Wolters Kluwer
Law & Business

Consumer Financial Protection Bureau Reporter

CFPB WATCH – FERRARA & KARCHER

Ralph C. Ferrara and Timothy Q. Karcher of Proskauer Rose LLP
www.Proskauer.com

AUGUST 2014 ISSUE NO. 16

INSIDE THIS ISSUE

1 State—created corporations: "Persons" for CFPB enforcement actions?

3 CFPB increases enforcement against consumer lending, debt collection, and foreclosure relief

4 "Would you trust these people with your money?" CFPB weighs in on virtual currencies

Editor's Note: The CFPB Watch provides Commentary and Analysis on developments relating to consumer financial protection issues involving the regulatory authority of the Consumer Financial Protection Bureau or related topics.

www.wolterskluwerlb.com

State-created corporations: "Persons" for CFPB enforcement actions?

By: Timothy Karcher (tkarcher@proskauer.com)
Jeffrey Chubak (jchubak@proskauer.com)

Certain states have established corporations to facilitate student loan debt issuance. These "state-created corporations" are corporate entities created by a state for the purpose of improving the availability of higher educational opportunities by financing, making, guaranteeing, and/or servicing student loans. Examples of state-created corporations include Pennsylvania Higher Education Assistance Agency (PHEAA), Vermont Student Assistance Corporation (VSAC), Arkansas Student Loan Authority (ASLA), and Kentucky Higher Education Student Loan Corporation.

Whether these corporations qualify as "persons" has significant implications for Consumer Financial Protection Bureau enforcement actions. Under section 1052 (12 U.S.C. § 5562) of the Consumer Financial Protection Act (12 U.S.C. § 5481 *et seq.*), the CFPB only may serve a civil investigative demand upon a "person." In addition, the prohibition in CFPA section 1036 (12 U.S.C. § 5531) against committing unfair, deceptive, or abusive acts or practices only applies to "covered persons" and "service providers." Section 1002(6) (12 U.S.C. § 4581(6)), in turn, defines "covered person" as a "person" that offers or provides a consumer financial product or service or an affiliate of such person if the affiliate acts as a service provider. In addition, section 1002(26) defines "service provider" as a "person" that provides a material service to a covered person in connection with the offering or provision of a consumer financial product or service.

Likewise, various enumerated consumer laws the CFPB is charged with enforcing only apply to "persons." For example, the Fair Debt Collection Practices Act (15 U.S.C. § 1601 *et seq.*) applies to "debt collectors," a term defined as a "person" who uses an instrumentality of interstate commerce to collect a debt due to another. The FDCPA does not define the term "person."

CFPA section 1002(19) (12 U.S.C. § 5482(19)) defines "person" as "an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity." While state-created corporations likely fall within the CFPA's definition of "person," it remains uncertain if such corporations would qualify for purposes of enforcing enumerated consumer laws that do not define the term "person," such as the FDCPA, or statutes that do not define the term broadly enough.

As described below, in evaluating whether state-created corporations are "persons" for purposes of enforcing such enumerated consumer laws, courts would likely consider *U.S. ex rel. Oberg v. PHEAA*, 745 F.3d 131 (4th Cir. 2014), a recent decision evaluating whether state-created corporations are "persons" for purposes of enforcing the False Claims Act (31 U.S.C. § 3729 *et seq*.), which does not define the term "person."

Oberg v. PHEAA

In *Oberg*, the Fourth Circuit addressed the issue of whether state-created corporations are "persons" for FCA purposes. The Fourth Circuit ultimately arrived at mixed results and held discovery was needed to determine if PHEAA and VSAC are "persons," but failed to reach agreement concerning whether ASLA qualifies as such.

In *Oberg*, the plaintiff alleged certain state-created corporations defrauded the U.S. Department of Education by engaging in sham transactions designed to inflate the amount of their loan portfolios eligible for certain "Special Allowance Payments." The district court dismissed the action on the grounds that state-created corporations are not "persons" for FCA purposes. On appeal, the Fourth Circuit noted that the issue of personhood is not so clear. The Fourth Circuit noted the Supreme Court held in *Vermont Agency of Natural Resources v. U.S. ex rel. Stevens*, 529 U.S. 765, 787-88 (2000) that states and state agencies are not "persons" for FCA purposes, but also held in *Cook County v. U.S. ex rel. Chandler*, 538 U.S. 119, 122 (2003) that municipal corporations (like counties) are "persons" for FCA purposes.

