STUDENT BORROWER PROTECTION CENTER

Berkeley Law | Center for Consumer Law & Economic Justice

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**MEMORANDUM**

**DATE:** Dec. 20, 2021
**TO:** Interested Parties
**FROM:** Kate Bulger and Doug Lewis, Center for Consumer Law & Economic Justice, University of California, Berkeley, School of Law
**RE:** Income Share Agreements and the DFPI

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## I. Introduction

Income share agreements (ISAs) provide borrowers, often students, an advance of money in exchange for a percentage share of the borrower's future income. Despite their growing contribution to student debt in the United States,[1] the majority of ISA providers and servicers maintain that ISAs are not loans or consumer credit and thus not subject to consumer loan regulation.[2] Recently, however, law enforcement at the state and federal level have affirmed scholars' and advocates' assertion that ISAs are loans.[3] In August 2021, the California Department of Financial Protection and Innovation (DFPI) made clear its intent to treat ISAs as loans. Two new pieces of California legislation, the California Consumer Financial Protection Law (CCFPL) and the Student Borrower Bill of Rights (SBBR), give the DFPI new rulemaking and enforcement authority to regulate consumer loans, including ISAs. This memo outlines how the DFPI and the California legislature can use their authorities to protect borrowers from

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[1] Spencer Israel, What Was Missing From The Income Share Agreement Market? A Marketplace (Nov. 4, 2020), https://libraryguides.law.pace.edu/ld.php?content_id=35067110. In 2019, $250M in income-share agreements originated in the United States, and that number was expected to double by the following year. Edly estimated that as many as 175 schools could issue as much as $500 million in ISAs in 2020.
[2] Student Borrower Protection Center, Inequitable Student Aid 11 (March 2021), https://protectborrowers.org/wp-content/uploads/2021/03/SBPC_Inequitable-Student-Aid.pdf.
[3] Accordingly, this memo will refer to ISAs as loans.

predatory ISAs. First, the memo begins by introducing ISAs and the risks and harms they create for student borrowers. In the second part, the memo outlines the California legislative framework applicable to the DFPI's regulation of ISAs. And finally, the memo proposes action that the DFPI and the CA legislature should take to support effective ISA litigation and regulation for the protection of student borrowers.

While some large, traditional universities offer or have offered ISAs (Purdue, University of Utah, and Yale), the typical program financed by an ISA is a short-term, skills-based educational and/or credentialing program, which may cover topics ranging from software engineering to HVAC repair, or attendance at a smaller college or university.[4] Students turn to ISAs as alternative financing for various reasons including but not limited to the exhaustion of federal borrowing options, ineligibility for Title IV aid due to immigration status, and the misguided notion that an ISA agreement is not a loan.

As of 2019, over forty colleges and universities and numerous alternative vocational, credentialing, and workforce development programs offered ISA financing in the U.S.[5] Some school programs make ISAs available to their students directly by financing the ISAs themselves or by partnering with other ISA servicers and financers. One flagship example is Purdue University's "Back a Boiler" ISA program, which launched in 2016 as a student financing stop-gap and is backed by a return-seeking investment fund.[6] Common ISA servicers that partner with schools and financiers to issue, structure, and/or service ISAs include Vemo and Leif. Other ISA servicers operate independent of any school program in a direct-to-student model (Better Future

[4] Dubravka Ritter & Douglas Webber, Modern Income-Share Agreements in Postsecondary Education: Features, Theory, Applications 7-8 (Dec. 2019), https://www.philadelphiafed.org/-/media/frbp/assets/consumer-finance/discussion-papers/dp19-06.pdf.
[5] *Id.* at 2.
[6] *Id.*

Forward, Stride Funding, Blair, Lumni).[7] All ISA firms differentiate their pricing in some way based on student characteristics such as school and academic major. The wide range in ISA providers and in programs financed by ISAs leads to a wide, and at times troubling, range in strategies for marketing, pricing and servicing ISAs.

## A. Common Financial Characteristics of ISAs

### 1. Monthly Income Shares

In exchange for upfront payments, student borrowers agree to pay an "income share," a percentage of their monthly gross income (pre-tax), during each month of the payment term or until the "payment cap" is reached. (Federal income-driven repayment (IDR) plans calculate a maximum of 20% of discretionary income, which itself varies in calculation across plans).[8] The percentage of income owed is set as part of the ISA pricing at the time that the payment is disbursed. Income share rates typically range from 10-20% for coding bootcamps and 3-5% for colleges, varying based on an individual's major or institution. For example, a loan of $10,000 for a computer science major at Purdue and graduating in May 2024 carries a 2.95% income share rate whereas the same loan will carry a 4.55% rate for an art history major.[9]

### 2. Payment Caps

A borrower pays their monthly income share until either the "payment cap," a total fixed amount, or the payment term length has been reached. ISA providers have discretion in setting payment caps. Maximum payment caps, often set at 1-3x tuition, are marketed as "safeguards" to protect borrowers from paying substantially more than they borrowed.[10] For some programs, ISA

[7] *Id.*
[8] Fed. Student Aid, https://studentaid.gov/manage-loans/repayment/plans/income-driven (last visited Dec. 16, 2021).
[9] Purdue Univ., https://www.purdue.edu/backaboiler/comparison/index.html (last visited Dec. 16, 2021).
[10] Better Future Forward, https://www.vennfoundation.org/pri-better-future-forward (last visited Dec. 16, 2021).

providers not only set maximum payment caps arbitrarily high but may also deceptively market these high caps as reflective of what the program would cost without ISA financing.

