programs,[2] and ISA providers' attempts to avoid regulation through discredited arguments that ISAs are not "credit" or "loans" under federal[3] and state[4] consumer finance statutes. However, ISA providers and schools market ISAs as an alternative to student loans, and the spurious claim that ISAs are not "loans" is central to their pitch to prospective borrowers. ISA providers' commitment to these arguments and resulting refusal to comply with federal and state consumer financial protections touch every aspect of the industry, as well as the schools with which ISA providers partner. For example, ISA providers have generally refused to comply with such rudimentary consumer protections as state laws requiring lenders to obtain a license and statutes capping the amount of interest that they may charge or collect. These decisions create significant legal liability, not just for the companies and schools that create and market ISAs, but also the companies that service and collect the ISAs—including traditional student loan servicing companies that have decided to enter the market.

[1] Danielle Douglas-Gabriel, *Groups to FTC: Company Pushing Student Income-Share Agreements Deceives Customers*, Wash. Post (June 1, 2020), https://www.washingtonpost.com/education/2020/06/01/groups-ftc-company-pushing-income-share-agreements-student-loans-deceives-customers/.
[2] Stacy Cowley, *A Novel Way to Finance School May Penalize Students From H.B.C.U.s, Study Finds*, N.Y. Times (Mar. 25, 2021), https://www.nytimes.com/2021/03/25/business/student-loans-black-students-hbcu.html.
[3] Joanna Pearl & Brian Shearer, *Credit by any Other Name: How Federal Consumer Financial Law Governs Income Share Agreements*, Student Borrower Prot. Ctr. (July 2020), https://protectborrowers.org/wp-content/uploads/2020/07/Pearl.Shearer_Credit-By-Any-Other-Name.pdf.
[4] Benjamin Roesch, Student Borrower Prot. Ctr., Applying State Consumer Finance and Protection Laws to Income Share Agreements (Aug. 4, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3672435.

While ISA servicing was initially dominated by a few companies that provided cradle-to-grave ISA program administration—assisting schools and/or third-party investors in setting up ISA origination programs, marketing to students, and then servicing the ISAs once borrowers entered repayment—traditional student loan servicers like the Higher Education Loan Authority of the State of Missouri ("MOHELA"),[5] Launch Servicing, LLC,[6] and others[7] have begun to service ISAs in addition to their more "traditional" student loan portfolios. Although these servicers may not have been involved in origination-related misconduct, their business partners' unlicensed lending and use of ISA design that regularly results in usurious payments lead inexorably to violations of federal and state laws prohibiting unfair, deceptive, and abusive acts and practices, as well as state student loan servicing laws.

As explained below, ISA providers' decisions not to obtain consumer loan licenses from state financial regulators and in many cases not to abide by state usury laws render the offending ISAs void and unenforceable under many states' laws. The unlawful nature of these ISAs has significant downstream legal consequences for servicers. Well-established Consumer Financial Protection Bureau ("Bureau") precedent establishes that when servicers seek payment on void ISAs—or payment of interest or other fees to which the lender is not entitled under state law—they create a deceptive net impression that these unlawful amounts are owed, when in truth and in fact the borrower has no obligation to pay. Several courts have endorsed the Bureau's position that servicing loans that are void or unenforceable under state law is an unfair, deceptive, and abusive act or practice for which servicers may be liable under the Consumer Financial Protection Act ("CFPA"). The Bureau should therefore take action to confirm that ISAs are "credit" under federal consumer finance law. Similarly, state regulators should clarify that ISAs are "loans" under state law, and the ISA industry is therefore subject to the licensing, usury, and other regulations applicable to loans. Moreover, both the Bureau and state officials should take action to hold servicers accountable for demanding and collecting payments on void and enforceable ISAs under the CFPA, state consumer protection statutes, and state student loan servicing laws commonly known as Student Borrower Bills of Rights.

II. ISA Providers' Violations of State Consumer Licensing and Usury Laws Render Many ISAs Unenforceable in Whole or in Part.

A. ISAs are "Loans" under Many States' Consumer Lending Statutes.

ISAs are loans that generally share certain characteristics.[8] First, the "Funding Amount" is the sum the bootcamp credits to the borrower's account, generally in the amount of its up-front tuition

[5] ISA provider Stride Funding, Inc. promotes "Origination & Servicing through trusted partners like Campus Door and MOHELA". *Universities*, Stride Funding, https://www.stridefunding.com/universities.
[6] *See* Launch Servicing, https://www.launchservicing.com/ (providing link for "ISA Login").
[7] *See infra* notes 68-71.
[8] For a more thorough discussion of ISA structures and common terms, see Dubravka Ritter & Douglas Webber, Fed. Rsrv. Bank of Phila., Modern Income-Share Agreements in Postsecondary Education: Features, Theory, and Applications, (Dec. 2019), https://www.philadelphiafed.org/-/media/frbp/assets/consumer-finance/discussion-papers/dp19-06.pdf. ISA providers and their partner schools also provide descriptions of common ISA terms and conditions. *See, e.g.*, *University of Utah ISA Program*, Vemo Educ., https://vemoeducation.com/university-of-utah-isa-program/; *Income Share Agreements*, Meratas, https://www.meratas.com/income-share-agreement-isa.

charge, and is analogous to the principal for a traditional student loan. Second, the "Income Share" is the percentage of the borrower's monthly income that they must pay each month of the payment term as long as they are making enough money to "trigger" the repayment obligation. Third, an ISA's "Payment Term" or "Payment Window" refers to the period during which the borrower will pay the Income Share back to the provider on a monthly basis. Finally, the "Payment Cap" represents the total fixed amount a student borrower must pay to fulfill the ISA before the end of the Payment Term, similar to an early payoff of a traditional student loan. And if a consumer defaults on the ISA, the ISA may be accelerated and the borrower typically owes the Payment Cap (less any payments already made).

