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Improvident Student Lending

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IMPROVIDENT STUDENT LENDING

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Abstract

The idea that lending without regard to ability to repay should be illegal is not particularly new, but it gained purchase in recent years with the rapid growth of high-cost mortgage loans. In the late 1990s, law enforcement and private litigants began attacking predatory mortgage lenders on the grounds they were making loans that borrowers could not afford. Both before and after the financial crisis of 2008, state and federal legislators imposed reforms on the mortgage market that provided relief to borrowers whose lenders failed to determine whether they had sufficient income to afford their monthly mortgage payments.

This Article seeks to address two gaps in the literature on ability to repay. The first is the lack of research on the application of the ability-to-repay standard to nonmortgage credit products. Second, the Article identifies a trend toward an increased focus on ex post loan performance as opposed to ex ante risk assessments to determine whether a lender considered a borrower's ability to repay. The example of litigation against for-profit colleges' student loan activities illustrates these points.

INTRODUCTION

At the turn of the twenty-first century, there was a scholarly consensus that the regulatory framework to protect consumers in the consumer financial marketplace was outdated. Proponents of reform were roughly divided in two camps: a rules camp and a standards camp.[1] The rules camp pushed for the creation of a new federal

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[1] Others have noted a similar division between reform proponents, though not necessarily identifying the division along the familiar rules versus standards line. *See, e.g.*, Jean Braucher, *Form and Substance in Consumer Financial Protection*, 7 BROOK. J. OF CORP., FIN. & COM. L. 107, 109–10 (2012) (detailing two policy arguments in favor of reform as formal rule-making and as anti-abuse standards to ensure financial products were free of "tricks and traps"); John Pottow, *Ability to Pay*, 8 BERKELEY BUS. L. J. 175, 193 (2011) (noting that "just as Elizabeth Warren agitated for a consumer financial protection agency for some time, so too have academics kept the pressure on for some form of suitability or similar duty on mortgage lenders").

regulator empowered to promulgate technocratic rules to ensure the safety of consumer financial products.[2] The standards camp pushed for standards that would impose duties on lenders to ensure financial products were suitable for prospective consumers.[3]

In 2010, Congress passed Dodd-Frank,[4] incorporating proposals from each camp. Dodd-Frank created a new federal agency empowered to promulgate rules to regulate consumer financial products.[5] Dodd-Frank also created a new standard[6] of abusiveness for consumer financial products, which, as some have argued, prohibits lenders from making loans without regard to ability to repay.[7] There is extensive literature examining the new regulatory framework Dodd-Frank created, but little scholarship on how the ability-to-repay standard in Dodd-Frank and a parallel standard under state unfair and deceptive practices laws ("UDAP") have been applied to curb abuses in nonmortgage financial products.[8] This Article seeks to fill that gap by examining the evolution of the ability to repay as a legal standard and describing its application by law enforcement against improvident lending by for-profit colleges.

Part I of this Article traces the evolution of ability to repay as a legal standard from the early efforts to outlaw improvident lending to recent scholarship advocating for a suitability standard in consumer lending. Part I considers why early efforts to outlaw improvident lending failed and how the growth in predatory lending in the latter-half of the twentieth century led scholars to reevaluate the effectiveness of existing consumer protection laws. Part I also examines how law enforcement and

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[2] This view is best encapsulated in Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1 (2008), and in Elizabeth Warren, *Unsafe at Any Rate*, 5 DEMOCRACY: J. IDEAS 3 (2007), https://democracyjournal.org/magazine/5/unsafe-at-any-rate/ [https://perma.cc/F3AN-ED5B], an earlier article from Warren arguing for the creation of a financial product safety commission.

[3] An early version of this argument can be found in Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1318–20 (2002). Engel & McCoy's proposal was for a suitability standard refined through rule-making. For a more extensive discussion of the history of suitability as a standard in American law, see Pottow, *supra* note 1, at 185–95.

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank] (codified in scattered parts of the United States Code).

[5] *Id.* at 1955–2113.

[6] *See* 12 U.S.C. § 5531(d)(2) (effective July 21, 2010).

[7] *See* Tiffany S. Lee, *No More Abuse: The Dodd-Frank and Consumer Financial Protection Act's "Abusive" Standard*, 14 J. CONSUMER & COM. L. 118, 122–24 (2011) (arguing that abusiveness in the CFPA should make it illegal for a lender to extend credit without regard to the borrower's ability to pay).

[8] For a discussion of the history and defining features of UDAP laws, see Prentiss Cox et al., *Strategies of Public UDAP Enforcement*, HARV. J. LEGIS. (forthcoming 2018), https://ssrn.com/abstract=2942406 or http://dx.doi.org/10.2139/ssrn.2942406 [https://perma.cc/48QW-VMMU].

private litigants fit ability to repay into traditional unfairness and unconscionability doctrines to combat predatory subprime mortgage lending.

Part II of this Article examines how law enforcement has applied ability to repay as a legal standard to combat fraud in nonmortgage financial products. Part II specifically considers the use of ability to repay in litigation against for-profit colleges for abusive lending practices. As Part II suggests, an important feature of recent applications of the ability-to-repay standard is the focus on *ex post* loan performance as opposed to *ex ante* risk assessment to determine whether a lender failed to consider a borrower's ability to repay a loan. This shift mirrors a similar shift in the legal literature with some scholars arguing that consumer regulation should move away from prescriptive rules and, instead, impose liability based on how well loans perform.[9]

This Article concludes by highlighting the critical role that states can play as the current President and Congress rollback many of the consumer financial reforms of the past decade.

I. IMPROVIDENT LENDING: A BRIEF HISTORY

This Section provides a brief history of efforts to curb improvident lending. This Section specifically focuses on litigation over predatory mortgage lending and legislative proposals to restrain these practices. We argue that an important aspect of early efforts to restrain improvident lending in mortgage markets is the focus on the features of a loan at the time of origination that indicate failure to consider ability to repay. This focus on *ex ante* risk assessment distinguishes these early efforts from more recent efforts, which look, in part, to *ex post* performance measures such as default rates to demonstrate a lender's failure to adequately assess ability to repay.

A. Early Efforts to Outlaw Improvident Lending[10]

The idea that improvident lending—lending without regard to a borrower's ability to repay—should be illegal is not particularly new. Complaints about unscrupulous creditors overloading unsuspecting debtors appeared as early as the Great Depression.[11] The concern over improvident lending emerged again in the

[9] *See* Lauren E. Willis, *Performance-Based Consumer Law*, 82 U. CHI. L. REV. 1309, 1311–15 (2015) (arguing in favor of performance-based standards in consumer regulation).

[10] This part provides a short overview of this history of efforts to outlaw improvident lending. For a more detailed discussion, see Teri R. Daniel, Note, *Improvident Extension of Credit as an Extension of Unconscionability:* Discover Bank v. Owens *and a Debtor's Rights Against Credit Card Companies*, 54 CLEV. ST. L. REV. 435, 440–46 (2006); *see also* Braucher, *supra* note 1, at 118–20 (outlining Vern Countryman's efforts to outlaw improvident lending).