### 3. Prepayment Penalties

If a borrower wants to pay off an ISA earlier than scheduled, the borrower must generally pay back more than the original upfront payment: they must pay up to the payment cap regardless of how much they've already paid.[11] In this way, payment caps create high prepay penalties. The CFPB has ruled this constitutes a prepayment penalty in violation of the Truth in Lending Act.[12]

| Coding Bootcamp | Income Threshold | Payment Cap | Loan Amount | Income Share | Window |
|---|---|---|---|---|---|
| General Assembly | $40,000 | 1.5 x tuition. ($22,425). | $14,950 (Software Engineering Immersive) | 10% | 48 months or cap. |
| Ironhack | $40,000 | 1.75 x tuition ($21,875) | $12,500 (UX / UI Design). | 12% | 48 months or cap. |
| App Academy | $50,000 | $31,000 | $20,000 | 15% | 36 months or cap. |
| Holberton | $40,000 | $85,000 | $55,000 | 17% | 42 months or cap. |

[11] For other programs where ISAs are the dominant financing method, ISA providers claim tuition to be extremely high in order to make high maximum payment caps look more reasonable.

[12] Consent Order, Better Future Forward, Inc., CFPB Docket No. 2021-CFPB-0005 (Sept. 7, 2021), https://files.consumerfinance.gov/f/documents/cfpb_better-future-forward-inc_consent-order_2021-09.pdf.

### 4. Default

ISAs' "payment cap" also creates harsh defaulting penalties for student borrowers. Typically, when a student misses a set number of payments and "defaults," the ISA "accelerates" and the borrower then owes the entire payment cap yet-to-be paid.[13] In some cases, agreements only allow one missed payment before rendering the student in default. A borrower who defaults on a $15,000 ISA before making any payments will owe the tuition plus the growth component immediately.[14] This leads to high up-front interest relative to normal loans. For example, a year of unpaid interest on a regular student loan of $15,000 (assuming 8% APR) could mean an additional $1,200 in repayment. In comparison, defaulting on a $15,000 ISA loan can immediately add $7,500 to the borrowers' total repayment obligation.

### 5. Income Threshold

Income thresholds are marketed as a "safety net." Borrowers are not required to pay their monthly ISA obligation if their monthly income falls below an income threshold, which can range from $20,000 to $50,000 or more. A borrower is not required to make a monthly payment if they did not earn above the monthly income threshold for that month. However, unlike for federal income-driven repayment plans, any month spent below the income threshold will usually not count towards an individual's required "payment term." Instead, these payments are effectively in forbearance. ISA servicers typically structure their payment windows to extend up to twice the length of the original payment term or more to lower the probability a borrower will repay less than the total amount financed.[15] For colleges, this generally ranges from 7-12 years.

[13] Leif, 3 months, https://leif.org/api/products/5b5b8bd0e59b743f9a086ed9/pd (last visited Dec. 16, 2021); Lambda, Our Income Share Agreements, https://lambdaschool.com/tuition/isa (last visited Dec. 16, 2021).

[14] 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.

[15] These payments do not count as $0 payments as they would in a federal IDR plan. See *Id.*; Brandon Varner, Meratas: How to Be Sure You're Getting an Amazing ISA (Apr. 22, 2021), https://careerkarma.com/blog/meratas-how-to-get-a-good-isa/.

For bootcamps, the range is generally 1-4 years.[16] Payment-window terms create favorable conditions for ISA servicers but much harsher repayment conditions for ISA borrowers when compared to IDR plans. An ISA borrower who does not earn above the product's income threshold is effectively unable to fulfill the loan's required payments until they make above a certain amount. In contrast, an IDR borrower experiencing economic hardship may have their payments reduced to $0—but the payment still counts toward their total repayment period.

### B. Common Predatory Characteristics of ISAs

In theory and in some exceptional cases, ISAs can be a safe and preferred financing option for student borrowers with a wide range of future incomes. When access to, marketing of, pricing of, and liability and penalty disclosures regarding ISAs are all fair, ISAs begin to look like a compelling educational tax for expanding access to education without creating unsustainable student debt. However, few ISA programs look like this in practice.