"Arm of the state" analysis

In determining whether a state entity is a "person" subject to liability, courts generally apply an "arm of the state" analysis that considers: (1) whether a state would be liable (or functionally liable) in the event a judgment is awarded; (2) the degree of autonomy exercised by the entity, including whether the state appoints directors or officers, funds the entity, or retains veto power over its actions; (3) whether the entity is involved with state concerns as distinct from non-state/local concerns; and (4) how the entity is treated under state law, such as whether its relationship with the state is sufficiently close to make it an "arm of the state."

The Fourth Circuit's decision on *Oberg* analyzed the relationship between each defendant state-created corporation and concluded that it is possible for a state-created corporation to be a "person" depending upon the specific facts and circumstances. Specifically, with regard to PHEAA and VSAC, the Fourth Circuit concluded some factors weighed in favor of finding them to be an "arm of the state" and some factors weighed against, and remanded to permit limited discovery on this issue. With regard to ASLA, the Fourth Circuit held *all* factors weighed in favor of holding it is an arm of the state. However, that conclusion was not unanimous. Chief Judge Traxler (who agreed with the decision to remand the issue with respect to PHEAA and VSAC) dissented with regard to ASLA. Judge Traxler stated various allegations were sufficient to support plaintiff's assertion the state treasury would not be liable in the event of a judgment against ASLA, including that, under Arkansas state law, ASLA may sue and be sued, Arkansas disclaimed liability for ASLA's obligations, and ASLA expenses are paid from revenue generated from lending activities (as opposed to state appropriations).

Conclusion

Given the CFPB's focus on student loans and debt collection, coupled with the fact that state-created corporations own, hold, and/or service a significant percentage of outstanding federal and private student loans, the issue of whether a state-created corporation is a "person" for purposes of enforcing enumerated consumer laws is likely to become increasingly relevant. Although the Fourth Circuit has provided guidance concerning whether state-created corporations are "persons" for purposes of enforcing statutes that do not define the term, the decision ultimately does not provide definite conclusions. Going

Consumer Financial Protection Bureau Reporter
CFPB WATCH

Newsletter Design: Publishing Production & Design Services
Sales Department: 888 224-7377
Customer Service: 800 344-3734 • support.cch.com

Timothy Q. Karcher: tkarcher@proskauer.com **Ralph C. Ferrara:** rferrara@proskauer.com

The Consumer Financial Protection Bureau Reporter with Practice Commentary and Analysis by Ralph C. Ferrara and Timothy Q. Karcher of Proskauer Rose LLP is published by Wolters Kluwer Law & Business.

forward, courts will likely need to analyze the corporation at issue to determine if it qualifies as a person under the "arm of the state" analysis and determine if it falls within the scope of the statutory framework.

CFPB steps up enforcement activity

By: Timothy Karcher (tkarcher@proskauer.com)
Jeffrey Chubak (jchubak@proskauer.com)

In what appears to be a recent increase in enforcement activity, the Consumer Financial Protection Bureau has commenced and/or resolved a number of enforcement actions targeting consumer lending/debt collection firms, foreclosure relief firms, and certain of their principals and related entities. This uptick indicates the CFPB's continuing concern about "debt traps" and unfair, deceptive, and abusive tactics relating to debt collection and foreclosure relief.

Consumer Lending/Debt Collection

*ACE***.** As we reported last month, on July 8, 2014, the CFPB entered a consent judgment against ACE Cash Express, Inc. (ACE). ACE offered consumer loans that were structured to be repaid in two weeks but generally were rolled over or renewed. ACE used in-house debt collectors to collect accounts that were 120 days or less past due, and third-party debt collectors for all other accounts. The consent judgment provides that both sets of debt collectors made excessive calls to consumers and non-liable third parties, failed to cease collection activity when instructed, and falsely threatened borrowers with litigation or criminal prosecution. In addition, the consent judgment provides that ACE's in-house debt collectors made misrepresentations to consumers, including that third-party debt collectors would tack on additional fees, report payment defaults to credit bureaus, or otherwise hassle consumers, and that in-house debt collectors could not prevent the transfer of consumer debt to third-party debt collectors. Further, the consent judgment provides that in-house debt collectors were instructed to create a "sense of urgency" when possible and were provided specific instructions for doing so. While ACE neither admitted nor denied any wrongdoing, the consent judgment provides that ACE's conduct constituted an unfair, deceptive, and/or abusive act or practice, in violation of sections 1031 and 1036 of the Consumer Financial Protection Act (12 U.S.C. §§ 5531 and 5536), and directed ACE to cease and desist from engaging in further unfair, deceptive, or abusive acts or practices, establish a compliance plan, pay $5 million in penalties to consumers and establish a redress plan for remitting the same, and pay $5 million in penalties to the CFPB.