While ISA providers claim that their financial product falls outside definitions of "loan" and "credit," and are therefore exempt from state and federal laws governing consumer financial transactions, previous work by consumer advocates has debunked these providers' claims to freedom from oversight. Not only are ISAs "credit" under federal consumer finance statutes such as the Truth in Lending Act and the Equal Credit Opportunity Act,[9] but they fall squarely within many states' definitions of "loan," subjecting ISAs and their providers to state licensing, usury, and other regulations.[10] For example, publicly available ISAs have described their "economic substance" as "a financial contract (in other words, as the 'sale' by you of part of the income stream you will earn in the future)."[11] This description of the transaction's "economic substance" places ISAs squarely within the definition of "loan" under many state laws, which stipulate that providing credit or money "as consideration for any sale or assignment of, or order for, the payment of wages, salary, commission, or other compensation for services, whether earned or to be earned, shall for the purposes of this chapter be deemed a loan of money secured by the sale, assignment or order."[12]

B. ISAs Issued by Providers Without Acquiring the Requisite State Consumer Loan Licenses Are Void Under Some States' Laws.

Most states require consumer lenders to obtain a license in order to extend consumer loans to their constituents.[13] State licensing and regulatory supervision of lenders—and financial services providers more generally—is critical to protecting consumers from unfair, deceptive, and otherwise abusive practices.[14] This requirement extends to schools that provide financing directly

[9] Pearl & Shearer, *supra* note 3; Stephen Hayes & Alexa Milton, Student Borrower Prot. Ctr., Solving Student Debt or Compounding the Crisis?: Income Share Agreements and Fair Lending Risk (July 2020), https://protectborrowers.org/wp-content/uploads/2020/07/SBPC_Hayes_Milton_Relman_ISA.pdf.

[10] *See* Roesch, *supra* note 4.

[11] *See id.* at 10, n.33 (quoting sample income share agreement from Rithm School's website).

[12] Va. Code Ann. § 6.2-1525 (2020). *See also* Alaska Stat. § 06.20.290 (2020); Fla. Stat. Ann. § 516.26 (West 2020); Md. Code Ann., Com. Law § 12-303(c)(2)(i) (West 2020); Mo. Rev. Stat. § 408.210 (2020); Neb. Rev. Stat. Ann. § 45-1021 (West 2020); Nev. Rev. Stat. Ann. § 675.330 (West 2020); N.M. Stat. Ann. § 58-15-21 (West 2020); 7 Pa. Stat. and Cons. Stat. Ann. § 6218 (West 2020); 19 R.I. Gen. Laws § 19-14.2-6 (2020); Vt. Stat. Ann. tit. 8, § 2234 (West 2020).

[13] *See, e.g.*, Fla. Stat. § 516.02(1) (2020) ("A person must not engage in the business of making consumer finance loans unless she or he is authorized to do so under this chapter or other statutes and unless the person first obtains a license from the office."); Minn. Stat. § 56.01(a) (2020); Wash. Rev. Code § 31.04.035(1) (2020).

[14] *See generally* Brian Shearer, Student Borrower Prot. Ctr., Federalism to the Rescue: State Regulators Can and Should Examine for Violations of Federal Consumer Financial Law (May 2020), https://protectborrowers.org/wp-content/uploads/2020/05/State-Powers-Report.pdf.

to their students. For example, the Minnesota Supreme Court held that two for-profit schools that made loans to their students at usurious interest rates had unlawfully "engaged in unlicensed lending."[15]

It appears that ISA providers have generally not obtained licenses to originate loans in most states.[16] In many states, the practice of making consumer loans without a license is a *per se* violation of consumer protection statutes.[17] However, some states impose even more significant penalties, which have consequences for ISA servicers.

Many states' laws render consumer loans issued by lenders who have not obtained the requisite licenses void and unenforceable. For example, Minnesota requires licenses for lenders making loans of less than $100,000,[18] and provides that where a lender fails to obtain "a license when required to make loans subject to this chapter, the loan is void and the debtor is not obligated to pay any amounts owing."[19] Similarly, Virginia law states that loans issued without appropriate licenses are void, and lenders are prohibited from collecting, receiving, or retaining "any principal, interest, or charges whatsoever with respect to the loan…."[20] Other states impose similar rules,[21]

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[15] *State v. Minn. Sch. of Bus., Inc.*, 899 N.W.2d 467, 476 (Minn. 2017) (finding that Minnesota School of Business and Globe University violated licensing requirements).

[16] The Student Borrower Protection Center (SBPC) examined the licensure status of various prominent ISA providers. The SBPC gathered a list of relevant providers by examining Career Karma's 2019 report "Income Share Agreements (ISAs) – State of the Market 2019" and supplementing the set of ISA companies included in the report with a broad online search and additional consultation with industry participants, legal practitioners, and researchers. *See* James Gallagher, *Income Share Agreements (ISAs)—State of the Market 2019*, Career Karma (Nov. 12, 2019), https://careerkarma.com/blog/income-share-agreement-market-report-2019/. The SBPC's final list of relevant firms included Vemo Education, Leif, Social Finance, Stride Funding, Lumni, Blair, Pando, Defynance, Align Income Share Funding, MentorWorks, and Education Equity. The SBPC then searched the public website of the Nationwide Multistate Licensing System (NMLS) for each of these firms. No firm produced any results in the SBPC's searches, indicating that these firms appear not to be licensed for any purpose in any state. *See*, Vemo Education [https://perma.cc/M86X-AEFB]; Leif [https://perma.cc/GN5X-TN7T] (note that Leif Investments, the firm produced by this NMLS search, is not the ISA provider); Social Finance [https://perma.cc/R5SS-8C4H]; Lumni [https://perma.cc/F2NV-GQRW]; Blair [https://perma.cc/3YRQ-HS85]; Pando [https://perma.cc/ZKM7-LBKA] (note that Pando Mortgage, the firm produced by this NMLS search, is not the ISA provider); Defynance [https://perma.cc/TY2F-QRB5]; Align Income Share Funding [https://perma.cc/Y2LK-JGFE]; MentorWorks [https://perma.cc/PW3P-VE5R]; Education Equity [https://perma.cc/2ATW-GXLU].