#### 1. Deceptive ISA Practices

ISA providers frequently market ISAs as low-cost financial products that are not "loans" that do not create "debt" despite functioning essentially as a consumer loan that creates consumer debt. ISA contracts used at the coding bootcamp Lambda School (now rebranded as the Bloom Institute of Technology[17]), for example, stated "THIS IS NOT A LOAN" below summaries of monthly payments.[18] However, ISA borrowers often face the same tax treatment for discharges as federal student loan providers. A federal student loan borrower who discharges their loans at the end of an income-driven repayment plan must report the discharged amount as income for

[16] Ritter and Webber at 12.
[17] Bloom Institute of Technology, https://www.bloomtech.com/ (last visited Dec. 16, 2021)
[18] Lambda, Income Share Agreement, Lambda School ISA (20200413).pdf (last visited Dec. 16, 2021).

tax purposes. Similarly, an ISA borrower who fails to repay the total amount financed must report the difference as income.[19]

ISA providers can also often easily confuse consumers as to how they calculate an individual's "income." A provider can require a borrower to pay a share of unemployment compensation and bury that obligation within the fine print of a contract. Additionally, agreements typically calculate an individual's monthly obligation based on their gross pre-tax income. This is substantially different from federal income-driven repayment loans that consider only discretionary income, a measure that subtracts out a baseline amount of income meant to be allocated toward basic needs. Confusion surrounding the nuances of ISAs could create untenable conditions for consumers through the "stacking" effect of combining private and federal loans and yield exceptionally high monthly payments. When combined with regular federal student loans, ISA's can burden student borrowers with monthly payments as high as 40 percent of pre-tax income for student borrowers who lack the basic protections federal law gives to federal loan borrowers.[20]

ISA providers frequently make use of calculators, "comparison tools," and "future earnings" statistics to market their products. These are easily manipulated or flawed.[21] Service providers' calculators often do not include a clear APR calculation or disclosure of potential prepayment penalties. However, this is not immediately clear to consumers.

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[19] Purdue Univ., ISA Sample Contract (Academic Year), https://www.purdue.edu/backaboiler/disclosure/contract.html (last visited Nov. 11, 2021). "Upon the maturity or termination of this ISA, if the aggregate amount of cash you received from us is greater than the aggregate sum of the payments you made to us during your Payment Term, then you will likely recognize ordinary income equal to the difference between the amount of cash received from us and the sum of the payments you made to us."

[20] Julie Morgan, Brittany Farr, & Daniel Hornug, Income Share Agreements: A Student Debt Promise Falling Short of Reality (Jan. 10, 2019), https://rooseveltinstitute.org/2019/01/10/income-share-agreements-a-student-debt-promise-falling-short-of-reality/.

[21] Benjamin Roesch, Applying State Consumer Finance and Protection Laws to Income Share Agreements, Student Borrower Prot. Ctr. (Aug. 2020), https://protectborrowers.org/wp-content/uploads/2020/08/ISAs-and-State-Law.pdf.

ISA borrowers also potentially face deceptive marketing practices or fraudulent and low-quality education. Fraudulent or low-quality schools can often attract students to their programs using ISAs to market the efficacy of their programs. Bootcamps have marketed themselves as accepting substantial risk in students' success. In funding a student's education through an ISA, schools claim their financial interests are directly aligned with their students' financial success.[22] However, the same schools have contradicted themselves. Lambda School, for example, engaged in debt-swapping practices and sold ISA agreements to investors, directly contradicting their statements that they wouldn't earn anything from a student until the student started earning money. Should students be responsible for paying a share of their income if their program fails the market test yet still reaps the benefits of student borrower ISA agreements?

**2. Discrimination & Disparate Impact in ISAs**

Unfortunately, borrowers from underrepresented backgrounds are often offered more expensive ISAs than their peers or not offered ISAs at all. ISA origination depends on a prediction of a borrower's future income and the relative certainty/uncertainty of that prediction. To predict income, ISA providers rely in part on earnings distributions for similarly situated borrowers.[23] Due to systematic biases, however, underrepresented populations are associated with lower average earnings, leading to higher pricing for the same ISA products. In addition to income distribution curves, ISA providers use proxy data to predict future income. Despite consumer protection laws that expressly prohibit the use of discriminatory data such as race, gender, and ethnicity in marketing and originating student loans, many ISA originators use

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[22] Zoe Schiffer and Megan Farokhmanesh, As Lambda students speak out, the school's debt-swapping partnership disappears from the internet, The Verge (Feb. 12, 2020), https://www.theverge.com/2020/2/12/21135134/lambda-school-students-edly-isa-debt-swapping-partnership-shares-investors.

[23] Ritter and Webber at 10. "Ultimately, the future success of the ISA depends heavily on the quality and length of the institutional and supplemental regional and national data on earnings patterns."

student institution and student major, data that is not expressly protected but is highly correlated with race, as proxies for future income.[24]

The result of ISA origination based on past income distributions and race-based proxies for future income is disparate pricing and availability of ISAs for students from underrepresented backgrounds. For example, students financing with Stride ISAs who attend historically-black-colleges-and universities (HBCUs) pay 5 to 40 percent more for the same upfront amount than students from similarly-ranked or lower-ranked non-HBCU institutions, controlling for major and post-school job market.[25] Students at tribal colleges are also likely to have to pay more for their Stride ISAs as they are selectively targeted for Stride's high cost, high-risk product.[26] Students at HBCU all-female colleges may not be offered a Stride ISA at all.