Fred Hanna. On July 14, 2014, the CFPB commenced an action in the U.S. District Court for the Northern District of Georgia against Frederick J. Hanna & Associates, P.C. (Fred Hanna) and its main partners. Fred Hanna is a law firm that instigated tens of thousands of state court actions annually in efforts to collect debts on behalf of its credit card issuer clients, which include JPMorgan, Bank of America, Capital One, and Discover. The complaint states that in prosecuting such actions the firm improperly delegated various decisions to non-attorney staff (*e.g.*, determining which actions were "suit worthy" and amounts owed, drafting complaints, etc.) and instructed attorneys to rely on an automated system to determine legally significant matters (*e.g.*, date of last payment, whether the borrower filed for bankruptcy, or whether the debt is time-barred). The complaint further states firm clients often could not support their collection activities with basic documents, and actions often were filed without adequate investigation, although the firm often submitted affidavits representing the affiant had personal knowledge of the validity of the debts. Most actions resulted in default judgments, and when they did not, the firm generally dismissed the cases. The CFPB claimed the foregoing acts and practices violated Fair Debt Collection Practices Act section 807(2)(A), (3), and (10) (15 U.S.C. § 1692e(2)(A), (3), and (10)) (false representation of the character, amount, or legal status of a debt, false representation that an individual is an attorney, use of false representation to attempt to collect a debt, respectively), FDCPA section 808 (15 U.S.C. § 1692f) (unfair means to attempt to collect a debt), and CFPA sections 1031 and 1036 (deceptive acts and practices). The CFPB requested the court enjoin future violations and order payment of damages and penalties and disgorgement of ill-gotten revenues.

Rome Finance. On July 29, 2014, the CFPB entered a consent judgment against Colfax Capital Corporation and Culver Capital, LLC (together, Rome Finance) and their principals. Rome Finance held over 12,000 financing agreements totaling approximately $60 million, primarily with U.S. military servicemembers. The consent judgment provides that Rome Finance hid inaccurate finance charges in the price of goods sold, in violation of Regulation Z (12 C.F.R. §§ 1026.6(b)(2) and 1026.14)), failed to provide periodic disclosures for open end credit, in violation of Regulation Z (12 C.F.R. §§ 1026.7(b)(4)-(6) and (10)), unfairly facilitated deception by merchant creditors from whom Rome

Finance took assignment, in violation of CFPA sections 1031 and 1036, and collected debt that is void under applicable state law, by virtue of, among other things, Rome Finance not being licensed or charging a usurious APR, in violation of CFPA sections 1031 and 1036 and applicable state law. While Rome Finance neither admitted nor denied any wrongdoing, the consent judgment directed Rome Finance to cease engaging in further consumer lending or debt collection, notify affected consumers of the judgment, update credit reporting agencies to indicate each affected contract is "paid as agreed," satisfy various reporting requirements, and pay a nominal monetary penalty to the CFPB.

USA Discounters. On Aug. 14, 2014, the CFPB entered a consent judgment against USA Discounters, Ltd. (USA Discounters), which operates retail stores located near military installations and finances the purchase of consumer goods through retail installment contracts. The consent judgment provides that USA Discounters' contracts required that servicemembers pay a $5 fee in order for a company called SCRA Specialists LLC (SCRA) to serve as their representative with respect to their rights under the Servicemembers Civil Relief Act (50 U.S.C. § 524 *et seq*.), when in fact SCRA existed for the purpose of commencing collection actions against defaulting servicemembers on USA Discounters' behalf. While USA Discounters neither admitted nor denied wrongdoing, the consent judgment provides that USA Discounters engaged in unfair and deceptive acts and practices in violation of CFPA sections 1031 and 1036 and directed USA Discounters to cease marketing the contracts at issue as beneficial to servicemembers or pretending SCRA is independent, stop charging a fee for any SCRA-related service, and pay $350,000 in restitution to servicemembers and a $50,000 penalty to the CFPB.