[17] For example, Washington's state legislature proclaimed that "the practices governed by [the state's Consumer Loan Act] are matters vitally affecting the public interest for the purpose of applying" the state's Consumer Protection Act, such that "any violation" of the Consumer Loan Act is not reasonable in relation to the development and preservation of business and is an unfair and deceptive act or practice and unfair method of competition in the conduct of trade or commerce in violation of" the Consumer Protection Act. Wash. Rev. Code § 31.04.208 (2020).

[18] *See* Minn. Stat. §§ 56.01(a), 56.131 (2020).

[19] Minn. Stat. § 56.19.4 (2020).

[20] Va. Code Ann. § 6.2-1541 (2021).

[21] For example, Illinois voids consumer-installment loans for principal amounts under $40,000 made without a license, and the person who made the loan shall have no right to collect, receive, or retain any principal, interest, or charges related to the loan, 205 Ill. Comp. Stat. 670/1, 670/20(d) (2021). Montana voids covered loans in any amount that are made, or for which any compensation is contracted for, charged, or received directly or indirectly, by a person without a license, and the person does not have the right to collect, receive, or retain any principal, interest, fees, or other charges on such loans, Mont. Code Ann. § 32-5-103(1), (4) (2019). New Jersey voids consumer loans of $50,000 or less that are made without a license, and the lender has no right to collect or receive any principal, interest, or charges on such loans, unless the act was the result of good faith error, N.J. Rev. Stat. §§ 17:11C-2, 17-11C-3, 17-11C-33(b) (2021).

while still others void loans made without a license if the unlicensed lender charges higher interest or fees than permitted to licensees.[22]

In other states, loans made without the requisite license are unenforceable in part. For example, in Colorado, a lender's or assignee's failure to obtain the requisite license removes the consumer's obligation to pay finance charges to the lender or assignee.[23] Similarly, Washington's Consumer Loan Act requires that fees or interest charged on a loan made without a license be refunded to the borrower.[24] As discussed below, where ISAs are unenforceable in whole or in part due to violations of state licensing laws, the act of servicing or collecting on them has significant consequences.

C. ISAs that Require Payments in Excess of State Usury Caps Are Void under Some States' Laws.

Many states have established maximum interest rates that may be charged on consumer loans through usury laws—including some states that apply different usury caps to licensed and unlicensed lenders. These laws apply to ISAs as loans, and while ISA payments are not calculated pursuant to an interest rate like other types of loans,[25] common-sense approaches to identify and calculate interest and finance charges on ISAs exist. For example, Virginia law states that "[t]he payment of any amount in money, credit, goods or things in action, as consideration for any sale or assignment of, or order for, the payment of wages, salary, commission, or other compensation for services" is treated as a loan.[26] Virginia law further provides that the difference between the amount credited to the borrower's account (i.e., the tuition financed through an ISA) and the ultimately paid by the borrower "shall be deemed for the purpose of this chapter to be interest upon the loan from the date of the payment to the date the compensation is payable."[27] This common-sense approach can be applied across the country.

Applying this approach confirms that many ISAs are designed to generate interest and finance charges well in excess of many states' usury caps. For example, the coding bootcamp Hack Reactor charges an up-front fee of $17,980 and also offers students an ISA to finance that amount.[28] This example will use that sum as the amount financed. Other assumptions derived from Hack Reactor's public representations include (1) a $2,000 down payment;[29] (2) a starting income of $115,000,

[22] *See* N.Y. Banking Law §§ 340, 355 (McKinney 2021).
[23] Colo. Rev. Stat. §§ 5-5-201(1), 5-2-301(1)(a), (b), 5-1-301(17).
[24] Wash. Rev. Code § 31.04.035(2)(b) (2020).
[25] ISA providers routinely make representations that "ISAs are not loans so they have no interest," and therefore decline to provide information on interest rates. *See, e.g.*, *Income Share Agreement*, Lambda Sch., https://lambdaschool.com/tuition/isa [https://perma.cc/D5AQ-9N87] (last visited June 10, 2021). Previous scholarship demonstrates that ISAs are indeed "loans," *see supra* notes 3-4, and well-established legal principles establish that the amounts repaid in excess of the amount financed are "interest" or a "finance charge."
[26] Va. Code Ann. § 6.2-1525 (2020).
[27] *Id.*
[28] *Tuition and Financial Options*, Hack Reactor, https://www.hackreactor.com/coding-bootcamp#Tuition%20&%20Financial [https://perma.cc/ZTP5-JS7J] (last visited June 10, 2021).
[29] *See ISA Calculator*, Galvanize, https://www.galvanize.com/income-share-agreements?_ga=2.211167253.164899724.1594933374-1447966430.1591556411#isa-calculator [https://perma.cc/ZY9T-7YA4].

which Hack Reactor has represented as the median salary for program graduates;[30] and (3) repayment commencing six months after enrollment.[31] Hack Reactor's ISA requires payments of 10 percent of the borrower's income for 48 months or until its repayment cap of $22,372 is reached.[32] Thus, Hack Reactor's represented median ISA borrower will make 23 monthly payments of $958.33, and one payment of $330.33 to reach the repayment cap in 30 monthly payments (including the first payment of $2,000 and the remaining five months of the in-school/grace period). The Office of the Comptroller of the Currency's Annual Percentage Rate calculation tool[33] calculates a "finance charge" of $6,392 and an APR of 22.8 percent.[34] Thus, Hack Reactor's ISA—like others—is *designed* to impose a usurious rate of interest on the median borrower.