**Excerpt of table from SBPC's *Inequitable Student Aid*:**

| **HBCU** | **Stride's Quoted Cost for the ISA** | **Nearby Comparisons** | **Stride's Quoted Cost for the ISA** | **Added Cost for the HBCU Attendee** | **Difference in Cost of Credit for the HBCU Attendee** |
|---|---|---|---|---|---|
| Tuskegee | $20,000 | Auburn | $17,198 | +$2,802 | +39% |
| Morehouse | $18,424 | Emory | $17,057 | +$1,367 | +19% |
| Howard | $17,952 | Georgetown | $16,702 | +$1,250 | +19% |
| Hampton | $18,122 | William and Mary | $16,889 | +$1,233 | +18% |
| Florida A&M | $18,122 | Florida State | $16,922 | +$1,200 | +17% |
| Xavier University of LA | $18,122 | Tulane | $17,304 | +$818 | +11% |
| Spelman | $17,404 | Emory | $17,057 | +$347 | +5% |

[24] Inequitable Student Aid.
[25] *Id.*
[26] *Id.*

### 3. Binding Arbitration Clause

Many ISAs contain mandatory or voluntary pre-dispute arbitration clauses and class action waivers that prohibit wronged student borrowers from seeking relief through the court system.[27] These clauses disadvantage student borrowers and prevent the broader public and government from learning whether an ISA agreement is wrongfully hurting consumers.[28]

## II. California Legislative Framework

### A. ISAs as Loans

ISA providers and servicers have historically argued that ISAs are not loans but rather contingent debt obligations. Consumer advocates, on the other hand, have long asserted that "ISAs are either loans or loan-like enough to be subject to some of the same regulations as student loans."[29] Increasingly, regulatory bodies and even some ISA providers agree.[30] Two new consent orders with ISA servicers from August and September 2021 concede that ISAs are student loans for the purposes of the litigation. In a consent order with Meratas, the DFPI found that "ISAs made solely for use to finance a post-secondary education are 'student loans' for the purposes of [the CA Student Loan Servicing Act]."[31] In a consent order with Better Future Forward (BFF), the CFPB alleged that BFF's ISAs were credit under the federal Consumer

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[27] Lambda, Income Share Agreement; Lief, 3 Months; San Diego Workforce Partnership, Income Share Agreement (ISA), https://workforce.org/wp-content/uploads/2020/10/Digital-Marketing-ISA-Sample-Contract.pdf (last visited Dec. 16, 2021). Leif's small-print provisions allow consumers to "opt-out" of the arbitration clause within 30 days of signing. San Diego Workforce Partnership allows opt-outs if you mail a signed rejection.

[28] *Cal. Chamber of Com. v. Bonta,* 13 F. 4th 766 (9th Cir. 2021). Obama-era legislation once banned schools that contained mandatory arbitration clauses in their enrollment contracts from using federal student loans, but this was later reversed by the Trump administration in 2020. However, the Ninth Circuit's recent ruling concerning AB 51 may create a pathway for the state to ban these clauses in school contracts. The circuit upheld a provision of AB 51 prohibiting employers from requiring mandatory (but not voluntary) arbitration clauses for claims against labor code or employment discrimination violation, finding the ban was not pre-empted by the FAA because it regulates only "pre-agreement conduct."

[29] Ritter and Webber at 5.

[30] Pearl & Shearer. "The thing an ISA most resembles in the world is a student *loan*." Avenify is one ISA provider that structures its ISAs as loans. Avenify, https://avenify.com, (last visited Dec. 15, 2021).

[31] Consent Order, Meratas, Inc. 3-4, DFPI Docket No. 2120180 (Aug. 5, 2021), https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/08/Meratas-Consent-Order.pdf.
In the consent order, Meratas agreed, while licensed under the SLSA, to report to the DFPI any ISAs it services and to not service any ISAs that have been declared unenforceable or void by the DFPI.

Financial Protection Act because they grant borrowers the right "'to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase.'"[32]

As student loans, ISAs are covered by the regulations and protections afforded to student loan borrowers under the CCFPL, the Student Loan Servicing Act (SLSA), and the Student Borrower Bill of Rights (SBBR). The CCFPL grants the DFPI authority to prescribe rules that protect against unfair, deceptive or abusive acts or practices (UDAAP) by consumer lenders and to pursue relief in cases of UDAAP violations. The SLSA requires student loan servicers to obtain licenses with the DFPI and subjects student loan servicers to DFPI oversight. And the Student Borrower Bill of Rights (the Act), a 2021 addition to the SLSA, requires that student loan servicers and lenders not engage in abusive or predatory acts (including failure to disclose accurate information and to help students avoid default), expands DFPI authority over unlicensed student loan servicers, and grants students a private right of action against student loan servicers who violate the Act.