Foreclosure relief

On July 23, 2014, the CFPB, Federal Trade Commission, and 15 states announced a sweep against various foreclosure relief firms alleged to have used deceptive marketing tactics against distressed homeowners. As part of the sweep, the CFPB filed three lawsuits against firms that collected over $25 million in advance fees for foreclosure prevention and mortgage renegotiation services. The CFPB's first lawsuit named Clausen & Cobb Management Company, Siringoringo Law Firm, and their principals as defendants; the second named The Mortgage Law Group, LLP, Consumer First Legal Group, LLC, and their principals as defendants; and the third named Hoffman Law Group, its affiliated companies (Nationwide Management Solutions, Legal Intake Solutions, File Intake Solutions, and BM Marketing Group), and their respective principals as defendants. The illegal practices alleged in the CFPB's complaints include collecting fees before a loan modification has been achieved, inflating success rates and the likelihood of obtaining a loan modification, "duping" consumers into thinking they were receiving legal representation, and making false promises about loan modifications to consumers. The CFPB alleges the defendants violated Regulation O (f/k/a Mortgage Assistance Relief Services Rule) (12 C.F.R. Part 1015), which generally bans mortgage assistance relief service providers from requesting or receiving payment from consumers for mortgage modifications before a consumer has signed a loan modification agreement with the lender, prohibits deceptive statements, and requires that certain disclosures be made in connection with the marketing of mortgage assistance relief services. The complaints also assert some defendants engaged in unfair, deceptive, and abusive acts and practices in violation of CFPA sections 1031 and 1036.

Conclusion

The past month has been a busy one for CFPB enforcement activity. Based on the rhetoric of the press releases announcing the foregoing actions, coupled with CFPB Director Richard Cordray's prepared remarks, it is likely we will see no slowdown of similar actions commenced by the CFPB in the future.

"Would you trust these people with your money?" CFPB weighs in on virtual currencies

By: Timothy Karcher (tkarcher@proskauer.com
Jeffrey Chubak (jchubak@proskauer.com)

In its latest consumer advisory, issued Aug. 11, 2014, the Consumer Financial Protection Bureau weighs in on virtual currencies. As set forth in the advisory, virtual currencies such as Bitcoin, XRP, and Dogecoin offer a way to track, store, and send value over the internet. According to the CFPB, virtual currencies can "offer the potential for innovation" but "a lot of big issues have yet to be resolved," including:

- Hackers: Virtual currencies are targets for hackers who have been able to breach sophisticated security systems.

- Cost: Virtual currencies can cost consumers more to use than credit cards or cash, and their value can fluctuate wildly.
- Fraud: Virtual currencies create opportunities for fraudsters and scammers, who are taking advantage of the hype surrounding virtual currencies to cheat people with fake opportunities.
- Fewer Protections: The protections offered to bank and credit card customers may not be available if something goes wrong.

The CFPB's advisory provides a cautionary summary outlining the basics of using virtual currencies and gives a number of "real world" examples for emphasis.

What could possibly go wrong?

The CFPB explains virtual currencies are a "kind of electronic money" that are not issued or backed by the United States or any other government or central bank. No one is required to accept virtual currencies as payment or exchange them for traditional currencies. They only work because of a large network of "unidentified, private computers around the world that maintains and updates a public ledger" that keeps track of the virtual currency. To access the virtual currency, holders need to store the virtual currency in a "digital wallet" that can be identified by the holder's "public key." To access or transfer the virtual currencies, holders use their "private key," which is a random sequence of 64 characters, to unlock their digital wallet.

According to the CFPB, "in many ways, your private keys are your virtual currency." In other words, anyone who has your "private key" can likely access your virtual currency. If your "private key" is hacked (or lost), your virtual currency may be lost too.

CFPB urges caution when buying, selling, and using virtual currencies

The CFPB offers the following practical advice for purchasing and using virtual currencies:

- *Know who you are dealing with*. If something goes wrong with a virtual currency transaction, you may have a difficult time getting it resolved. The CFPB cautions consumers to ask "in any other business transaction, would you trust these people with your money?"
- *Price Risks.* The CFPB advisory notes that there may be hidden costs in buying, selling, and using virtual currencies and that holders must be prepared for large price fluctuations. As an example, the CFPB notes transaction fees as high as 7 percent have been reported, and the currencies have been subject to extreme price fluctuations and exchange rate variations of $50 over rates available elsewhere.
- *Anonymity.* One of the attractions of virtual currencies is the perceived anonymity of the transactions. However, according to the CFPB, the transactions may not be entirely anonymous because information about each and every Bitcoin transaction is publicly shared and stored forever. Accordingly, "people will likely be able to link your transactions to, among other things, your other transactions and public keys, as well as to your computer's IP address."