Another example is the ISA that the company General Assembly offers to attendees of its coding bootcamps, including its software engineering bootcamp in Minneapolis, Minnesota.[35] The full tuition of these courses is $14,950,[36] which can be taken as in the preceding example as the amount the ISA borrower finances. Students who take on the ISA pledge 10 percent of their income for a 48 month period while their annual income is above $40,000, with a repayment cap of 1.5 times the amount borrowed.[37] Students are expected to make a $250 deposit upon starting the three-month bootcamp course[38] and are given a three-month grace period[39] before they enter repayment.[40] Because General Assembly does not specify mean or median graduate incomes in its transparency reports,[41] this example assumes graduate income of $86,143, the average reported

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[30] Council on Integrity in Results Reporting, Hack Reactor @ Galvanize San Francisco: CIRR Outcomes Report H2 2018 (2018), https://static.spacecrafted.com/b13328575ece40d8853472b9e0cf2047/r/b5f25a05a4ab42afa5e62987629bbf12/1/Hack%20Reactor%20@%20Galvanize%20San%20Francisco%20(H2%202018).pdf [https://perma.cc/P83E-E6KT]. Note that the present example assumes no income growth.

[31] Hack Reactor has a three-month full-time program, which is followed by a three-month "grace" period for the ISA. This example assumes that the student makes their $2,000 deposit in the first month and makes no additional payments during the remaining five months of the in-school-plus-grace period before entering repayment.

[32] *See* Galvanize, *supra* note 29. Hack Reactor represents that its payment cap is 1.4 times the deferred portion of the tuition, which appears to be $15,980 after the borrower makes their $2,000 down payment on tuition of $17,980. *Id.* Note that in combination with the $2,000 down payment, a borrower hitting the repayment cap would pay $24,372.

[33] *See APR Tool*, Fed. Fin. Insts. Examination Council, https://www.ffiec.gov/examtools/FFIEC-Calculators/APR/#/accountdata.

[34] *APR Tool*, Fed. Fin. Insts. Examination Council [https://perma.cc/6NL4-NXEW]. ISAs issued in conjunction with other schools may carry even higher effective interest rates. For example, while Hack Reactor's ISA calls for payment of 10% of borrowers' income, ISAs issued by Lambda School require payment of 17% of borrowers' gross income. *See* Lambda Sch., *supra* note 25.

[35] *Software Engineering Immersive: Minneapolis*, General Assembly, https://generalassemb.ly/education/software-engineering-immersive/minneapolis [https://perma.cc/KH8N-QKNR].

[36] *Id.*

[37] *Catalyst Income Share Agreement*, General Assembly, https://generalassemb.ly/financing/catalyst-income-share-agreement [https://perma.cc/M7VV-KECG].

[38] General Assembly, *supra* note 35.

[39] General Assembly, Student Financing Handbook 8 (2018), https://ga-core.s3.amazonaws.com/cms/files/files/000/004/894/original/StudentFinanceHandbook_nof_12062018.pdf.

[40] As above, for the purposes of the APR calculation the borrower is modeled as paying $250 in the first month and $0 for the remaining 5 months of the in-school and grace periods.

[41] General Assembly, Student Outcomes Report (2019), https://generalassemb.ly/sites/default/files/2021-04/GA_OutcomesReport_19_Final_0.pdf [https://perma.cc/Z7YH-YLHE].

salary for a software engineer in Minneapolis.[42] Under these assumptions, a typical General Assembly ISA borrower in Minneapolis who has exited his or her post-graduation grace period will make 30 payments of $717.86 and one payment of $639.25 to reach the repayment cap in 37 monthly payments (including the first payment of $250 and the remaining five months of the in-school/grace period). The Office of the Comptroller of the Currency's Annual Percentage Rate calculation tool calculates a "finance charge" of $7,475 and an APR of 23.5 percent.[43] General Assembly's ISA therefore imposes a usurious rate of interest on the typical borrower.

Figure 1: Widely available ISAs involve APRs that could violate state usury laws[44]

	Tuition	Total ISA payments	ISA APR
Hack Reactor	$17,980	$24,372	22.8%
General Assembly	$14,950	$22,425	23.5%

These interest rates significantly exceed the usury caps in many states.[45] Notably, these large finance charges persist even in the presence of the "repayment cap" feature of the ISA, which is generally marketed to prospective borrowers as a protection against paying too much for their education.[46] For example, ISA provider MentorWorks states that "[i]f students find a very high paying job, the payment cap will protect them from overpaying,"[47] while Vemo states that its "repayment cap limits "the amount participants pay" and is one of several "key protections for students."[48] Moreover, while financial advice websites warn potential borrowers to "[w]atch out