**B. California Consumer Financial Protection Law**

The CCFPL, enacted in 2021, is intended to expand the DFPI's ability to protect consumers, particularly vulnerable consumers such as students, from abusive financial practices.[33] The CCFPL charges the DFPI with executing CA law relating to "issuers of payment instruments or the payment instrument business … [and] persons offering or providing consumer financial products or services in this state."[34] This covers more than fifty CA consumer finance

[32] 12 U.S.C. § 5481(7); Consent Order, Better Future Forward Consent Order 2-3, 7. BFF engaged in deceptive acts concerning ISAs (violating CFPB Act of 2010 and 12 U.S.C.); misled students about the nature of their products (i.e. they're credit); failed to give certain disclosures required under Regulation Z; violated Truth in Lending Act with its payment caps and prepayment penalties on private education loans.
[33] Cal. Fin. Code § 9000(a)(4).
[34] Cal. Fin. Code § 300(a)(3)(b).

laws and some twenty federal consumer protection laws.[35] In particular, the DPFI has authority to prescribe rules applicable to and take enforcement action against "covered persons" or service providers.[36]

The DFPI's rules may require registration with the DFPI and should help protect against unfair, deceptive, or abusive acts or practices (UDAAP), especially where the act or practice in question is frequent. "Unfair" and "deceptive," which must be interpreted consistently with California's Unfair Competition Law and case law thereunder, and "abusive," which must be interpreted consistently with the federal Consumer Financial Protection Act of 2010, cover a wide range of practices relevant to ISA providers.[37] The DFPI may declare an act abusive if it materially interferes with a consumer's ability to understand a term or condition, takes unreasonable advantage of a consumer's lack of understanding of the product's risks, costs or conditions, or takes advantage of the consumer's reliance on the service provider to act in its interests.[38] The California Civil Code also explicitly classifies as abusive any attempt to collect on a loan that is unenforceable, including any loans made by ISA providers without approval to operate.[39] Where interpretation of a UDAAP term is inconsistent or ambiguous, the CCFPL

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[35] Goodwin Law, 10 KEY TAKEAWAYS FROM CALIFORNIA'S NEW CONSUMER FINANCE REGULATORY AND ENFORCEMENT REGIME (Nov. 19, 2021), https://www.goodwinlaw.com/publications/2020/11/11_19-10-key-takeaways-from-californias-new.

[36] Cal. Fin. Code § 9005(f)(1-3). "Covered person" means anyone "offering or providing a consumer financial product or service" to a resident of CA, "any affiliate of a person described in this subdivision if the affiliate acts as a service provider to the person", and any service provider engaged in the "offering or provision of its own consumer financial product or service".

[37]Gibson Dunn, California Enacts New Consumer Financial Protection Law, Increasing Authority of Its Financial Regulator (Oct. 13, 2020), https://www.gibsondunn.com/california-enacts-new-consumer-financial-protection-law-increasing-authority-of-its-financial-regulator/. CA courts have used one of two tests to determine "unfairness." 1) Balancing the impact on the alleged victim of the unfair practice against the justifications of the alleged wrongdoer. *Motors, Inc. v. Times Mirror Co.*, 102 Cal. App. 3d 735, 740 (1980). Or (2) the FTC's definition of "unfair," also used by the CFPB, which requires that the act causes substantial injury to consumers, the injury is not reasonably avoidable, and any benefits to consumers or to competition do not outweigh the injury to consumers. 15 U.S.C. § 45(n). In April 2021, the SBPC made the case that discrimination, which fits neatly within the statutory language defining "unfair" and is consistent with the purposes of UDAAP law, should be considered an "unfair" practice. Their unfairness-discrimination theory would help close the gap where discriminatory practices, including those with disparate impact, are currently unregulated. Stephen Hayes & Kali Schellanberg, *Discrimination is "Unfair": Interpreting UDA(A)P to Prohibit Discrimination*, Student Borrower Prot. Ctr. (Apr. 2021), https://protectborrowers.org/wp-content/uploads/2021/04/Discrimination_is_Unfair.pdf.

[38] Cal. Fin. Code § 9009(c)(2)(A-B).

[39] Cal. Civ. Code § 1788.17; Cal. EDC § 94917.

holds that the interpretation should be resolved in favor of greater protections to the consumer and more expansive coverage.[40]

In addition to rulemaking, the DFPI has enforcement authority to bring civil action to enforce the provisions of the CCFPL as well as the federal Consumer Financial Protection Act of 2010 and regulations issued by the CFPB, with respect to an entity that is licensed, registered, or subject to oversight by the DPFI.[41] With a 4 year statute of limitations, the DFPI may seek remedies including (but not limited to) rescission or reformation of contracts, refunds, restitution, disgorgement or compensation for unjust enrichment, payment of damages or other monetary relief, public notice of the violation, limits on activities and functions, and monetary penalties.[42] The DFPI can impose a monetary penalty of up to $5,000 for each day any violation continues or $2,500 for each act or omission in violation; a penalty of up to $25,0000 each day for any *reckless violation* or $10,000 for each act or omission in violation; and a penalty of up to 1% of the violator's total assets or $1 million each day for *knowing violation* or $25,000 for each act or omission in violation.[43]

