UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No. SACV 15-1329-JLS (JCGx) Date: December 14, 2016
Title: Consumer Financial Protection Bureau et al. v. Pension Funding, LLC et al.

Present: **Honorable JOSEPHINE L. STATON, UNITED STATES DISTRICT JUDGE**

Terry Guerrero	N/A
Deputy Clerk	Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFF:	ATTORNEYS PRESENT FOR DEFENDANT:
Not Present	Not Present

PROCEEDINGS: (IN CHAMBERS) ORDER APPROVING IN PART THE RECEIVER'S REPORT AND RECOMMENDATIONS (Doc. 116)

Before the Court is the Receiver Krista Freitag's unopposed Forensic Accounting Report and Recommendations. (Report, Doc. 116.) For the reasons provided below, the Court APPROVES IN PART the Receiver's Report and Recommendations.

I. THE RECEIVER'S FINDINGS

On August 20, 2015, CFPB brought an enforcement action against Defendants Pension Funding, LLC, Pension Income, LLC, Steven Covey, Edwin Lichtig, and Rex Hofelter. (Compl., Doc. 1.) The Complaint alleged violations of the Consumer Financial Protection Act and various New York regulations stemming from Defendants purported involvement with and sale of so-called "pension advances," defined as "lump-sum payments that consumers could receive in return for agreeing to redirect all or part of their pension payments, over eight years, to repay the funds." (*Id.* ¶ 1.)

On January 7, 2016, pursuant to a stipulation between CFPB and all of the Defendants except Covey (Stip., Doc. 57), the Court entered a preliminary injunction enjoining certain conduct by Defendants (PI, Doc. 61.) In relevant part, the injunction appointed Freitag, of E3 Advisors, as the "receiver of Pension Funding, LLC and Pension Income, LLC[.]" (*Id.* at 3.) In her role as receiver, Freitag was permitted to "employ attorneys, accountants, and others to investigate, advise, and where appropriate, to institute, pursue, and prosecute all claims and causes of action of whatever kind and nature which may now or hereafter exist[.]" (*Id.* at 6.)

As noted in the Receiver's Forensic Report, the Receivership Entities used Investor funds to cover (1) the lump sum payments to Pensioners; (2) commissions and agency fee payments; (3) "the Receivership Entity Management Fee, Life Insurance and Reserve impound accounts"; and (4) the "Receivership Entity 'profit.'" (Report at 3.) After a Pensioner received his or her lump sum, the Pensioner's monthly payments were payable to the paired Investor. (*Id.*) These Investors include third parties, insiders, and the Receivership Entities. (*Id.* at 3-4.) In total, there are 286 Pensioners and183 Investors (four insider Investors and 179 third-party Investors). (*Id.* at 8.) Several Pensioners entered into multiple agreements with Investors. (*Id.*)

Most of the Investor-Pensioner pairings were memorialized through multiple documents. First, the Investor signed the Offer Sheet, which provides basic information about the Investor-Pensioner pairing. (*Id.* at 4.) Second, the Investor signed a document acknowledging the risks of the transaction (the "Risks Document"). (*Id.* at 4-5.) Although the Risks Document indicates that the source of repayment "should be secure and at the low end of the risk scale," the document continues by detailing several risks of the transaction. (*Id.*) Third, Investors and the Receivership Entities signed the "Buyer's Master Agreement," which characterizes the Receivership Entities as an escrow agent matching Pensioners with Investors. (*Id.* at 5.) This document also indicates how much of the Pensioner's cash flow an Investor would receive and provides that this amount includes a 9% marketing distribution, an 8% default insurance distribution, and a 2.84% death insurance distribution.[1] (*Id.*) Fourth, Investors signed "the Buyer and Reserve Funds Agreement," which purports to protect Investors in the event that their paired Pensioners defaulted or passed away by allocating some of their initial payments to certain reserve accounts. (*Id.* at 5-6.) Fifth, both the Investor and the Pensioner signed the

[1] The Receiver's Report uses the word "redirect" as synonymous with default. (Report at 5 n.3.) But since this meaning of the word "redirect" is hardly intuitive, the Court uses the word "default" instead.