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[42] *Software Engineering Salaries in Minneapolis-St. Paul, MN Area*, Glassdoor [https://perma.cc/8Y7E-HHRB] (last updated Apr. 17, 2021). Note that as in the preceding example, no income growth is assumed.
[43] *APR Tool*, Fed. Fin. Insts. Examination Council [https://perma.cc/HCZ4-MRYR].
[44] Student Borrower Prot. Ctr. calculations. For calculation assumptions and inputs, see *supra* notes 23 to 38.
[45] *See, e.g.*, Ark. Const. amend. 89, §§ 3, 6(b) (providing that all "loans or contracts" with interest above 17% "shall be void as to principal and interest"); 815 Ill. Comp. Stat. 205/1 (2021) (9%); Minn. Stat. § 334.01 (2020) (8%); N.Y. Gen. Oblig. Law § 5-501; N.Y. Banking Law § 14-a (16% for civil usury); N.Y. Penal Law § 190.40 (25% for criminal usury); 41 Pa. Stat. and Cons. Stat. Ann. § 201 (West 2020) (6%).
[46] Indeed, the "repayment cap" often harms consumers by acting as an unlawful pre-payment penalty for ISA borrowers who would refinance or otherwise pay off their loans quickly. *See* Mike Pierce & Tamara Cesaretti, Student Borrower Prot. Ctr., *Income Share Agreements and TILA's Ban on Prepayment Penalties* (Mar. 30, 2021), https://protectborrowers.org/wp-content/uploads/2021/03/ISA-Prepayment- Memo.pdf.
[47] Karthik Krishnan, *ISA Investment 101: What are Income Share Agreements?*, MentorWorks (Jan. 8, 2019), https://blog.mentorworks.com/2019/01/08/isa-investment-101-what-are-income-share-agreements/ [https://perma.cc/HU52-ZVHV].
[48] *What are Income Share Agreements (ISAs)?*, Vemo Education, https://vemoeducation.com/about-income-share-agreements/.

for caps above 2X borrowed," because "[y]ou could repay far more than you got,"[49] this advice only underscores the illusory "protection" provided by ISA repayment caps, as even repayment caps set at 1.5 times the amount financed result in payments far in excess of those permitted by the *actual* protection provided by state usury laws.

States impose a variety of penalties upon lenders and their agents for violations of usury caps.[50] Most consequently for ISA servicers, some state laws void usurious loans in their entirety, rendering them unenforceable. For example, in New York "a usurious transaction is void *ab initio*,"[51] and Minnesota law invalidates usurious transactions,[52] while the Arkansas Constitution provides that all "loans or contracts" with interest above 17 percent "shall be void as to principal and interest."[53] Indeed, charging or collecting usurious finance charges in some states is a criminal violation,[54] as is the possession of "usurious loan records."[55]

D. ISAs Issued to Students at Schools Operating without Regulatory Approval are Often Void and Unenforceable.

Many ISAs have been issued to students at private schools that, at the time the ISAs were issued, had not obtained approval to operate from relevant state regulatory agencies. For example, California requires that private schools ranging from traditional for-profit colleges to vocational institutions that provide educational services in California obtain approval through the state's

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[49] Ryan Lane, *Income Share Agreements: What Are They, and How Do They Work?*, NerdWallet (Apr. 28, 2021), https://www.nerdwallet.com/article/loans/student-loans/income-share-agreements-what-students-should-know-before-borrowing.

[50] For example, in some states, borrowers have no obligation to pay any charge that exceeds the legal rate. *See, e.g.*, Colo. Rev. Stat. § 5-5-201(2) (2021).

[51] *Szerdahelyi v. Harris*, 490 N.E.2d 517, 522-23 (N.Y. 1986); *see also* N.Y. Gen. Oblig. Law § 5-511.

[52] Minn. Stat. §§ 334.03, 47.601, subdiv. 6(b).

[53] Ark. Const. amend. 89, §§ 3, 6(b). Other states have similar rules. *See, e.g.*, Mass. Gen. Laws Ann. ch. 271, § 49 ("Any loan at a rate of interest proscribed under the provisions of paragraph (a) [20% APR] may be declared void by the supreme judicial or superior court in equity upon petition by the person to whom the loan was made."); Vt. Stat. Ann. tit. 8, § 2231(b) ("[I]f any interest, consideration, or charges in excess of those permitted by this subsection, except as the result of an accidental or bona fide error are charged, contracted for, or received, the contract of loan shall be void and the licensee shall have no right to collect or receive any principal, interest, or charges whatsoever.").

[54] *See, e.g.*, Mass. Gen. Laws Ann. ch. 271, § 49(a) ("Whoever in exchange for either a loan of money or other property knowingly contracts for, charges, takes or receives, directly or indirectly, interest and expenses the aggregate of which exceeds an amount greater than twenty per centum per annum upon the sum loaned or the equivalent rate for a longer or shorter period, shall be guilty of criminal usury"); N.Y. Penal Law § 190.40 ("A person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period.").

[55] *See, e.g.*, Mass. Gen. Laws Ann. ch. 271, § 49(b) ("Whoever, with knowledge of the contents thereof, possesses any writing, paper, instrument or article used to record a transaction proscribed under the provisions of paragraph (a) shall be punished by imprisonment in a jail or house of correction for not more than two and one half years, or by a fine of not more than five thousand dollars, or by both such fine and imprisonment."); N.Y. Penal Law § 190.45 ("A person is guilty of possession of usurious loan records when, with knowledge of the contents thereof, he possesses any writing, paper, instrument or article used to record criminally usurious transactions prohibited by section 190.40.").

Bureau for Private Postsecondary Education ("BPPE") to operate.[56] Many coding bootcamps—career or vocational programs that promise to transform students into software engineers with lucrative career opportunities—are based in California and fall within the BPPE's purview. However, many operated for years without seeking, much less receiving, BPPE approval—meanwhile promoting ISAs as their preferred financing arrangement with students, and issuing ISAs directly to most of them.

The California Education Code provides that "[a] note, instrument, or other evidence of indebtedness relating to payment for an educational program is not enforceable by an institution unless, at the time of execution of the note, instrument, or other evidence of indebtedness, the institution held an approval to operate."[57] ISAs are "debt" under California law. For example, The Rosenthal Fair Debt Collection Practices Act also defines "debt" as "money, property, or their equivalent that is due or owing or alleged to be due or owing from a natural person to another person."[58] More recently, "debt" has defined as "liability on a claim," where "claim" is defined as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[59] Many coding bootcamps issued ISAs directly to their students—for example, Rithm School's and Lambda School's ISAs are each e-signed by their CEOs, and identify "Rithm, Inc." and "Lambda, Inc.," respectively, as the parties to whom the student's monthly payments are owed.[60] Rithm School operated from 2016 to 2018 before obtaining approval from the BPPE;[61] Lambda School operated without approval from the BPPE from 2017 until August 20, 2020. ISAs issued before those dates—and ISAs issued by similarly unapproved bootcamps and other schools—are unenforceable.