[11] Wesley A. Sturges & Don E. Cooper, *Credit Administration and Wage Earner Bankruptcies*, 42 YALE L. J. 487, 524 (1933) (noting that "[c]redit is often extended carelessly

1960s and 1970s, championed most prominently by Vern Countryman. Countryman, citing the rise of consumer bankruptcies in the 1960s, lamented the fact that unscrupulous creditors failed to engage in thorough credit investigation of potential borrowers "[b]ecause loss ratios are low, thanks in part to the ability of the institutional credit extenders to reach the debtor's future wages even though he obtains a bankruptcy discharge."[12]

Countryman pushed for legislative changes to define and expressly prohibit improvident extensions of credit or include the concept of improvident credit extension in the definition of unconscionability.[13] As an example, in 1972, the National Commission on Consumer Finance proposed the following amendment, drafted by Countryman, to Chapter 13 of the Bankruptcy Code:

> In determining whether a consumer credit transaction is unconscionable, the bankruptcy court, in addition to case law, should consider whether the transaction entailed an "improvident extension of credit." The court should, in fact, consider whether the creditor made "an extension of credit to a debtor where it cannot be reasonably expected that the debtor can repay the debt in full in view of the circumstances of the debtor as known to the creditor and of such circumstances as would have been revealed to him upon reasonable inquiry prior to the credit extension."[14]

The National Consumer Law Center, the Brookings Institute, the American Bar Association, and the National Bankruptcy Conference made similar proposals during this time period.[15] Not all scholars, however, agreed that the law should be modified. Ronald Hersbergen, for example, believed that unconscionability encompassed claims based on improvident extensions of credit.[16] Specifically, Hersbergen argued that procedural unconscionability—unconscionability in the contract formation process—covered the nonuse or misuse of credit information and creditors taking advantage of unsophisticated consumers.[17] Hersbergen further argued that substantive unconscionability—unconscionable contract terms—could be used to

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and without adequate inquiry, or with the expectation that profits from the increased volume of sales will exceed probable credit losses").

[12] Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1, 6 (1975) (emphasis omitted).

[13] *See id.* at 8–15.

[14] *Id.* at 13–14 (quoting NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 42 (1972)).

[15] *See id.* at 8–15.

[16] *See* Ronald L. Hersbergen, *The Improvident Extension of Credit as an Unconscionable Contract*, 23 DRAKE L. REV. 225, 292 (1974).

[17] *See id.*

attack contract terms that reflect extreme exploitation by a creditor of a borrower's lack of sophistication.[18]

While no major federal legislation emerged during this period, several states expanded state law unconscionability to cover improvident extensions of credit. As an example, the D.C. Administrative Code provides that it is an unlawful trade practice to "make or enforce unconscionable terms or provisions of sales or leases" and that "in applying this [standard], consideration shall be given to," among other factors, "knowledge by the person at the time credit sales are consummated that there was no reasonable probability of payment in full of the obligation by the consumer."[19]

B. The Emergence of Predatory and Subprime Lending

Although concern over improvident credit extensions had some purchase in the early twentieth century, it did not feature prominently in efforts to curb fraud perpetrated against consumers. One explanation for the paucity of improvident lending claims is that the kind of predatory lending that concerned Countryman was practiced primarily by businesses operating at the margins of the credit industry. As these businesses were likely also engaging in various forms of deception, federal and state laws prohibiting deceptive conduct provided consumers with adequate protections.

In 1981, economists Joseph Stiglitz and Andrew Weiss proposed a formal model of lending using information economics, which helps explain why predatory lending operated at the margins and not the center of consumer financial markets.[20] In *Credit Rationing in Markets with Imperfect Information*, Stiglitz and Weiss suggested that lenders operating in markets in which they possess imperfect information about potential borrowers would engage in credit rationing and limit the

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[18] *See id.* at 292–93. As an example, Professor Hersbergen points to a New York state court decision in which a court found unconscionable a sale to welfare recipients of a freezer unit, having an actual value of $300, for a total price, including sales tax and credit charges, of $1440. *Id.* Credit charges alone exceeded by $100 the retail value of the freezer, which fact itself was felt by the court to be sufficient to sustain the decision. *Id*; *see also* Anne Fleming, *The Rise and Fall of Unconscionability as the "Law of the Poor,"* 102 GEO. L. J. 1383 (2014) (discussing the famous DC Circuit unconscionability decision *Williams v. Walker-Thomas* furniture, which held that credit sales of merchandise may be unconscionable if the terms of the sale made it impossible for the borrower to obtain the merchandise).

[19] D.C. CODE § 28-3904(r)(1) (2017). In addition to the District of Columbia, the Idaho, Iowa, Kansas, Maine, and Ohio legislatures each similarly expanded the definition of unconscionability under state law to include knowledge that the borrower had no reasonable probability of repaying their obligation. *See* IDAHO CODE § 28-46-111(3) (1983); IOWA CODE § 537.5108 (1974); KAN. STAT. ANN. § 16a-6-111 (1973); ME. STAT. tit. 9-A, § 6-111 (1973); OHIO REV. CODE ANN. § 1345.03 (1977).

[20] *See* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393, 394 (1981).

amount of credit available.[21] Stiglitz and Weiss suggested that rationing occurs for two reasons. First, where lenders cannot effectively distinguish among borrowers, lenders will set interest rates below the market-clearing rate as a screening device in order to avoid adverse selection:

> The adverse selection aspect of interest rates is a consequence of different borrowers having different probabilities of repaying their loan. The expected return to the bank obviously depends on the probability of repayment, so the bank would like to be able to identify borrowers who are more likely to repay. It is difficult to identify "good borrowers," and to do so requires the bank to use a variety of *screening devices*. The interest rate which an individual is willing to pay may act as one such screening device: those who are willing to pay high interest rates may, on average, be worse risks; they are willing to borrow at high interest rates because they perceive their probability of repaying the loan to be low. As the interest rate rises, the average "riskiness" of those who borrow increases, possibly lowering the bank's profits.[22]

Second, where banks can distinguish between borrowers *ex ante* through credit scoring or some other means, lenders will likely engage in redlining by limiting credit to borrowers whose expected return (given the borrower's expected probability of default) is above the lender's cost of funds.[23] The consequence of the Stiglitz-Weiss model is that lenders with limited information and high capital costs will generally only lend to the most credit-worthy borrowers.

The Stiglitz-Weiss model accurately described the home mortgage market (and likely the broader consumer lending market) until the late 1980s.[24] As Kathleen Engel and Patricia McCoy explained in an article on the early rise of subprime mortgage lending, the lending market changed in the late 1980s in two ways that brought predatory lending into the mainstream. First, "longitudinal data and sophisticated credit-scoring and underwriting models" made it possible for lenders "to engage in more accurate risk assessment of people who, in the past, were observationally indistinct."[25] Second, securitization "reduced the marginal cost of procuring additional capital to lend and consequently lenders are less constrained in terms of the amount of money that they can lend."[26] In addition, securitization also enabled lenders to shift risk onto investors.[27] Securitization and improved credit-scoring models freed mainstream lenders from engaging in credit rationing and redlining to minimize losses.