"Buyer and Pensioner Purchase Agreement for Purchase of Future Income Stream" ("BPPA"), which states that the Pensioner agreed to remit his or her pension payments for (typically) 96 months in return for a lump sum payment.[2] (*Id.* at 6.) Sixth, the Receivership Entities made Pensioners sign an agreement authorizing the Receivership Entities "to take legal action . . . via punitive or accommodating relief" if the Pensioner defaulted. (*Id.*) Finally, many Pensioners issued documents granting the Receivership Entities a limited power of attorney so that the Receivership Entities could set up a bank account and conduct transactions on their behalf. (*Id.*)

Most of the files also contained an internal document ("the Waterfall") that calculated the expected return for the Investor and the effective interest rate for the Pensioner. (*Id.* at 7.) While the Receiver did not examine these figures for each Pensioner, a typical transaction involved a 6.14% expected return for the Investor and a 28.55% effective interest rate for the Pensioner. (*Id.*)

The Receiver's Report reveals that the funds set aside to protect Investors against Pensioner defaults have been substantially depleted. (*Id.* at 9.) While the scheme operated, an Investor received his or her monthly payment, regardless of whether the paired Pensioner had defaulted. (*Id.*) Further, the Receivership Entities invested $967,000 of these reserve funds into new Pensioner agreements. (*Id.*) Assuming the depletion of the reserve account funds had continued at the pre-receivership rate, these funds would have been entirely exhausted by August 2016. (*Id.*)

Through her examination, the Receiver has concluded that third-party Investors outlays to Pensioners amounted to $24,968,096, while Investors received $9,796,068 in Pensioner payments and $1,121,777 in reserve subsidies through January 2016. (*Id.* at 10.) Thus, third-party Investors' total losses equal $14,050,251. (*Id.*) The average loss for each investor is approximately 57%, but there is considerable variation. (*Id.*) Early investors have experienced a net loss of approximately 28%, while the most recent investors have suffered a net loss of about 84%. (*Id.*)

[2] A few of the Pensioner agreements were for shorter periods (*e.g.*, 48 or 82 months). (Report at 7.)

The Receiver has concluded that Pensioners have repaid $12,326,637 of the $15,409,684 in lump sum payments they received. (*Id.* at 11.) Thus, $3,083,047 in lump sum payments remain due, as elaborated below:

	Number of Contracts	**Amount Unpaid**
Pensioner Has Passed Away	3	$50,433
Pensioner Has Filed for Bankruptcy	35	$865,025
Pensioner Has Entered a Legal Settlement or a Default Judgment Has Been Secured	11	$323,847
Pensioner Has Defaulted	55	$1,216,344
Pensioner Has Repaid/Overpaid Lump Sum	97	-$672,217
Pensioner Remains Current	104	$1,299,605
Total	**305**	**$3,083,047**

(*Id.* at 11.) As a result of Pensioner deaths and Chapter 7 bankruptcy discharges, $589,851 of this $3,083,047 is unrecoverable. (*Id.* at 12.) The Receiver has filed the necessary proofs of claim in new bankruptcy filings and will continue to do so in any future filings (assuming the debtor has significant asserts that will be distributed to unsecured creditors). (*Id.*) None of the default judgments or default settlements secured against Pensioners have been enforced yet. (*Id.* at 12.) And the Receiver has ceased collection activities against Pensioners who have fully repaid their lump sum(s). (*Id.* at 13.) Finally, after the Receiver sent letters to all defaulted Pensioners, nine of these Pensioners (accounting for ten contracts) have either restarted their payments or pledged to restart their payments. (*Id.*)

After her appointment, the Receiver has significantly increased the cash book balance of the Receivership Entities through collection and recovery efforts. (*Id.* at 17-18.) Specifically, the cash balance of the Receivership Entities has risen from $526,664 at the time the Receiver was appointed to $2,500,797 as of September 30, 2016. (*Id.*) An itemized chart of the Receiver's collection and recovery efforts is provided on page 18 of the Receiver's Report. (*Id.* at 18.) The Receiver has also discovered that the Receivership Entities have a $1.2 million loan participation interest in a commercial note secured by real property in Maryland. (*Id.* at 14-15.) While $100,000 of the principal has been repaid, the original maturity date has long since passed and the date of repayment or foreclosure has not yet been determined. (*Id.* at 15.)