III. ISA Servicers Face Significant Liability and Commercial Risk Arising from Providers' Misconduct.

A. Several traditional student loan services are now operating as ISA servicers.

A variety of companies now act as ISA servicers. This includes firms offering third-party servicing as part of cradle-to-grave ISA program administration, such as Leif,[62] Vemo Education,[63]

[56] Cal. Educ. Code § 94886.
[57] Cal. Educ. Code § 94917.
[58] Cal. Civ. Code § 1788.2.
[59] Cal. Civ. Code § 3439.01(b), (d).
[60] *See* Benjamin Roesch & Ben Kaufman, Student Borrower Prot. Ctr., *Income Share Agreement and the FTC's Holder Rule* 4, (March 2021), https://protectborrowers.org/wp-content/uploads/2021/05/SBPC_Holder_Rule_Final.pdf.
[61] *See BPPE Approval and Outcomes Numbers*, Rithm Sch. (July 25, 2018), https://www.rithmschool.com/blog/bppe-approval-and-outcomes-numbers.
[62] Press Release, Leif, *Leif and Lambda School Sign an Estimated $20 Million Multi-Year Agreement to Invest Directly in Students*, BusinessWire (Oct. 24, 2017), https://www.businesswire.com/news/home/20171024005482/en/Leif-and-Lambda-School-Sign-an-Estimated-20-Million-Multi-Year-Agreement-to-Invest-Directly-in-Students [https://perma.cc/HQB3-72XB].
[63] *Higher Education*, Vemo Education, https://vemoeducation.com/higher-education-income-share-agreements/ [https://perma.cc/NAA6-R9V2].

Meratas,[64] IonTuition,[65] and Blair.[66] As Leif explains in media materials for its own offerings, these companies service as part of a suite of "origination, servicing, and financing solutions for Income Share Agreements."[67] In addition, several firms operate as servicers on behalf of third parties who originate their own ISAs. These companies include MOHELA,[68] Launch Servicing, LLC,[69] Scratch,[70] and Knowledge Finance (a non-profit subsidiary of MOHELA that also services ISAs in addition to its parent company).[71] As Knowledge Finance indicates on its website, this business line involves providing "servicing solutions . . . to support Direct to School, Direct to Consumer and Workforce Income Share Agreement channels."[72] These servicers are already required to be licensed under many states' student loan servicer statutes, and ISA servicers are also subject to the licensing requirements under, and supervision imposed by, those laws.[73] State regulators, as well as the Bureau, should therefore examine these servicers for the violations described in this memorandum and elsewhere.

B. Servicing void and unenforceable ISAs is an unfair, deceptive, and abusive act or practice.

The Consumer Financial Protection Act (CFPA) prohibits "unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service,"[74] which is defined to include "extending credit and servicing loans."[75] ISA servicers are therefore "covered persons" subject to the CFPA,[76] and the Bureau's precedents establish that servicing or attempting to collect on void or unenforceable loans, or seeking payment on an obligation that the borrower does not owe, is a deceptive, prohibited practice.

In *Consumer Financial Protection Bureau v. CashCall, Inc.*,[77] the Bureau alleged that a group of defendants had "engaged in unfair, deceptive, and abusive acts and practices … by servicing and collecting full payment on loans that state-licensing and usury laws had rendered wholly or partially void or uncollectible." CashCall was a California-based consumer lender that made "loans

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64 *Meratas*, LinkedIn, https://www.linkedin.com/company/meratas/about/ [https://perma.cc/6JCZ-HLFN].
65 Press Release, IonTuition, *PIE by IonTuition to Partner with MentorWorks' Income Share Agreements*, BusinessWire (Nov. 5, 2019), https://www.businesswire.com/news/home/20191105005884/en/PIE-by-IonTuition-to-Partner-with-MentorWorks%E2%80%99-Income-Share-Agreements [https://perma.cc/C8UJ-H87Z].
66 Danny Chrichton, *PIE by IonTuition to Partner with MentorWorks' Income Share Agreements*, TechCrunch (Feb. 8, 2021), https://techcrunch.com/2021/02/08/blair-launches-100m-facility-to-fund-isas-for-students/ [https://perma.cc/F9ZE-DJXE].
67 Leif, *supra* note 62.
68 Higher Educ. Loan Auth. of the State of Mo., Investor Presentation (Feb. 2020), https://www.mohela.com/DL/common/publicInfo/investorInformation.aspx?idx=2039.
69 Press Release, Goal Structured Solutions, *Goal Solutions Now Live With Another Innovative Consumer Financing Program* (Oct. 6, 2020), https://www.goalsolutions.com/news/goal-solutions-now-live-with-another-innovative-consumer-financing-progra/ [https://perma.cc/RV4A-3T2F].
70 *About*, Scratch, https://www.scratch.fi/about [https://perma.cc/LU4F-8K8U].
71 Knowledge Fin., https://www.knowledgefinance.com/ [https://perma.cc/9WZ7-2TND].
72 *About*, Knowledge Fin., https://knowledgefinance.com/Content/About.aspx [https://perma.cc/PDX9-WV62].
73 *See* Roesch, *supra* note 4 at 24.
74 12 U.S.C. §§ 5531(a), 5536(a).
75 12 U.S.C. § 5481(15)(A)(i).
76 *See* 12 U.S. Code § 5481(6).
77 *Consumer Fin. Prot. Bureau v. Cashcall, Inc.*, No. CV 15-7522, 2016 WL 4820635, at *4 (C.D. Cal. Aug. 31, 2016).