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[21] *See id.*
[22] *Id.* at 393.
[23] *See id.* at 406–07.
[24] *See* Engel & McCoy, *supra* note 3, at 1272.
[25] *Id.* at 1278.
[26] *Id.* at 1279.
[27] *See id.*

As credit expanded, concerns surfaced about unscrupulous lenders extending credit to borrowers who could not afford to repay their debts. Engel and McCoy described a segmented mortgage market with a prime market, a legitimate subprime market, and a predatory market.[28] The legitimate subprime market served borrowers who presented elevated risk levels and were previously shut out of credit markets due to Stiglitz-Weiss-type rationing.[29] Lenders in the legitimate subprime market sought to lend to these borrowers at higher rates than borrowers were charged in the prime market.[30] By contrast, the predatory lending market exploited the expansion of credit to target a wider range of borrowers, most of whom were disconnected from credit markets.[31] This included borrowers with blemished credit and borrowers who actually would have qualified for prime loans, but were lured into loans with predatory terms.[32]

C. *Litigation Over Improvident Lending*

The growth in predatory mortgage lending prior to the financial crisis of 2008 spurred private litigants and state law enforcement to pursue claims alleging that improvident extensions of credit violated state consumer protection laws. These cases broadly fell into three categories: (1) claims that lending without regard to ability to repay was unconscionable; (2) state UDAP claims arguing that it was unfair and deceptive for a lender to make a loan without sufficient underwriting; and (3) UDAP claims that loans engineered to fail were structurally unfair.[33]

Unconscionability claims were brought under both state common law and specific state statutes. These claims typically involved unsophisticated consumers who were exploited by lenders falsifying loan information or making otherwise unrealistic assumptions about the consumers' ability to repay costly loans. For example, in *City Financial Services v. Smith*,[34] the plaintiff loaned the defendant $3,000 at 22% interest plus $618 in insurance and other charges.[35] At the time of the loan, the defendant had $574 in monthly disability income, was already in default on a separate loan from the plaintiff, and had over $6,700 in other credit card debt.[36] The defendant defaulted on her first payment and the plaintiff brought a breach of contract claim.[37] The defendant countered that the entire loan transaction should be

[28] *See id.*

[29] *See id.*

[30] *See id.*

[31] *See id.*

[32] *See id.*

[33] For an extensive discussion of UDAP claims against improvident extensions of credit, see CAROLYN L. CARTER & JONATHAN SHELDON, NAT'L CONSUMER L. CTR., UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 6.3 (9th ed. 2016).

[34] No. 97 CVF 00679, 2000 WL 288469 (Ohio Mun. Ct. Jan. 4, 2000).

[35] *See id.* at *1.

[36] *See id.* at *2.

[37] *See id.* at *1.

voided based on a theory of improvident lending.[38] The Court agreed.[39] Specifically, the Court noted that the plaintiff inflated the defendant's income to make it appear that she could afford to repay the loan when, in fact, her income was not sufficient to meet the monthly payments.[40] The Court held that:

> The enhancement of [defendant's] income . . . creates an element of unconscionability in the contract when it was made. In light of the specific terms of repayment, leaving [defendant] with only $120 in disposable income per month while knowing of outstanding credit card debt of over $6,700, and her timely failure to pay on an original loan with [plaintiff], this contract is unenforceable.[41]

Other courts reached the same conclusion when confronted with unconscionability claims under similar facts.[42]

Although some private litigants who fought improvident extensions of credit on unconscionability grounds such as the defendant in *City Financial Services* fared well, litigants who brought similar claims under state UDAP laws had more mixed results. While some courts have held that knowingly approving loans based on falsified information is unfair,[43] many other courts have concluded that where lenders failed to adequately underwrite a loan, did not determine the borrower's ability to repay, or placed the borrower in a loan with terms much worse than those for which the borrower qualified did not violate state UDAP laws because the lenders were not fiduciaries and did not owe the borrowers a duty of care.[44]

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[38] *See id.* at *2.

[39] *See id.*

[40] *Id.*

[41] *Id.*

[42] *See, e.g.*, Williams v. First Gov't Mortg. & Inv'rs Corp., 225 F.3d 738, 744 (D.C. Cir. 2000) (holding that a reasonable jury could conclude defendant lent to plaintiff knowing there was no reasonable probability of payment in full of the obligation where plaintiff's income was misstated and defendant was aware that plaintiff was disabled, elderly, and unlikely to be able to supplement his meager income over the life of the loan); Carrol v. Fremont Inv. & Loan, 636 F. Supp. 2d 41, 52 (D.D.C. 2009); Matthews v. New Century Mortg. Corp., 185 F. Supp. 2d 874, 892 (S.D. Ohio 2002).

[43] *See* Martinez v. Freedom Mortg. Team, Inc., 527 F. Supp. 2d 827, 837 (N.D. Ill. 2007) (holding that "knowingly approving home loans based on false information offends public policy, is unscrupulous and can cause substantial injury to consumers" is unfair, "if not downright deceptive" where plaintiff's loan application was approved, even though lender knew appraisal was false, to induce plaintiff to take out a larger loan).

[44] *See, e.g.*, Teaupa v. U.S. Nat'l Bank N.A., 836 F. Supp. 2d 1083, 1099 (D. Haw. 2011) (relying on this theory to dismiss a UDAP claim for failure to state a claim); Marzan v. Bank of America, 779 F. Supp. 2d 1140, 1152 (D. Haw. 2011), *abrogated by* Compton v. Countrywide Fin. Corp., 761 F.3d 1046, 1055–56 (9th Cir. 2014) (disagreeing with this line of cases and holding that "borrowers are not obliged to show that the lender owed the borrower a common law duty of care to state a claim" under Hawaii's UDAP statute; they

Perhaps the most interesting of the improvident lending cases of the past decade was the Massachusetts Attorney General's case against notorious subprime mortgage lender, Fremont.[45] In *Fremont*, the Massachusetts Attorney General alleged that loans originated by Fremont with the following features were engineered to fail and, thus, structurally unfair under Massachusetts' UDAP law: (1) adjustable-rate mortgages with teaser rates of three years or less; (2) teaser rates 3% below the fully indexed rate; (3) debt-to-income ratios calculated using the teaser rate; and (4) loan-to-value ratios close to 100% or loans that featured large prepayment penalties that extended beyond the introductory rate period.[46] The Massachusetts Supreme Court agreed with the Massachusetts Attorney General which held that:

> Fremont as a lender should have recognized that loans with the first three characteristics just described were "doomed to foreclosure" unless the borrower could refinance the loan at or near the end of the introductory rate period, and obtain in the process a new and low introductory rate. The fourth factor, however, would make it essentially impossible for subprime borrowers to refinance unless housing prices increased . . . . To issue a home mortgage loan whose success relies on the hope that the fair market value of the home will increase during the introductory period is as unfair as issuing a home mortgage loan whose success depends on the hope that the borrower's income will increase during that same period.[47]

The Court in *Fremont* further noted that Fremont made no effort to consider the borrower's ability to "make the scheduled payments under the terms of the loan."[48] Furthermore, Fremont was insulated from losses arising from borrower default because it sold the loans on the secondary market.[49]

A common thread among the various claims outlined in this section is that lenders knew or should have known consumers had no ability to repay their loan based on factors that existed at the time the loans were originated. The focus on lenders' failure to determine borrowers' ability to repay *ex ante* is a defining feature of subprime mortgage litigation and, as explained in Part II, a characteristic that distinguishes these cases from the more recent attacks against improvident lending in nonmortgage credit products, which focus on loan performance *ex post*.

"need only address whether the complaint adequately alleges that the lender used unfair or deceptive acts in its relationship with the borrower").

[45] *See* Commonwealth v. Fremont Inv. & Loan, 897 N.E.2d 548 (Mass. 2008).

[46] *Id.* at 554.

[47] *Id.* (citation omitted).

[48] *Id.* at 558.

[49] *Id.* at 552.