II. RECOMMENDATIONS

In crafting her recommendations to the Court, the Receiver has attempted to balance the interests of the Pensioners against those of the third-party Investors. (*See id.* at 18-19.) The Receiver was appointed due to the Receivership Entities' serious violations of the Consumer Financial Protection Act, New York banking laws, and New York financial services laws. (*See id.*) Considering this serious wrongdoing, collecting the full amount the Pensioners owe would be unjust. (*See id.* at 19.) On the other hand, collecting nothing from the Pensioners would leave them with a windfall. (*Id.*) Thus, the Receiver believes that the appropriate remedy is to collect from the Pensioners only the amount they received in lump sum payments. (*Id.*) This remedy recognizes that the

Receivership Entities made serious misrepresentations but avoids giving Pensioners an unjustified windfall. (*Id.*)

To implement her proposal, the Receiver seeks authorization to begin collection efforts against Pensioners who have not repaid their lump sum payments. (*Id.* at 20.) The Receiver indicates that she "will endeavor to work with Pensioners on payment plans and will focus on keeping collection costs to a minimum." (*Id.*) The Receiver, however, believes that in some circumstances she will need to retain "collection counsel to pursue and enforce claims against Pensioners." (*Id.*) Any fees for collection counsel will be submitted in the Receiver's quarterly fee requests. (*Id.*) For those Pensioners that have fully repaid their lump sum payments, the Receiver proposes to cease collecting any further payments.

Finally, the Receiver seeks to establish a streamlined claims process for the third-party Investors. Through her forensic accounting, the Receiver has calculated each Investor's net loss. (*Id.* at 21.) The Receiver proposes to send a letter to each Investor detailing the Investor's calculated loss and stating that the Investor must respond in thirty days if he or she wishes to dispute this amount. (*Id.*) If the Receiver cannot reach an agreement with an Investor on how much the Investor is owed, a motion will be filed in this Court to resolve the dispute. (*Id.*) If there are insufficient funds to cover all of the Investors' direct losses (as is likely to be the case), the Receiver proposes to use the so-called "money in, money out" methodology to determine how much to distribute to each Investor. (*Id.*) Because of the limited funds available for distribution, Investors will not be able to submit claims for indirect losses or consequential damages. (*Id.* at 22.)

The Court believes that the Receiver's proposals appropriately balance the interests of the Pensioners and Investors, and therefore generally agrees with the Receiver's recommendations. The Court, however, adds the following qualifications: First, any collection efforts against defaulted Pensioners must strictly comply any applicable state or federal collection laws. Second, the Court believes that thirty days is too limited a period for Investors to gather the necessary documentation to challenge the Receiver's calculation of their losses. Instead, Investors should be given sixty days to submit any challenge. Third, the Receiver's letter to Investors detailing their losses must be written in plain English so that Investors can understand the claims process and what documentation they need to submit to contest the Receiver's determination. Fourth, the Court does not believe that judicial proceedings are an efficient way of resolving in the first instance any disputes between Investors and the Receiver. Accordingly, the Receiver must develop an alternative process for resolving disputes that is both impartial and cost effective. Only if this process proves unsuccessful should the Receiver or an Investor seek to resolve a dispute in this Court.

III. CONCLUSION

For the aforementioned reasons, the Court APPROVES IN PART the Receiver's Report and Recommendations. The Receiver is ORDERED to submit an alternative process for resolving disputes with Investors within ten days of this Order.

Initials of Preparer: tg