### C. SLSA/Student Borrower Bill of Rights

The SBBRA, passed in 2020, intends to protect student loan consumers and establish several protections for students and standards for student loan servicers. Perhaps most notably for ISA servicers, SBBRA expands DFPI's authority to regulate student loan servicers from those "licensed" under the SLSA to any organization servicing a student loan under a broad "student loan servicer" definition.[44] Thus so long as ISA's are considered "student loans" under

[40] Cal. Fin. Code § 9005(p).
[41] Cal. Fin. Code § 326(b).
[42] Cal. Fin. Code § 90012(b)(1-8).
[43] Cal. Fin. Code § 90012(b)(8)(c)(1)(A)(1-3).
[44] The SBRRA defines "student loan servicer" as "any person engaged in the business of servicing student loans in this state."

the SBBRA's definition,[45] ISA servicers are "student loan servicers," regardless of their license status.

Under the SBBRA, student borrower protections that once only applied to student loan servicers licensed under SLSA now apply to all ISA student loan servicers—the vast majority of which are likely currently unlicensed. Regulations include prohibiting student loan servicers from engaging in general fraud and deceptive practices, omitting information for a borrower, misleading a borrower, misapplying payments, misapplying payments made by a borrower, and making false statements to a governmental agency.[46] Additionally, under the SBBR student loan servicers cannot impose late fees that exceed 6 percent of any amount past due. ISA student loan servicers are also liable for the conduct of their service providers' engagement in student loan servicing.

Perhaps SBBRA's most relevant move for ISA student loan servicers is its creation of a private right of action for student borrowers that allows consumers to recover damages and fees for a servicer's failure to comply with state standards or federal law.[47] This includes actual and substantive damages, restitution, punitive damages, attorney's fees, and any other relief a court deems proper from an unlicensed servicer for a violation of this act or federal law. A plaintiff is allowed at least $500 in actual damages and at least $1,500 for a violation that "substantially interferes" with a financial benefit provided by the HEA. However, a borrower may only pursue a private right of action if they have notified a servicer of their claim and allowed them an opportunity to "remedy" or "correct" the alleged complaint.

[45] Cal. Civ. Code §1788.100
[46] *Id.*
[47] This language is heavily drawn from the similar right of action provided to consumers in the Consumers Legal Remedies Act.

The SBBRA requires a borrower to provide a student loan servicer a qualified written notice at least 45 days before filing an action and allow them time (30 days) to remedy or agree to remedy the consumer's complaint. Thus ISA servicers cannot report information related to a payment subject to a qualified request to a credit reporting agency for 60 days after the receipt of a request.[48] However, a student borrower cannot maintain their action "upon a showing by a person that an appropriate correction and remedy is given, or agreed to be given within a reasonable time, to the consumer within 30 days after receipt of the notice."[49] The SBRRA did not provide any specific guidelines as to what is an adequate remedy or agreed remedy in response to a qualified written request, beyond providing that a borrower who is dissatisfied with the outcome of an initial qualified request from a servicer can escalate the concern to a supervisor. However, the SBRRA allows DFPI's commissioner latitude to create regulations and enforce provisions under the SBBRA. [50]

Finally, SBRRA also establishes a "Student Loan Ombudsman" to oversee student loan servicing complaints for student loan servicer licensees. Non-licensees complaints are referred to the Department of Justice. The Ombudsman can also request and compile information provided by a student loan servicer.

## III. ISA Guidelines and Enforcement Action

### A. Introduction

In order to protect consumers against harmful and illegal ISA practices, the DPFI should take advantage of new CA consumer loan legislation applicable to ISAs as well as lenders'

[48] Cal. Civ. Code §1788.103.
[49] Cal. Civ. Code §1788.103(e).
[50] Cal. Civ. Code §1788.103(i).

growing acknowledgement that ISAs are loans to increase and clarify ISA guidance-setting and enforcement action against ISA lenders.[51]

Across consumer financial products, guidance and regulatory enforcement for UDAAP violations is on the rise. At the beginning of 2020, the Office of the Comptroller of the Currency released a new Comptroller's Handbook on UDAAPs, signaling its own focus on UDAAP risks.[52] This increase in UDAAP guidance-setting has been backed by an increase in UDAAP enforcement action by federal regulatory agencies. In 2020, the CFPB and the FTC filed a combined 25 public UDAAP complaints and 30 public UDAAP consent orders and settlements, winning more than $80M in total civil money penalties and more than $536M in consumer redress.[53] These UDAAP violations included deceptive advertising (e.g. false and misleading representations about annualized percentage rates (APR), costs and terms of loans), abusive and threatening debt collection (including new deception claims based on violations of state licensing requirements), and unfair servicing (e.g. collecting fees that consumers were not contractually obligated to pay).[54]