D. *Suitability, Exploding Loans, and the Creation of a Federal Unconscionability Standard*

Although private litigants and law enforcement found some success combating improvident lending in mortgage markets as unconscionable or unfair, some scholars contended that the existing legal tools were inadequate to address the problem. Engel and McCoy, for example, argued that existing contract and antifraud laws were insufficient to address the growing problem of predatory lending.[50] Specifically, they argued that courts narrowly applied unconscionability.[51] Engel and McCoy also argued that while state UDAP laws held some promise, state attorneys general selectively enforcing state UDAP laws against predatory lenders made it an inadequate remedy.[52] Engel and McCoy proposed a federal suitability standard, similar to the standards imposed on securities brokers and insurance agents, which would impose a duty on lenders to determine the suitability of a loan for a particular borrower.[53] Engel and McCoy believed a broad standard of suitability that would be refined through rulemaking[54] with dual federal and state jurisdiction would be a more effective tool against the problem of predatory lending.[55]

Oren Bar-Gill and Elizabeth Warren similarly argued against the adequacy of existing laws to combat improvident lending in their now famous article *Making Credit Safer*.[56] Bar-Gill and Warren lamented the lack of parity between consumer safety laws governing traditional consumer products and those governing consumer financial products.[57] Bar-Gill and Warren noted that consumers of physical products could enter the market confident that they would not be "deceived into buying exploding toasters."[58] In contrast, consumers could not enter the market for consumer financial products confident they would not be sold exploding loans.[59] Bar-Gill and Warren took the position that the problem with existing law was that it did not prohibit specific practices.[60] Instead, the law evolved through common law interpretations of unconscionability, which courts were "very circumspect" in applying.[61] Moreover, Bar-Gill and Warren argued that federal preemption of state law enforcement[62] and the limited authority of the Federal Trade Commission[63]

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[50] *See* Engel & McCoy, *supra* note 3, at 1299–1305.

[51] *See id.* at 1300–01.

[52] *See id.* at 1303–05.

[53] *See id.* at 1342–43.

[54] *See id.* at 1343.

[55] *See id.* at 1340.

[56] *See* Bar-Gill & Warren, *supra* note 2, at 70–95.

[57] *See id.* at 6.

[58] *See id.* at 7.

[59] *See id.*

[60] *See id.* at 75–76.

[61] *Id.* at 71.

[62] *See id.* at 79–83.

[63] *See id.* at 95–97.

prevented federal and state law enforcement from attacking the worst of abuses in the lending industry. Bar-Gill and Warren's proposed solution was the creation of a new federal agency that would be empowered to promulgate *ex ante* regulation to ensure the safety of consumer financial products.[64]

In 2010, Congress passed the Dodd-Frank, which incorporated elements of the Bar-Gill and Warren and the Engel and McCoy proposals.[65] As Bar-Gill and Warren advocated, Title X of Dodd-Frank (known as the "Consumer Financial Protection Act of 2010" or "CFPA") created a new federal agency, the Consumer Financial Protection Bureau ("CFPB"), empowered to create rules to regulate consumer financial products.[66] Dodd-Frank not only addressed regulation of mortgage markets, but also gave the CFPB and state attorneys general the authority to bring claims against creditors for engaging in unfair, deceptive or abusive acts or practices ("UDAAP").[67] The UDAAP prohibitions apply to consumer credit products, not just mortgages. The concepts of unfairness and deception have been part of the federal and state UDAP laws for decades;[68] however, the abusive standard is unique to the Dodd-Frank Act.

Dodd-Frank defined an abusive act or practice as one that:

> (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
> (2) takes unreasonable advantage of—
>   (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
>   (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
>   (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[69]

Although the definition of abusive does not expressly refer to ability to repay, it has been argued that the language of the provision encompasses these concepts.[70] Section (2)(B) mirrors the definition of unconscionability under the Uniform Commercial Code and in many state laws to create a federal unconscionability

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[64] *See id.* at 98.

[65] *See* Dodd-Frank, *supra* note 4.

[66] *See id.* at 1955–2113 (codified in scattered sections of 12 U.S.C.).

[67] *See* 12 U.S.C. § 5552 (effective July 21, 2010) (providing state enforcement of the provisions of CFPA).

[68] *See* Cox et al., *supra* note 8.

[69] Dodd-Frank, *supra* note 4, at 2006, sec. 1031 (codified at 12 U.S.C. § 5531 (effective July 21, 2010)).

[70] *See* Lee, *supra* note 7, at 122–23.

standard.[71] Section (2)(A) encompasses the idea that a lender has a duty to avoid taking advantage of consumers, who do not understand that they cannot afford the proffered loan.[72] And arguably, Section (2)(C) prohibits lenders from taking advantage of borrowers who reasonably rely on their lenders to make loans that they can afford.[73] Such a loan would also take advantage of the consumer's expectation that a lender will not make a loan the lender is almost certain will fail.

II. IMPROVIDENT LENDING IN THE PRIVATE STUDENT LOAN MARKET

This section examines the recent application of the ability-to-repay standard to curb improvident, private student loans.[74] In claims against private schools, the CFPB and state attorneys general have alleged that the schools, by offering or guaranteeing loans that their students could not afford, violated the prohibition on unfair or abusive acts or practices.[75] These cases are significant, in large part because the government attorneys successfully developed a new approach to assessing borrowers' ability to repay. Rather than an *ex ante* approach that looks at borrowers' financial situations at consummation to determine whether they could afford a loan,

[71] Dodd-Frank, *supra* note 4, at 2006, sec. 1031 (codified at 12 U.S.C. § 5531 (effective July 21, 2010)).

[72] *Id.* Lee, *supra* note 7, at 122–23 (arguing that Section (2)(A) makes it an abusive practice to fail to adequately assess a consumer's ability to repay based on the extensive empirical literature demonstrating that consumers often fail to understand "common financial products because of their complexity and prolix agreements").

[73] Dodd-Frank, *supra* note 4, at 2006, sec. 1031 (codified at 12 U.S.C. § 5531 (effective July 21, 2010)).

[74] Although this Section focuses on the example of private student loans, it is important to note that the ability-to-repay standard has been applied in other contexts after the financial crisis. *See, e.g.*, Complaint at ¶ 57, CFPB v. Am. Debt Settlement Sols., Inc., No. 9:13-cv-80548-DMM, 2013 WL 12094225 (S.D. Fla. June 7, 2013) [hereinafter Am. Debt. Complaint] (alleging that defendants engaged in abusive practice by enrolling consumers in debt-relief programs they were highly unlikely to complete); Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472, 54,521 (Nov. 17, 2017) (codified at 12 C.F.R. § 1041) [hereinafter CFPB's Payday Rule] (noting that "although the legislative history on the meaning of Dodd-Frank Act's abusiveness standard is fairly limited, it suggests that Congress was particularly concerned about the widespread practice of lenders making unaffordable loans to consumers").

[75] Second Amended Complaint at 73–80, Illinois v. Alta Colls., Inc., No. 14-cv-3786, 2014 WL 4377579 (N.D. Ill. Sept. 4, 2014) [hereinafter Second Amended Complaint]; Complaint for Injunctive Relief and Damages at 1, CFPB v. ITT Educ. Serv., Inc., 219 F. Supp. 3d 878 (S.D. Ind. 2014) (No. 1:14-cv-00292) [hereinafter ITT Complaint].

law enforcement centered their legal arguments on *ex post* evidence, arguing that high default rates indicate that the loans were unaffordable from the start.[76] The shift from an *ex ante* analysis of borrowers' financial situation to an *ex post* review of loan performance gives courts a simple, objective indicator that loans were not affordable.

A. *The Private Student Loan Market and Institutional Loans*

A common feature of predatory lending practices is that profit and performance are decoupled. Put differently, a lender only disregards a borrower's ability to repay when the lender's profit is disconnected from the borrower's ability to repay.[77] Risk-shifting in subprime mortgage lending, collateral churning by "buy here/pay here" car dealers, and wage assignments in small-dollar, high-cost lending separate profit from performance. As explained below, in the market for institutional loans by for-profit colleges, federal law makes it possible to separate profit from performance.