The CFPB also offers additional words of caution for storing virtual currencies, including that your account may be hacked, and your private key may be compromised. Further, the CFPB notes there is no guarantee storing virtual currency with an exchange or other company will provide you with greater protection—they also can be hacked or fail, as was the case with Mt. Gox, a Tokyo-based Bitcoin exchange that commenced liquidation proceedings earlier this year following the disappearance of approximately $450 million worth of Bitcoin. Unlike a bank or credit union, the failure of a virtual currency depository will not be covered by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund.

In addition, the CFPB notes simple mistakes can be costly. For example, if you are trying to send money using virtual currency and inadvertently provide the wrong public key for the recipient, it may be impossible to unwind the transaction and recover your funds. Likewise, the CFPB urges caution when buying goods or services with a virtual currency, and notes tax treatment for virtual currency gains may be complicated.

Preparing for complaints

In preparation for an influx of complaints regarding virtual currencies, the CFPB is adding a new category for submitting complaints. The complaint form is still being developed, and the CFPB is asking users to share their feedback regarding the proposed form. In the meantime, consumers can use the "money transfer" complaint form to submit complaints regarding virtual currency transactions.

Conclusion

Virtual currency is still experimental, so it is probably too soon to determine how useful the CFPB's advisory and complaint form will be. If digital currency overcomes some of its obvious shortcomings (hacker vulnerability, price fluctuations, merchant acceptance, etc.) and becomes more commonplace, then the CFPB's actions will be viewed not only as forward-thinking, but prescient. Moreover, because virtual currency is not backed by the FDIC, but has nevertheless been considered a "currency" (as opposed to a commodity, for example) for securities law purposes (*see SEC v. Shavers*, No. 13-cv-416 (E.D. Tex. Aug. 6, 2013 [Docket No. 23]), the CFPB is a logical referee for disputes concerning virtual currencies.

Stay current with

Consumer Financial Protection Bureau Reporter

Table of Contents

Volume 1

- Topical Index
- Consumer Financial Protection Act
- Mortgage Reform and Anti-Predatory Lending Act
- Alternative Mortgage Transaction Parity Act
- Consumer Leasing Act
- Equal Credit Opportunity Act
- Fair Credit Reporting Act
- Fair Debt Collection Practices Act

Volume 2

- Home Mortgage Disclosure Act
- Homeowners Protection Act
- Real Estate Settlement Procedures Act
- Secure and Fair Enforcement for Mortgage Licensing Act
- Truth in Lending Act; Fair Credit Billing Act
- HOEPA; Omnibus Appropriations Act, 2009
- Electronic Fund Transfer Act
- Expedited Funds Availability Act
- Federal Deposit Insurance Act
- Truth in Savings Act
- Gramm-Leach-Bliley Act
- Interstate Land Sales Full Disclosure Act
- Telemarketing and Consumer Fraud and Abuse Prevention Act

Volume 3

- Case Table
- Court Developments
- Bureau and Related Materials
- Rulemaking Proposals and Adoptions

Volume 4

- Legislative Documents
- Articles
- Last Report Letter

Ralph C. Ferrara, Partner, Proskauer Rose LLP

Ralph Ferrara represents corporations and individuals in complex securities class and shareholder derivative actions, advises corporate clients on Securities and Exchange Commission reporting and disclosure requirements, represents corporations and individuals in government investigations and enforcement proceedings, conducts corporate internal investigations, handles consumer financial services issues, and counsels corporate officers and boards on all of these matters. Mr. Ferrara has argued on five occasions before the United States Supreme Court on cases, appeared in each of the U.S. Circuit Courts of Appeal, and represented clients in state and federal courts across the country.

Timothy Q. Karcher, Partner, Proskauer Rose LLP

Timothy Karcher concentrates his practice on financial restructuring and insolvency law, crisis management, and the acquisition and sale of assets and troubled companies in Chapter 11. He has substantial experience representing public and private companies, secured and unsecured creditors, investors, funds, and financial institutions in a broad range of U.S. and international business restructuring and litigation cases.

Original co-author:
Gary Apfel, Partner, Pepper Hamilton LLP

Gary Apfel's experience includes advising on compliance matters, corporate governance issues, reorganizations and restructurings, mergers and acquisitions, public and private securities offerings, and commercial transactions. He also advises boards of directors regarding their fiduciary duties and other responsibilities.