Why Private Equity Firms Should Pay Attention to the U.S. Consumer Financial Protection Bureau

October 19, 2022

Private equity firms that invest in the consumer finance space (or want to) should take note that another regulator in Washington is looking to add itself to the alphabet soup of federal agencies that flex their muscles against the private equity industry. In the year since the Consumer Financial Protection Bureau (CFPB) has been under Director Rohit Chopra's leadership, the agency has fired warning shots at the private equity firms that provide the capital and strategic leadership to companies that offer financial products and services to consumers.

Those warning shots include the "naming-and-shaming" of private equity firms invested in companies against which the Bureau has taken public enforcement actions. The press releases announcing enforcement actions against prepaid debit card provider JPay, Inc., and the affiliated companies comprising the remittance transfer business known to the general public as MoneyGram, identified their owners. Notably, the CFPB made no allegations of wrongdoing against those owners, but the agency clearly intended to inflict a reputational wound against the private equity firms that dared to fund companies whose practices the CFPB contends violate the law. A joint CFPB and Department of Justice settlement last summer against Trident Mortgage Company, LP, went even further, identifying Berkshire Hathaway as the ultimate holding company in the federal complaint filed in tandem with the consent order. As in the JPay and MoneyGram matters, the description of Berkshire Hathaway is limited solely to its corporate relationship, but the salacious allegations of discriminatory lending and redlining outlined in detail in the complaint inflict reputational damage on the parent entity.

Director Chopra has also criticized the "private equity takeovers" of the $240 billion-a-year nursing home industry, noting that incentives to maximize investor returns may lead to the "increased risks of [] financial exploitation" of America's elderly population. The CFPB's priorities in this space undoubtedly will include debt collection (and, downstream from that, credit reporting of nursing home debt), areas in which the agency may exercise jurisdiction.

What sort of legal theories could the CFPB assert against a private equity firm? The CFPB has authority to enforce federal consumer financial laws, including a prohibition on unfair, deceptive, or abusive acts or practices (UDAAP) contained in Consumer Financial Protection

Act of 2010 (CFPA), the statute that authorized the CFPB's creation, against covered persons and their service providers. Covered persons are those engaged in the offering or providing of statutorily-enumerated consumer financial products or services, and service providers refers to those that provide material services to covered persons in connection with the latter's offering or providing of consumer financial products or services.[1] These are the statutory authorities underpinning the CFPB's enforcement actions against entities that maintain deposit accounts, make payday loans, collect debts, furnish information to credit reporting agencies, service mortgages, and service auto loans.

That's a lot of jargon, but further unpacking these and other definitions in the CFPA reveals how a firm that invests in consumer finance companies might become subject to the CFPB's jurisdiction. Under the CFPA, a covered person also includes the affiliate of a covered person that acts as its service provider.[2] An affiliate, in turn, includes any person that controls another person,[3] which is not defined but could, depending on the facts, extend to a private equity firm invested in the subject company. The CFPB may also enforce against related persons, which includes, among others, directors and officers with managerial responsibility for, or controlling shareholders of, a covered person.[4] The definition also includes shareholders or other persons that materially participate in the conduct of a covered person's affairs.[5] Of course, being a "related person" is only half the equation; the CFPB must also show the related person—like a covered person—committed a UDAAP or violated a federal consumer financial law.

The final arrow in the CFPB's quiver, substantial assistance, might be the most potent, and yet its contours remain largely unknown due to a paucity of case law and administrative consent orders that might shed light on possible legal interpretations. The CFPB can bring an enforcement action against anyone that knowingly or recklessly provides substantial assistance to a covered person or service provider in the commission of a UDAAP.[6] Merely investing in a covered person or service provider is unlikely to give rise to substantial assistance liability, but facts suggesting a private equity firm's knowledge or reckless indifference to potential UDAAPs by a portfolio company could support a potential case by the CFPB under this authority.

It may be only a matter of time before a private equity firm is named as a party to a CFPB consent order or defendant in an enforcement lawsuit. Indeed, private equity firms may have found themselves ensnared in CFPB investigations already. With limited exceptions not applicable here, the CFPB may use its investigative tools—including the issuance of civil

---

1 12 U.S.C. § 5481(6)(a), (26).

2 12 U.S.C. § 5481(6)(b).

3 12 U.S.C. § 5481(1).

4 12 U.S.C. § 5481(25)(c)(i).

5 12 U.S.C. § 5481(25)(c)(i)(ii).

6 12 U.S.C. § 5536(a)(3).

investigative demands for documents and testimony—against anyone to obtain information relevant to potential violations of the laws it enforces, even if they would not be subject to the CFPB's enforcement jurisdiction.[7] These demands may seek information about the financial and managerial arrangements between a private equity firm and its consumer finance portfolio company.

If the CFPB develops facts to support holding a private equity firm liable for a violation of one of the many federal consumer financial laws it enforces, the incentive to bring that action may prove irresistible. Obtaining relief against an owner advances the remedial objectives that underpin the agency's enforcement priorities, including payment of civil money penalties, restitution to consumers, and injunctive measures that could include industry bans, or, in the case of LendUp, an order to cease certain business activities that effectively shuttered the entity.

More significantly, the CFPB, like other federal regulators, uses enforcement action to message the industry at large. Any action against a private equity firm might result in firms potentially engaging in additional due diligence and exercising an even higher level of regulatory oversight of business practices of the consumer finance companies in their portfolios. Such additional diligence and oversight could include attention to both the nature and volume of consumer complaints about business practices, and how the portfolio company handles remediation.

* * *

Please do not hesitate to contact us with any questions.

NEW YORK

Courtney M. Dankworth
cmdankworth@debevoise.com

WASHINGTON, D.C.

Jehan A. Patterson
jpatterson@debevoise.com

[7] 12 U.S.C. § 5562(c).