Much of the higher education sector is financed through student loans. There are currently \$1.45 trillion in outstanding student loans.[78] Of that \$1.45 trillion, the vast majority, \$1.3 trillion, consists of federal student loans.[79] For most schools, access to federal student loans is essential to their ability to continue operating. Title IV of the Higher Education Act of 1965 ("HEA") provides the statutory framework for federal student loans.[80] Under Title IV, the Department of Education administers the bulk of federal student loan programs, including the Federal Family Education Loan ("FFEL") Program and the William D. Ford Direct Student Loan Program ("Direct Loan" program).[81]

Proprietary, or for-profit schools,[82] experienced rapid growth in the last two decades.[83] For example, in the 2008–2009 academic year, for-profit schools accounted for 10 percent of all post-secondary degrees (i.e., associate, bachelor's,

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[76] Second Amended Complaint, *supra* note 75, at ¶¶ 12, 127, 152–155, 162, 172, 181; *see also id.* at ¶¶ 112-117, 136, 462–67, 480, 483, 491-492.

[77] *See* Todd J. Zywicki & Joseph D. Adamson, *The Law & Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 12 (2009) (quoting guidance from prudential banking regulators defining predatory lending practices as practices where a lender underwrites a loan based on the value of the borrower's collateral or some measure other than the borrower's ability to repay).

[78] *Consumer Credit Outstanding (Levels) (Q2, 2017)*, BOARD OF GOVERNORS OF THE FED. RES. SYS. (Mar. 7, 2018), https://www.federalreserve.gov/releases/g19/HIST/cc_hist_memo_levels.html [https://perma.cc/TWL7-S2X3].

[79] *Student Loan Portfolio (Q2, 2017)*, FED. STUDENT AID, https://studentaid.ed.gov/sa/about/data-center/student/portfolio [https://perma.cc/AC9X-EHPX].

[80] 20 U.S.C. §§ 1070–1099 (2018).

[81] *Id.*

[82] *See* 20 U.S.C. § 1002(b) (2018).

[83] *Undergraduate Enrollment, Figure 4*, NAT'L. CTR. FOR EDUC. STAT. (MAY 2017), https://nces.ed.gov/programs/coe/indicator_cha.asp [https://perma.cc/Z2RH-MUJB].

and master's), up from 4 percent in 1998–1999.[84] In the 2010–2011 academic year, for-profit schools enrolled approximately 2.4 million students or close to 12 percent of all postsecondary students.[85]

For-profit schools offer expensive educational programs of dubious merit and target their services to vulnerable populations.[86] As a result, for-profit schools are subject to several regulatory constraints on their operation, including a limit on the percentage of income they are allowed to receive under Title IV of the HEA, a requirement commonly referred to as the 90/10 Rule. The 90/10 Rule requires that for-profit schools obtain 10% of their income from non-Title IV sources.[87] The 90/10 Rule was designed to ensure for-profit schools were not set up to solely take advantage of federal funds for private education and modeled in part on amendments to the original G.I. Bill.[88]

In practice, the 90/10 Rule has the unintended consequence of creating financial products that are loss leaders, designed to allow schools access to Title IV money.[89] These products are often referred to as "institutional loans" because they are made or guaranteed by the post-secondary institution the borrower attends.[90] For a time, students regularly obtained loans from banks to cover the 10 percent of their costs not covered by private loans. However, in the late 2000s, banks retreated from

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[84] *See* Anthony J. Guida & David Figuli, *Higher Education's Gainful Employment and 90/10 Rules: Unintended "Scarlet Letters" for Minority, Low-Income, and Other At-Risk Students*, 79 U. CHI. L. REV. 131, 137 (2012).

[85] *See* Sarah Ann Schade, *Reining in the Predatory Nature of For-Profit Colleges*, 56 ARIZ. L. REV. 317, 320 (2014). Changes to federal regulations over the past five years have reduced enrollment at for-profit schools. *See Undergraduate Enrollment*, *supra* note 83. The current Department of Education, however, has initiated formal rulemaking to rollback these regulations, which present the possibility of a rebound in enrollment at for-profit schools. *See, e.g.*, Negotiated Rulemaking Committee; Public Hearings, 82 Fed. Reg. 27,640, 27,640–41 (June 16, 2017).

[86] *See* Schade, *supra* note 85, at 322–27. *But see* Guida & Figuli, *supra* note 84, at 141 (acknowledging that for-profits target their services at low-income consumers at high risk of not completing their educational program but contending that demographic factors as opposed school quality and cost are responsible consumers' high risk).

[87] *See* 20 U.S.C. § 1094(a)(24) (2018).

[88] For more detailed background on the 90/10 rule, see generally Jaclyn Patton, *Encouraging Exploitation of the Military by For-Profit Colleges: The New GI Bill and the 90/10 Rule*, 54 S. TEX. L. REV. 425 (2012) (providing history of 90/10 rule and arguing against allowing GI Bill funds to satisfy proprietary schools' 10 percent requirement).

[89] *See* STAFF OF S. COMM. ON HEALTH, EDUC., LABOR AND PENSIONS, 112TH CONG., REP. ON FOR-PROFIT HIGHER EDUCATION: THE FAILURE TO SAFEGUARD THE FEDERAL INVESTMENT AND ENSURE STUDENT SUCCESS 144–46 (Comm. Print 2012), https://www.help.senate.gov/imo/media/for_profit_report/PartI-PartIII-SelectedAppendixes.pdf [https://perma.cc/U325-G7VY] [hereinafter FOR-PROFIT HIGHER EDUCATION].

[90] *See id.* at 117, 135.

making private student loans because of the financial crisis.[91] For-profit schools were left without an income source to fill the 10% requirement, and thus risked losing access to Title IV funds, an outcome that would have put many out of business.[92] In response, schools began to issue their own loans, 50 percent of which could be immediately booked as non-Title IV income.[93] Schools also began to engineer private loan programs issued through third parties, which the schools guaranteed in the event of default.[94] This enabled schools to book 100 percent of the income as non-Title IV upon origination of the loan.[95] Regardless whether the school operated as an originator or a guarantor, the for-profit schools made the loans for the purpose of being eligible for Title IV funding; they had no expectation of loans being repaid.

B. For-Profit College Litigation

Following the financial crisis of 2008, state attorney generals' offices and the newly created CFPB began to see institutional loans crop up in consumer complaints against for-profit schools.[96] In 2014, the Illinois Attorney General ("Illinois AG") and the CFPB both filed complaints[97] against for-profit colleges, claiming that they had engaged in unfair and abusive practices with respect to institutional loans they provided or guaranteed.[98] These cases led to some of the first court opinions on what

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[91] *See id.*; DEANNE LOONIN, NAT'L CONSUMER LAW CTR., TOO SMALL TO HELP: THE PLIGHT OF FINANCIALLY DISTRESSED PRIVATE STUDENT LOAN BORROWERS 6 (2009), http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/TooSmalltoHelp.pdf [https://perma.cc/S3P7-RDAF]; CFPB, PRIVATE STUDENT LOANS 33–34 (Aug. 29, 2012) http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf [https://perma.cc/S3P7-RDAF].

[92] FOR-PROFIT HIGHER EDUCATION, *supra* note 89, at 137–38; Robert Kelchen, *How Much Do For-Profit Colleges Rely on Federal Funds?*, BROOKINGS INST. (Jan. 11, 2017), https://www.brookings.edu/blog/brown-center-chalkboard/2017/01/11/how-much-do-for-profit-colleges-rely-on-federal-funds/ [https://perma.cc/WD9B-5BCC].

[93] FOR-PROFIT HIGHER EDUCATION, *supra* note 89, at 144.