to credit-impaired borrowers and small businesses," and in 2006 sought to expand its business beyond California. However, CashCall chose not to obtain licenses in other states whose usury laws would not allow it to make loans at rates which it believed would be profitable. Instead, CashCall tried to make an end-run around these regulations by contracting with Western Sky Financial, a lender based on the Cheyenne River Sioux Tribe reservation that—under federal Indian law—was not subject to licensing and usury laws. Western Sky would make loans that CashCall could not, and then immediately sell those loans to CashCall.[78] The CashCall court rejected the company's attempt to evade state regulation and held that CashCall was the "true" or "de facto" lender, and applied the law of the borrowers' home states to the loan agreements.[79] Because CashCall lacked the requisite state consumer loan licenses and most of the loans violated state usury laws, the loans were void or uncollectible.[80]

The *CashCall* court then held that CashCall and its servicer, Delbert Services, violated the CFPA's prohibition on deceptive conduct by creating "the 'net impression' that the loans were enforceable and that borrowers were obligated to repay the loans in accordance with the terms of their loan agreements," when in fact "that impression was patently false—the loan agreements were void and/or the borrowers were not obligated to pay" as a result of CashCall's licensing and usury violations.[81] Indeed, it would be virtually impossible to service or collect on a loan without creating the net impression that payments are due and the obligation enforceable—otherwise, borrowers would never make payments. The *CashCall* court also rejected the servicer's argument that its belief that the loans were valid and enforceable served as a defense to liability, dismissing this "general mistake-of-law defense" to the CFPA as unsupported by any relevant authority.[82]

At this point, it is well-established that "[i]nforming Consumers that they have an obligation to repay under a transaction in which the assignment is void or unenforceable clearly meets the materially misleading threshold under the CFPA," and that [c]ollecting on loans that are void is materially misleading because it gives Consumers the impression that 'borrowers were obligated to repay' the [lender] when in reality the loan agreements were void and the borrowers were not legally obligated to pay."[83] Accordingly, companies who service ISAs that are void and unenforceable, or which request and/or receive fees to which they or their lender principals are not entitled, are operating in violation of the CFPA.

[78] *Id.* at *2-*4.
[79] *Id.* at *5-*9.
[80] *Id.* at *9.
[81] *Id.* at *10. Because the court found the servicer's conduct to be deceptive, it did not proceed to address whether it was also unfair and abusive; such inquiries were unnecessary to impose liability. *Id.* at *11.
[82] The court also rejected the servicers' argument that it could not be liable because it was "merely enforcing the express terms of their agreements with the borrowers" because those agreements were void. *Id.*
[83] *Consumer Fin. Prot. Bureau v. RD Legal Funding, LLC*, 332 F. Supp. 3d 729, 777 (S.D.N.Y. 2018), *amended*, No. 17-CV-890 (LAP), 2018 WL 11219167 (S.D.N.Y. Sept. 12, 2018), *vacated on other grounds, aff'd in part, and remanded*, 828 F. App'x 68 (2d Cir. 2020).

C. Servicing void and unenforceable ISAs violates state consumer protection and student loan servicing laws.

All states have adopted generally applicable consumer protection statutes that prohibit unfair or deceptive acts and practices in trade or commerce. Some state consumer protection statutes broadly prohibit "unfair or deceptive acts or practices in the conduct of any trade or commerce,"[84] while others prohibit more targeted categories of harmful practices, such as misrepresentations concerning the nature of or obligations incurred in a credit transaction.[85]

In addition, a growing number of states have enacted laws governing student loan servicers, often referred to as a "Student Borrower Bill of Rights."[86] These statutes generally apply to ISA servicers[87] and contain several provisions that prohibit acts associated with the servicing of void or unenforceable ISAs. For example, the Colorado Student Loan Servicers Act provides that a student loan servicer shall not

> Engage in an unfair or deceptive practice toward any person or misrepresent or omit any material information in connection with the servicing of a student education loan, including misrepresenting the amount, nature, or terms of any fee or payment due or claimed to be due on a student education loan, the terms and conditions of the loan agreement, or the student loan borrower's obligations under the loan.[88]

Other states' student loan servicing statutes contain substantially the same provision.[89] For the reasons discussed above, demanding payment on a void or unenforceable ISA violates this central tenet of loan servicing. The legal exposure facing companies that violate this edict can be severe—for example, Colorado permits the borrower to recover their actual damages, a "monetary award equal to three times the total amount the student loan servicer collected from the student loan borrower in violation of" the law, punitive damages, and attorney's fees.[90]

Servicers who become involved with void or unenforceable ISAs may violate state student loan servicing laws in other ways, as well. For example, many student loan servicers furnish information about borrowers' payment histories to consumer credit reporting agencies like Equifax, Experian, and Transunion. State student loan servicer laws generally prohibit servicers from "[p]rovid[ing] inaccurate information to a consumer reporting agency,"[91] and servicers may violate this prohibition in numerous ways to the extent they furnish any information concerning

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[84] *See, e.g.*, Wash. Rev. Code § 19.86.020.
[85] *See, e.g.*, Or. Rev. Stat. § 646.608(e).
[86] *See, e.g.*, Amy Loftsgordon, *What Is a Student Loan Bill of Rights?*, Nolo, https://www.nolo.com/legal-encyclopedia/what-is-a-student-loan-bill-of-rights.html ("A student loan 'bill of rights' is a set of laws that protects borrowers from abusive student loan servicing companies.").
[87] *See* Roesch, *supra* note 4 at 37-40.
[88] Colo. Rev. Stat. Ann. § 5-20-109(1)(b).
[89] *See, e.g.*, 110 Ill. Comp. Stat. Ann. 992/5-5(a); N.Y. Banking Law § 719(2).; Wash. Rev. Code § 31.04.027(2)(b).
[90] *See* Colo. Rev. Stat. Ann. § 5-20-112.
[91] Colo. Rev. Stat. Ann. § 5-20-109(1)(e). This is also a common provision in state laws applicable to student loan servicers. *See, e.g.*, N.Y. Banking Law § 719(4) (same); Md. Code Ann., Educ. § 26-602(7) ("Knowingly or recklessly provide inaccurate information to a consumer reporting agency, or refuse to correct inaccurate information provided to a consumer reporting agency").

