



August 9, 2021

IN “FIRST OF ITS KIND” CONSENT ORDER CA DFPI TO REGULATE INCOME SHARE AGREEMENT SERVICER

On August 5th, the California Department of Financial Protection and Innovation (“DFPI”) entered into a consent order with a fintech that provides software to schools and other institutions to enable the institutions to issue income share agreements (“ISAs”). The fintech also services the ISAs for the institutions. Under the consent order, the DFPI granted conditional approval for the fintech to obtain a student loan servicer license under the California Student Loan Servicing Act (“SLSA”). The fintech had voluntarily applied for the servicer license in April.

In its press release, the DFPI described the consent order as “the first of its kind” to subject an ISA servicer to state licensing and regulation. The DFPI expects to clarify requirements for ISA providers and servicers through future rulemaking as ISAs become increasingly popular financing options for post-secondary education and training expenses.

Under an ISA, a student agrees to repay a school a certain percentage of the student’s future gross income after graduation, but only if certain conditions are met, such as the student is employed and earns a certain level of income. According to the DFPI, ISA issuers have not treated ISAs as loans or credit but rather as contingent debt. Accordingly, ISA issuers generally have not followed federal and state laws regulating loans or credit.

In the consent order, the DFPI concluded that ISAs made solely for use to finance postsecondary education are “student loans” for purposes of the SLSA. The DFPI noted that the definition of “student loan” under the SLSA generally encompasses “any loan” or “extension of credit” and does not exclude contingent debts or ISAs. The DFPI also observed that the SLSA defines “student loans” by the purposes for which financing is used (*i.e.*, postsecondary expenses) instead of the type of financing agreement used. The DFPI believed the state legislature intended contingent debt (including ISAs) to be regulated under the SLSA if the contingent debt is used to finance postsecondary expenses.

Notably, the consent order describes ISAs as contingent debt and not purchase transactions. Historically, some ISAs have been designed as a purchase of a percentage of a student’s future income.

Structured as a purchase, a transaction arguably would not be a loan or credit product subject to credit regulation. Whether the DFPI will respect this product distinction in future SLSA enforcement remains to be seen.

The DFPI has not been shy to enter into “first of its kind” agreements with innovative financial services providers. In January 2021, the DFPI signed a memorandum of understanding with five earned wage access companies that enabled the companies to continue to operate in California. See DT ALERT of Feb. 1, 2021. In its press release, the then-DFPI Commissioner said generally “these first of their kind agreements reflect the type of balanced approach and oversight we strive to provide that encourages responsible innovation.” When California acts, it is not uncommon for other states to follow. We will continue to monitor any state law developments on the regulation of ISAs. □

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