[94] *Id.* at 144–46; 20 U.S.C. § 1094(d)(1)(D) (2018); Complaint at ¶¶ 62–67, CFPB v. Aequitas Capital Mgmt., Inc., No. 17-1278 (D. Or. Aug. 17, 2017) [hereinafter Aequitas Complaint].

[95] FOR-PROFIT HIGHER EDUCATION, *supra* note 89, at 144–46.

[96] *See The Looming Student Debt Crisis: Providing Fairness for Struggling Students: Hearing Before the S. Subcommittee on Admin. Oversight and the Cts. of the S. Comm. on the Judiciary*, 112th Cong. 4, 6, 36, 44 (2012) (testimony of Illinois Attorney General Lisa Madigan and Kentucky Attorney General Jack Conway); CFPB, ANN. REP. OF THE STUDENT LOAN OMBUDSMAN 11 (2012), http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf [https://perma.cc/4LAW-GRPP].

[97] As described in the next Section, the Illinois Attorney General amended an existing complaint which alleged state law UDAP violations by the school.

[98] Second Amended Complaint, *supra* note 75; ITT Complaint, *supra* note 75.

constitutes a valid claim for abusiveness under the CFPA.[99] More recently, the CFPB took action against Aequitas Capital Management ("Aequitas"), a hedge fund that financed Corinthian Colleges' institutional loans, making similar allegations.[100] In all of these cases, law enforcement alleged high default rates as evidence that the schools were not considering ability to repay. This Section provides background on the claims made in each case and the way federal courts evaluated these claims.

1. Illinois v. Westwood College

Westwood College was a national for-profit, post-secondary school with four campuses in Illinois and an online school that operated in Illinois.[101] The Illinois AG filed a lawsuit against Westwood and its parent company Alta Colleges in January 2012 in Illinois state court, alleging various state UDAP violations, including misrepresentations about cost, transferability of credits, accreditation, and career opportunities.[102] In 2014, the Illinois AG amended its complaint against Westwood to include claims that Westwood's institutional loan program was unfair under the Illinois UDAP statute and unfair and abusive under the CFPA.[103] Central to the claims was the fact that Westwood continued to make institutional loans despite an extraordinarily high default rate.[104] The Illinois AG alleged that Westwood's institutional loans defaulted at rates from 50–90 percent, depending on the cohort, and that the loans were nothing more than a loss-leader designed to ensure access to Title IV funding under the 90/10 Rule.[105]

The Illinois AG alleged that making loans knowing that 50–90 percent of the students would default was unfair under Illinois's UDAP statute and the CFPA.[106] The Attorney General also alleged that these practices were abusive under the

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[99] Illinois v. Alta Colls., Inc., No. 14-cv-3786, 2014 WL 4377579 (N.D. Ill. Sept. 4, 2014); CFPB v. ITT Educ. Servs., Inc., 219 F. Supp. 3d 878 (S.D. Ind. 2015).

[100] Aequitas Complaint, *supra* note 94. Several state attorneys general simultaneously settled with the SEC receiver winding down Aequitas's assets. The allegations in those settlements are similar to the CFPB's. This Article only discusses CFPB's consent judgment. *See, e.g.*, Ally Marotti, *Ex-Corinthian Students in Illinois Could be Eligible for Part of $11.6M Settlement*, CHI. TRIB. (Aug. 18, 2017, 4:18 PM), http://www.chicagotribune.com/business/ct-corinthian-student-loans-settlement-0819-biz-20170818-story.html [https://perma.cc/X6JF-4392] (describing settlement between the Aequitas Receiver, the CFPB and 13 state attorneys general).

[101] Second Amended Complaint, *supra* note 75, at ¶ 1.

[102] Complaint for Injunctive and Other Relief, Illinois v. Alta Colls., Inc., 2014 WL 4377579 (N.D. Ill. Sept. 4, 2014) (No. 12 CH 01587).

[103] The Westwood matter was removed to federal court in May 2015 following the amendment to the complaint that added the CFPA claims, providing a basis for federal question jurisdiction. Second Amended Complaint, *supra* note 75.

[104] Second Amended Complaint, *supra* note 75, at ¶¶ 136, 462–67.

[105] *Id.* at ¶¶ 90, 113–14.

[106] *Id.* at ¶¶ 467, 479–80.

CFPA.[107] In particular, the Illinois AG alleged that Westwood took unreasonable advantage of students' reasonable reliance on the school to act in their interest in violation of the CFPA, by "[p]ushing students into expensive, high-risk loans Defendants' [sic] knew the majority of students would default on for the purpose of enabling federal funding to support Defendants' revenue stream."[108] The Illinois AG further alleged that by failing to tell students that a majority would default on the institutional loans, Westwood materially interfered with the ability of consumers to understand the terms and conditions of the institutional loan program;[109] took unreasonable advantage of students' lack of understanding of the risks, costs, and conditions of the institutional loan program;[110] and took unreasonable advantage of a borrower's inability to protect their interest in selecting or using the institutional loan program.[111]

Westwood moved to dismiss the Illinois AG's complaint on several grounds, including failure to state a claim for unfairness under the Illinois UDAP and unfairness and abusiveness under the CFPA.[112] In September 2014, the Court denied Westwood's motion to dismiss in what was the first decision in the country to rule on what constitutes a claim for abusiveness under the CFPA.[113] The Westwood Court upheld the Illinois AG's claims that Westwood's institutional loan program was unfair under the Illinois UDAP and unfair and abusive under the CFPA.[114] Acknowledging that the ability to repay was a factor, the Westwood Court noted "[p]laintiff also alleges that Westwood takes these actions knowing that most students will leave Westwood without a degree or the hope of obtaining a well-paying job and with a debt that will take decades to repay and/or the certainty of being hounded by collection agencies."[115]

2. CFPB v. ITT Technical Institute

ITT was a large, national for-profit college with campuses across the country.[116] In 2014, the CFPB sued ITT alleging that the school engineered and directed an institutional loan program that was unfair and abusive.[117] The CFPB alleged that ITT offered certain financially needy students short term, no interest

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[107] *Id.* at ¶¶ 485–93.

[108] *Id.* at ¶ 491(d).

[109] *Id.* at ¶ 492(c).

[110] *Id.* at ¶ 492(d).

[111] *Id.* at ¶ 492(e).

[112] Illinois v. Alta Colls., Inc., No. 14-cv-3786, 2014 WL 4377579, at *2, *5 (N.D. Ill. Sept. 4, 2014).

[113] *Id.* at *1–*4.

[114] *Id.* at *1–*5.

[115] *Id.* at *2.

[116] ITT Complaint, *supra* note 75.

[117] *Id.*

loans upon enrollment, to meet the "tuition gap" created in part by the 90/10 rule.[118] ITT referred to this loan program as "temporary credit."[119] When the temporary credit came due, the CFPB alleged that students were pulled out of class and told that they had to pay off the temporary credits to continue their education.[120] Students were presented with the "option" of paying immediately or taking out institutional loans with third-party lenders.[121] Because students enrolled in the temporary credit program were predominantly low-income, the CFPB alleged that this option was illusory and most students were compelled to enter into high-cost private loans in order to continue their educations.[122] Third-party lenders nominally originated the loans, but the CFPB alleged that the loans were guaranteed by, and effectively offered by, ITT.[123] The CFPB further alleged that ITT knew the loans defaulted at rates exceeding 60 percent and that ITT nonetheless continued the lending program.[124]

Like the *Westwood* Court, the *ITT* Court found that the CFPB had stated unfairness and abusiveness claims under the CFPA, denying ITT's motion to dismiss.[125] ITT argued that the court lacked a standard by which it could measure the affordability of student loans.[126] The court rejected the need for such a measure under the CFPA's unfairness standard, holding that the CFPB "must plead that ITT's conduct harmed the students' welfare, and the facts it has plausibly pled could support such an inference if proven."[127] Among the factors the court identified as supporting the CFPB unfairness claim included the CFPB's allegation that "the students who took out these loans were predominantly in fragile financial health, and, according to ITT's own projections, some 64% of them defaulted, exacerbating their debt and financial distress."[128]

The holding in *ITT* was also one of the first to rule on what constitutes a claim for abusiveness.[129] First, the Court held that CFPB's allegation that ITT had taken unreasonable advantage of its students by steering them into loans with a known default rate in excess of 60 percent in order to achieve financial objectives beyond the return on the loans was sufficient to state a claim.[130] In particular, the court noted:

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[118] *Id.* at ¶¶ 4–5, 97.