While this increased UDAAP clarity and enforcement is a good sign for financial consumers generally, it has lagged in reaching the ISA market. Despite the consumer harm associated with ISAs, the last few years have seen substantially less public and private action

[51] In August 2021 Meratas conceded that "ISAs made solely for use to finance a postsecondary education are 'student loans' for the purposes of [the CA Student Loan Servicing Act]." Consent Order, Meratas 3-4. In September, Better Future Forward (BFF) also conceded that their ISAs were credit under the federal Consumer Financial Protection Act because they grant borrowers the right "'to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase.'" 12 U.S.C. § 5481(7); Consent Order, Better Future Forward 7.
[52] Office of the Comptroller of the Currency, *Unfair or Deceptive Acts or Practices and Unfair, Deceptive, or Abusive Acts or Practices*, Comptroller's Handbook: Consumer Compliance (June 2020), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/unfair-deceptive-act/index-udaap.html.
[53] Mayer Brown, *Consumer Financial Services UDAAP Round-Up: 2020 Year in Review* 8 (Jan 2021), https://www.mayerbrown.com/en/perspectives-events/publications/2021/01/udaap-round-up-2020-year-in-review.
[54] *Id.* at 9-15.

against ISA providers and servicers compared to other types of creditors.[55] In this section, we identify three opportunities for the DPFI to strengthen accountability and oversight in ISA lending: clarification of what pervasive ISA practices constitute violations of law, in particular deceptive marketing and deceptive calculation of APRs; clarification of what remedies are adequate under California law; and finally, preparation for litigation when ISA lenders continue illegal practices.

## B. UDAAP Violations

### 1. Deceptive ISA Marketing

The DFPI has an opportunity to mandate compliance and protect ISA student borrowers by clarifying which common ISA marketing practices constitute noncompliance with UDAAP.[56]

ISA provider's insistence that ISAs are not loans not only suggests that student loan regulations do not apply to ISA products but also deceptively attracts students, wary of traditional loans, to ISAs. The DFPI should set clear rules prohibiting these common and deceptive tactics. The SBPC's suit against Make School, a for-profit coding academy, and ISA-provider Vemo highlights many of the deceptive practices that should be explicitly prohibited across the ISA industry: falsely advertising the quality of education and employment prospects;[57] falsely advertising ISAs as superior to traditional tuition or student loan models when a substantial chance exists of paying many times the actual cost of tuition plus living expenses[58]; failing to disclose how the ISA provider uses (and cashes in on) the ISAs while actively and

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[55] Lexis+, https://plus.lexis.com/ (last visited Nov. 10 2021). Looking at cases decided between Jan 1, 2019 and November 10, 2021, Lexis+ has 157 cases containing the term "federal student loan", thirty containing the term "payday lender", eleven containing the term "VA-guaranteed loan", and two containing the term "income share agreement."

[56] Cal. Fin. Code §90009 . The DFPI has authority to declare an act abusive if it materially interferes with a consumer's ability to understand a term or condition, takes unreasonable advantage of a consumer's lack of understanding of the product's risks, costs or conditions, or takes advantage of the consumer's reliance on the service provider to act in its interests.

[57] Complaint, *Aguocha et. al. v. Make School, Inc*. 27, Superior Court of the State of Cal (June 25, 2021), https://protectborrowers.org/wp-content/uploads/2021/06/AS-FILED-Aguocha-et-al-v-Make-School-and-Vemo-et-al-Complaint-062021.pdf. 86 percent of the 2017 Make School class withdrew or was dismissed.

[58]See *Id* at 22-4.

falsely claiming aligned incentives with students; making misleading statements about payment penalties and caps;[59] making misleading statements regarding payment term length;[60] and failing to give some students fair chances to review their initial ISA contracts.

APR disclosures are of particular importance for regulators. The disclosure of APR and "finance" charges is of primary importance to enable creditors to understand the cost of a loan and compare options. However, ISA servicers often obfuscate their products' APR rates for borrowers, thereby preventing them from comparing rates to other traditional student loans.

The DFPI has authority to require APR disclosures for all student financing, including ISA service providers, and prohibits servicers from "misrepresenting or omitting material information in connection with a student loan" connected to the borrower's obligations.[61] We recommend the DFPI regulate ISA servicers to ensure they are disclosing APR rates to consumers. The CFPB has already followed suit and issued a consent order identifying an ISA servicer provide in violation of Regulation Z for failing to disclose the "the annual percentage rate, using that term," for their loans, as required in 12 C.F.R. § 1026.18(e).[62] Other states are considering requiring that ISA servicers disclose additional, supplemental APR rates based on different annual income amounts.[63]

**2. Unconscionable APR**

The DFPI's rule-making should seek to go beyond the disclosures and fair marketing concerns raised above and clarify when ISA APRs violate CA law, especially considering student borrowers' vulnerability. The CA Constitution prohibits non-exempt lenders from