borrowers whose ISAs are void or unenforceable. Reporting borrowers as delinquent or in default of such non-existent obligations is particularly harmful for obvious reasons, but *any* reporting relating to void or unenforceable obligations is problematic. For example, if a borrower's income falls below the repayment threshold, furnishing information stating that the borrower is in an agreed forbearance falsely implies that they are unable to meet their legitimate violation. Even a seemingly innocuous report that the borrower is paying as agreed is inaccurate to the extent that no such obligation exists, and may harm borrowers by falsely inflating their debt-to-income ratio.

IV. Conclusion

The traditional student loan servicing industry has, as a whole, struggled to avoid practices and servicing errors that harm borrowers. The Bureau, state attorneys general, and state regulators have therefore brought numerous enforcement actions against traditional student loan servicers over the last five years over issues ranging from misrepresentations to private student loan borrowers and cosigners,[92] to improper steering of federal student loan borrowers into forbearances rather than income-driven repayment programs,[93] to misrepresentations and other unfair actions in connection with the Public Service Loan Forgiveness Program.[94] An increasing number of state legislatures across the country have passed Student Borrower Bills of Rights to address these and other concerns raised by their constituents.[95]

Meanwhile, the ISA industry—including those who service ISAs—has largely flown under the regulatory radar. This lack of attention from regulators creates significant risks for borrowers, with online financial websites warning potential borrowers about "the lack of regulation around ISAs,"[96] and even that "[i]ncome share agreements are unregulated."[97] This must change—not least because the servicing of ISAs may prove to be even more complicated than servicing traditional student loans (and ISA servicers therefore in even greater danger of committing unfair or deceptive acts or practices beyond those discussed above). The Bureau should take decisive

[92] *See* Seth Frotman, *Reimagining State Bank Regulators: How the Principles Underlying the Consumer Financial Protection Bureau Can Serve as a Blueprint for a New Regulatory Federalism*, 72 Me. L. Rev. 241, 248 n.39 (2020).

[93] *See, e.g.*, *Consumer Fin. Prot. Bureau v. Navient Corp.*, No. 3:17-cv-00101, 2018 WL 2088760 (M.D. Pa. 2018); N.J. Att'y Gen., *AG Grewal Files Suit Against Navient Corp. Alleging Student Loan Servicing Giant Targeted New Jersey Student Borrowers with Deceptive, Misleading Tactics to Boost Company Profits* (Oct. 20, 2020), https://www.nj.gov/oag/newsreleases20/pr20201020a.html; First Amended Complaint, *California v. Navient Corp.*, No. CGC-18-567732 (Cal. Super. Ct. Oct. 16, 2018) (available at https://oag.ca.gov/system/files/attachments/press_releases/CA%20AG%20First%20Amended%20Complaint%20-%20Navient.pdf#page=2).

[94] Att'y Gen. Maura Healey, Mass., *AG Healey Sues to Protect Public Service Loan Forgiveness* (Aug. 23, 2017), https://www.mass.gov/news/ag-healey-sues-to-protect-public-service-loan-forgiveness; Atty' Gen Leticia James, N.Y., *AG James Sues Student Loan Servicer For Mismanaging Loan Forgiveness Program* (Oct. 3, 2019), https://ag.ny.gov/press-release/2019/ag-james-sues-student-loan-servicer-mismanaging-loan-forgiveness-program.

[95] *See* Cal. Civ. Code § 1788.100 *et seq.*; Colo. Rev. Stat. Ann. § 5-20-101 *et seq.*; Conn. Gen. Stat. Ann. § 36a-846 *et seq.*; D.C. Code Ann. § 31-106.01 (creating student loan ombudsman); 110 Ill. Comp. Stat. Ann. 992/1-1 *et seq.*; Me. Rev. Stat. tit. 9-A, § 14-101 *et seq.*; Md. Code Ann., Educ. § 26-601 *et seq.*; Mass. Gen. Laws Ann. ch. 12, § 35 (establishing student loan ombudsman); N.Y. Banking Law § 710 *et seq.*; N.J. Stat. Ann. § 17:16ZZ-1 *et seq.*; Va. Code Ann. § 6.2-2600 *et seq.*; Rev. Code Wash. § 31.04.027(2).

[96] Andrew Pentis, *What Are the Repayment Protections of Income-Share Agreements?*, Student Loan Hero (Dec. 16, 2019), https://studentloanhero.com/featured/repayment-protections-income-share-agreements/.

[97] Lane, *supra* note 49.

action to clarify beyond doubt that ISAs are “credit” under the CFPA and other federal financial statutes, and coordinate with its state civil law enforcement partners to address unlawful practices from the marketing and origination to the servicing and collection of ISAs.

The stakes here are high, as ISA providers’ claims of immunity from consumer protection statutes appear only to compound their products’ illegality. In particular, the very fact that ISA providers market their products as not being loans has led them down the dangerous path of not obtaining lending licenses, as doing so would amount to an acknowledgment that their products fall under state law. But by remaining unlicensed, these companies—as discussed above—render their loans prohibited under many states’ usury statutes. Such cynical decision-making by industry and the cascading violations of law that it triggers must be met with the full force of the law. Policymakers and law enforcement must act now to protect borrowers.