[119] *Id.* at ¶¶ 6–12.

[120] *Id.* at ¶ 87.

[121] *Id.* at ¶ 110.

[122] CFPB v. ITT Educ. Servs., Inc., 219 F. Supp. 3d 878, 918 (S.D. Ind. 2015).

[123] ITT Complaint, *supra* note 75, at ¶ 8–11.

[124] *Id.* at ¶ 127.

[125] *ITT Educ. Servs., Inc.*, 219 F. Supp. 3d at 915–21.

[126] *Id.* at 914.

[127] *Id.*

[128] *Id.* at 913.

[129] *See id.* at 918–21 (discussing the CFPB's counts alleging "abusive" acts or practices).

[130] *Id.* at 918.

> [T]he Bureau has alleged that signing up students for the private loans enabled ITT to clear the "doubtful assets" represented by the Temporary Credit off its balance sheets, converting it into "immediate income and cash-on-hand." In fact, the Bureau's allegations quote senior ITT officials stating that ITT designed the loan programs precisely in order to derive such an economic benefit from them.[131]

Second, the *ITT* Court held that the CFPB adequately pled that students were unable to protect their interests due to the unequal bargaining power of ITT relative to the students.[132] The court reasoned this bargaining asymmetry created oppressive circumstances that students were not able to *practically* avoid, noting similarities between the "unreasonable advantage" under the CFPA and common law unconscionability:

> A reasonable reading of the statutory language, however, is that it refers to oppressive circumstances—when a consumer is unable to protect herself not in absolute terms, but *relative to* the excessively stronger position of the defendant. *See, e.g.*, *Ting v. AT & T*, 319 F.3d 1126, 1148–1149 (9th Cir.2003) (noting that, under doctrine of procedural unconscionability, a literal, physical lack of consumer choice is not necessary to show oppressiveness). *See also* Carey Alexander, *Abusive: Dodd–Frank Section 1031 and the Continuing Struggle to Protect Consumers*, 85 ST. JOHN'S L. REV. 1105, 1114–1119 (2011) (discussing the legislative history of the "abusive" standard as consistent with the understanding that it is a statutory codification of the common-law doctrine of unconscionability).[133]

Finally, the *ITT* court held that ITT took advantage of students' "reasonable reliance" that ITT would act in their interests and not steer them into risky loans with high default rates that would undermine their ability to succeed in college and find employment after college.[134]

3. CFPB v. Aequitas

Aequitas, unlike ITT and Westwood, was not a school. Aequitas was a hedge fund that provided capital to Corinthian Colleges ("Corinthian"), another major for-profit school, in order to fund Corinthian's institutional loan program.[135] Aequitas would buy the loans made by third parties, effectively funding the loans.[136] Aequitas

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[131] *Id.*
[132] *Id.* at 919–20.
[133] *Id.* at 919.
[134] *Id.* at 920.
[135] Aequitas Complaint, *supra* note 94, at ¶ 1.
[136] *Id.* at ¶¶ 1, 4, 24, 28.

would continue to collect on these loans as long as they were current.[137] Similar to ITT, Corinthian guaranteed the loans and would buy the loans from Aequitas when the loans became delinquent.[138] The Aequitas loans allowed Corinthian to stay in compliance with the 90/10 Rule through the façade that the loans were made by a third party.[139] Compliance with 90/10 allowed Corinthian access to federal student loans, which gave it the capital to guarantee the loans, mitigating Aequitas's risk.[140]

In its complaint against Aequitas, the CFPB alleged that Aequitas engaged in abusive acts and practices by funding Corinthian's loan program.[141] In particular, the CFPB alleged that Aequitas funded Corinthian's loans program knowing the program was a "sham" with no economic substance and offered as a naked form regulatory arbitrage to get around the 90/10 rule.[142] The CFPB further alleged that Aequitas' practices were abusive because default rates on Corinthian's loan program "were historically high—between 50 and 70 percent"[143] and Aequitas "knew but disregarded the fact that most Corinthian student borrowers would default on these loans and would suffer the consequences of such defaults."[144]

C. An Emerging Performance-Based Standard in Consumer Law

A brief survey of recent law enforcement actions against for-profit colleges reveals two new trends in consumer law. First, attorneys general and the CFPB have begun crafting unfairness and abusiveness claims based on defendants' failure to assess borrowers' ability to repay nonmortgage loans and, to date, courts have sanctioned this view.[145] Second, the CFPB and state attorneys general have established that data on *ex post* loan performance can serve as evidence of improvident lending.[146]

The modern evolution of improvident lending began with lawsuits against subprime mortgage lenders, claiming that they violated state law unconscionability and UDAP statutes by failing to consider whether borrowers could afford their

[137] *Id.* at ¶ 14.

[138] *Id.* at ¶¶ 29, 90.

[139] *Id.* at ¶¶ 3–4.

[140] *Id.* at ¶ 89–90.

[141] *Id.* at ¶¶ 111–26. Aequitas was taken into SEC receivership, and the SEC receiver entered into a consent judgment with the CFPB, which was filed at the same time as the CFPB's complaint. SEC v. Aequitas Capital Management et al., No. 3:16-cv-00438-PK, (D. Ore, Mar. 16, 2016) (Stipulated Interim Order appointing Receiver).

[142] *Id.* at ¶¶ 119, 122.

[143] *Id.* at ¶ 5.

[144] *Id.* at ¶ 121.

[145] *Id.; See* Second Amended Complaint, *supra* note 75, at ¶¶ 79–84; ITT Complaint, *supra* note 75, at ¶¶ 166–82.

[146] *See* Illinois v. Alta Colls., Inc., No. 14-cv-3786, 2014 WL 4377579, at *1–*4, (N.D. Ill. Sept. 4, 2014); CFPB v. ITT Educ. Servs., Inc., 219 F. Supp. 3d 878, 915–21 (S.D. Ind. 2015).

loans.[147] The evidence used to determine whether lenders made unaffordable loans focused on the borrowers' finances and their loan terms at the time the lenders originated the loans. For example, in *Fremont*, the factors used to demonstrate that the lender knew the borrowers would not be able to repay their loans were known to Fremont when it made the loans.[148] Similarly, in *City Financial Services*, the Court concluded that a borrower's loan was unconscionable based on her debt-to-income ratio at origination.[149] The focus on *ex ante* risk assessment was not only central to legal claims against lenders, but also formed a core part of the scholarly push towards a federal suitability standard.[150] Mortgage regulation has a long history of prescriptive underwriting rules. As such, it is perhaps natural that litigants turned to objective underwriting standards to demonstrate that mortgage lenders failed to consider ability-to-repay.