[59] Make School encouraged students to "stack" ISAs to fully fund Make School's program but failed to disclose that each new ISA would have its own payment cap rather than a total payment cap across all ISAs.
[60] Term length implied that the obligations would stop within forty-two to sixty months.
[61] Cal. Civ.. Code § 1788.101 (a)(2)
[62] Consent Order, Better Future Forward, Inc. 10-11, CFPB Docket No. 0005 (Sep. 7, 2021), https://files.consumerfinance.gov/f/documents/cfpb_better-future-forward-inc_consent-order_2021-09.pdf
[63] Income Share Agreements, Required Disclosures, Colorado Uniform Consumer Credit Code and Student Loan Equity Act, 4 CCR 902-3 (Proposed Nov. 2021), https://coag.gov/app/uploads/2021/11/Draft-Income-Share-Agreement-Rule.pdf.

charging more than 10% of an outstanding loan in annual interest.[64] Where usury maximums are not directly applicable, the CA Supreme Court found annual interest can be voided if "overly harsh," "unduly oppressive" or "so one-sided as to shock the conscience."[65] In addition to helping borrowers make informed lending decisions, clarifying APR calculations will also help ISA providers and servicers comply with usury laws and help the DFPI identify when usury enforcement action is warranted.

### C. Clarifying Adequate Remedy for Student Enforcement

The SBBR provides a private right-to-relief for student borrowers for a failure to comply with California licensing standards and federal protections. Borrowers are required to give servicers notice and at least 30 days to provide an "appropriate remedy."[66] The DFPI should help bring justice to consumers harmed by deceptive, unfair or abusive ISAs and clarify what constitutes an adequate remedy under the SBBR in response to borrowers' notice of noncompliance. With the new student loan ombudsman, DFPI can compile information related to student borrower complaints to identify potential misconduct and appropriate remedies for the consumer. Such information may prove crucial for ensuring a student borrower receives timely and appropriate relief. For a student borrower with minimal savings, any time longer than 30 days without appropriate relief may be the difference between paying their rent on time or late.

Furthermore, new UDAAP language in CCFPL and SBBR allows DFPI latitude to issue various relief options for consumers, ranging from rescission of contracts, restitution, or monetary relief. Given the high stakes for student borrowers, DFPI should provide more clarity as to what constitutes an adequate remedy under SBBR's private right of action provision. An

[64] "California Constitution, article XV, section 1.
[65] Mark Hargrave and Lauren Haahr, *California Supreme Court Rules that Consumer Loans Not Subject to Usury Cap May Still be Deemed Unconscionable*, Stinson, (Aug. 2018), https://www.stinson.com/newsroom-publications-california_supreme_court_rules_that_consumer_loans_not_subject_to_usury_cap_may_still_be_deemed_unconscionable.
[66] Cal. Civ.. Code § 1788.101 (e).

explicit right of rescission or option to re-sign an ISA contract for a servicer's violation, for example, can provide student borrowers clear and certain relief.

Additionally, DFPI should specify appropriate and timely remedies for consumers bringing complaints about a servicer's collection of unenforceable loans. Many Californian ISA lenders are private coding bootcamps or vocational schools previously unlicensed to operate under the BPPE. These loans are unenforceable under California law.[67] However, servicers have continued to attempt to collect void and unenforceable payments that neither them or their lender are entitled to collect.[68] DFPI should protect consumers from unfair and deceptive servicing practices and ensure timely relief and remedies are available when appropriate.

**D. Litigation for UDAAP Violations**

Rulemaking that clarifies which ISA practices are illegal can encourage compliance. Additionally, this clarity can lay the groundwork for enforcement action against ISA providers that violate the law. The DPFI should prepare to sue ISA providers for unfair and deceptive servicing practices. DFPI rulemaking and enforcement action may help clarify for students when they might have a viable private cause of action against an ISA provider. To encourage public action, the DFPI should consider the deterrent impact of arbitration clauses, common to ISA contracts, and where possible, make clear any route for legal action available to students under California law, despite arbitration clauses.

In addition to enforcement action for deceptive or misleading marketing, the DPFI can take action against ISA servicers who attempt to collect on ISAs that are unenforceable (e.g. issued by a provider that was not licensed to operate at the time of issuance). The DFPI should

[67] Cal. Educ. Code § 94886.
[68] Ben Kaufman, et al., *Unfair, Deceptive, and Abusive Acts and Practices in the Servicing of Void and Unenforceable ISAs*, Student Borrower Protection Center, (June 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3867801.

make clear that if ISAs' servicers do not verify the enforceability of their ISAs, they are exposed, risking deprivation of license, financial penalties, as well as statutory damages.

### E. Conclusion

The ISA industry is rapidly growing and expanding beyond coding bootcamps to vocational industries and traditional higher education. DFPI's consent order establishing ISA as "student loans" can provide much-needed oversight over an industry burdening students with unaffordable debts for low-quality credentials. In doing so, the agency can establish consumer-friendly regulations and protect students from servicers and educational programs misleading students. Without DFPI's further clarifications, ISAs will continue operating in a legal grey area that will leave consumers vulnerable to deceptive and predatory financial products.