The CFPB and state attorneys general have expanded the jurisprudence on improvident lending to use loan default rates to demonstrate lenders' failure to consider borrowers' ability to repay.[151] Cases alleging improvident student lending provided a natural forum for this expansion because there is a basis in federal regulation to use an *ex post* analysis. The federal cohort default rate examines the percent of federal student loans that are in default three years after the loans enter repayment.[152] If the default rate at a given institution exceeds certain thresholds, the institution loses access to Title IV funding.[153] In addition, in the private student loan market, it is widely acknowledged that underwriting is imperfect,[154] making default rates a superior measure of affordability. Students often have a limited credit history or are embarking on a new career, limiting the ability of financial institutions to assess their ability to pay.[155]

Default rate, however, is not the only way to measure unaffordability *ex post* and recent regulations in student and payday lending provide alternate measures.[156]

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147 *See* discussion *supra* Part I.C.

148 Commonwealth v. Fremont Inv. & Loan, 897 N.E.2d 548, 554 (Mass. 2008).

149 City Fin. Servs v. Smith, No. 97 CVF 00679, 2000 WL 288469, at *2 (Ohio Mun. Ct. Jan. 4, 2000).

150 *See* Engel & McCoy, *supra* note 3, at 1334.

151 ITT Complaint, *supra* note 75, at ¶ 12.

152 34 C.F.R. § 668.202(a)(2) (2018).

153 *Id.* at § 668.206(a).

154 *See* ANDREW P. KELLY & KEVIN J. JAMES, AM. ENT. INST., LOOKING BACKWARD OR LOOKING FORWARD? EXPLORING THE PRIVATE STUDENT LOAN MARKET (2016), https://www.luminafoundation.org/files/resources/looking-backward-or-looking-forward.pdf [https://perma.cc/35JT-3N8G]. Federal student loans, by contrast, are not underwritten for risk, but have a host of borrower protections that are not available for private student loans that make them more appropriate from an ability to repay standpoint such as income-driven repayment (*see* 34 C.F.R. § 685.209 (2018)), disability discharge (*see id.* at § 685.213), and closed school discharge (*see id.* at § 685.214).

155 KELLY & JAMES, *supra* note 154, at 2.

156 *See* Willis, *supra* note 9, at 1311 (noting that "[p]erformance-based regulation is . . . more functional and more adaptive than prescriptive regulation").

One example is Department of Education's Gainful Employment Rule, which seeks to measure whether students have sufficient income to repay their student loans.[157] Programs where graduates' debt-to-income ratio is too high must inform prospective students and can ultimately lose access to federal student loans.[158] Another example is repayment rate, a relatively new statistic that measures the rate of loans where at least $1 of principal is paid down within five years.[159] Repayment rate has been lauded as a superior measure of federal student loan performance when compared with the cohort default rate, as it cuts out the effects of deferments and forbearances, which can mask whether payments are being made in the short term.[160] Finally, the CFPB's recently finalized payday regulations look to re-borrowing as evidence of a lender's failure to consider a borrower's ability to repay.[161] These three examples are attempts to determine the affordability of a loan with flexible performance-based standards as opposed to static underwriting limits.

CONCLUSION

In their landmark article, *Making Credit Safer*, Oren Bar-Gill and Elizabeth Warren lamented the fact that courts were "very circumspect" about applying doctrines such as unconscionability to lending practices.[162] Recent law enforcement actions against for-profit colleges, however, have shown that some courts are willing to apply state UDAP and the CFPA to improvident lending. One explanation for this shift could be changing attitudes in courts after the financial crisis. A second

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[157] 34 C.F.R. §§ 668.401–.415 (2018). In June 2017, however, the U.S. Dept. of Education announced a new negotiated rulemakings on the gainful employment rules. Negotiated Rulemaking Committee; Public Hearings, 82 Fed. Reg. 27,640, 27,640 (June 16, 2017).

[158] 34 C.F.R. §§ 668.401–.415 (2018). The U.S. Department of Education stopped implementation of some gainful employment disclosures and calculations. *See* Program Integrity: Gainful Employment, 82 Fed. Reg. 30,975 (Jul. 5, 2017). Several state attorneys general have challenged these delays. *See* Complaint, State of Maryland et al. v. United States Department of Education et al., No. 1:17-cv-02139, (D. D.C. Oct. 17, 2017).

[159] *See* Michael Stratford, *A Tougher Test for Colleges*, INSIDE HIGHER ED (Sept. 23, 2015), https://www.insidehighered.com/news/2015/09/23/new-college-scorecard-repayment-data-fuels-debate-over-accountability-higher-ed [https://perma.cc/N6D3-NR75].

[160] *See, e.g.*, *id.*; *see also* Doug Lederman, *A More Meaningful Default Rate*, INSIDE HIGHER ED (Nov. 30, 2007), https://www.insidehighered.com/news/2007/11/30/defaults [https://perma.cc/B6L9-SS7B] (discussing the benefits of extending the cohort default rate from two to three years and noting the pros and cons of the CDR as a measurement, including the problem of forbearances).

[161] *See* CFPB's Payday Rule, *supra* note 74, at 54,631.

[162] *See* Bar-Gill & Warren, *supra* note 2, at 71. *But see* State of Colorado et al. v. Center for Excellence in Higher Education et al., No. 2014 CV 34530 (Denver Dist. Ct., Oct. 13, 2017) (Order denying defendants motion for summary judgment on UCCC Administrator and state attorney general's claim that school's institutional loan program was unconscionable under Colorado state UCCC.).

explanation is that recent cases using *ex post* evidence made ability to repay easier to evaluate. High-default rates are simple, objective indicators that loans were not affordable. In contrast, analyzing whether a loan was adequately underwritten to determine whether a borrower could afford the loan is more nuanced and necessarily involves a great deal of information; the inquiry must include examining the borrower's financial situation in light of the loan terms. Courts' increased willingness to entertain improvident lending claims and the ease with which *ex post* default evidence can be marshaled provide some hope for regulators and private litigants who seek to curb predatory lending practices.

The current President and Congress seem intent on rolling back many of the federal protections put in place in the last decade to prevent another financial crisis.[163] Moreover, certain regulators are attempting to use federal preemption of state law to blunt state efforts to regulate unfair and abusive lending practices.[164] In this environment, the ability of state law enforcement to bring claims against entities engaged in predatory lending for violations of laws of general applicability is increasingly important. The CFPB and Illinois AG's claims against for-profit colleges provide a useful template for future actions.

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[163] *See* Negotiated Rulemaking Committee; Public Hearings, *supra* note 157 (announcing new negotiated rulemaking for gainful employment regulations). The same Federal Register notice announced a new rulemaking for borrower defense to repayment regulations. Rescission of Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products, 82 Fed. Reg. 74,602, 74,602 (Oct. 12, 2017) (rescinding prior guidance restricting small dollar, high-cost loans issued by banks in direct response to the promulgation of the CFPB's Payday Rule).

[164] *See* Federal Preemption and State Regulation of the Department of Education's Federal Student Loan Programs and Federal Student Loan Servicers, 83 Fed. Reg. 10619 (Mar. 12, 2018). Prior to the issuance of the Department of Education's Interpretation, a bi-partisan group of twenty six state attorneys general sent a letter to Secretary DeVos arguing that the Department lacked the power to issue binding preemption guidance and that now was the time for the Department to work with state partners to stop student loan fraud and protect borrowers. *See* Letter from N.Y. Att'y Gen., to Betsy DeVos, Sec'y, U.S. Dep't of Educ. (Oct. 23, 2017), http://www.illinoisattorneygeneral.gov/pressroom/2017_10/The-Honorable_Betsy_DeVos.pdf [https://perma.cc/3YJM-H8VY].

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