

Expert Analysis

Private Student Lenders and Servicers Face CFPB Scrutiny

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Regulators and congressional leaders have identified similarities between the lending practices that led to the subprime mortgage crisis and an escalating default rate in the burgeoning level of student loan debt. Rather than wait for a student loan crisis, they appear poised to act to prevent one by various means, including by the reform of student loan servicing practices. To this end, in 2012 the Consumer Financial Protection Bureau released two major reports aimed at curbing purported violations of law. In addition, in March, partly to address the complaints of student loan debtors, the CFPB announced its intention to supervise and examine the larger non-bank education loan servicers.

This commentary reviews the 2012 CFPB student loan ombudsman's annual report, the CFPB's December 2012 release of examination procedures for student lenders and the proposed regulation on the supervision of non-bank student loan servicers. Taken together, these initiatives leave no doubt that education lending and servicing and the regulation of education lenders and servicers are a top priority for the CFPB.

STUDENT LOAN OMBUDSMAN'S REPORT

The CFPB student loan ombudsman's annual report, released Oct. 16, 2012, summarizes nearly 3,000 consumer complaints that were filed in a six-month period. Complaints about private student lending fell into six categories:

- Responsible borrowers are stymied.
- Servicing surprises.
- Frustration faced by struggling borrowers.
- Challenges faced by military families
- Issues with for-profit college affiliated loans.
- Overall confusion between private and federal student loans.

The CFPB report draws parallels between problems in student loan servicing and those in mortgage loan servicing. Nearly identical complaints include the misapplication of payments, untimely error resolution and consumer difficulty in contacting appropriate

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personnel. So evident were the similarities in the eyes of the CFPB that its student loan ombudsman, Rohit Chopra, urged the Treasury secretary, the CFPB and secretary of education to consider whether mortgage servicing program “fixes” can be applied in the student loan context.

STUDENT LOAN EXAMINATION PROCEDURES

Following release of the ombudsman’s report, the CFPB issued its examination procedures for student lenders in December. They will be used to supervise and review both large banks and non-banks. Lenders will have to show compliance with a variety of federal laws applicable at various stages (called modules) of the lending process, as discussed below, and will be examined for potentially unfair, deceptive or abusive acts and practices.

The CFPB’s examination personnel will review the lender’s organizational documents and process flowcharts, board minutes, annual reports, management reports, policies and procedures, rate and fee sheets, loan applications, account documentation, notes and disclosures, file contents, operating checklists and worksheets, computer system details, due diligence and monitoring procedures, lending procedures, underwriting guidelines, compensation policies, audit reports and responses, training materials, service provider contracts, advertisements, and complaints. Examiners may also interview the lender’s personnel and observe customer interactions.

Examiners will review potential legal and regulatory violations in modules roughly corresponding to the processes by which education loans are developed, marketed, originated and serviced, and the processes for handling consumer complaints, delinquencies and defaults, credit reporting and privacy protection. The examination process is intended to help the CFPB determine whether consumer financial protection laws have been violated and, if so, whether supervisory or enforcement actions are warranted.

TABLE 2: PRIVATE STUDENT LOAN COMPLAINTS BY COMPANY
MARCH 2012 – SEPTEMBER 2012

Company	%	N
Sallie Mae	46%	1145
American Education Services (PHEAA)	12%	296
Citibank	8%	198
Wells Fargo	7%	176
JPMorgan Chase	5%	123
ACS Education Services	5%	116
KeyBank	4%	90
Others	13%	329
Total	100%	2473

Note: This chart comprises complaints that have been matched to a company on the CFPB’s “company portal.” For commentary on the distribution of complaints by company, see part two of this report.

Source: CFPB student Loan Ombudsman’s 2012 Report

The modules and primary areas for review within each module are as follows:

Advertising, marketing and lead generation

The advertising and marketing process for education loans should take into account the lender's compliance with the Truth in Lending Act, 15 U.S.C. § 1601, and its implementing Regulation Z; the Equal Credit Opportunity Act, 15 U.S.C. § 1691, and its implementing Regulation B; and whether the lender's arrangements with service providers such as agents, brokers and lead generators are being monitored for compliance with consumer laws.

Customer application, qualification, loan origination and disbursement

Examiners will review applications, policies and procedures, audits, and training materials to evaluate lender compliance with TILA, ECOA, implementing Regulations Z and B, and the Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229, commonly known as the E-Sign Act. This review will also include the lender's underwriting and pricing guidelines and use of credit scoring and automated underwriting systems. These reviews are intended to reveal whether underwriting or pricing policies differ based on applicant race, color, religion, national origin, sex, marital status or age, or any other prohibited criteria. Other areas to be reviewed include the lender's policies for requiring co-signers and for canceling a loan, and any lender-imposed limitations on the student's use of the education loan funds.

Loan repayment, account maintenance, payoff processing and payment plans

Education lenders may service their own loans or contract to have them serviced by others. The CFPB examiners will determine whether examinations should cover the lender, its contractors or both. Compliance with the Electronic Fund Transfer Act, 15 U.S.C. § 1693, and its implementing Regulation E will be assessed, along with the lender's procedures for handling payment processing (including application of payments, partial and full repayment, and the issuance of statements), providing repayment options (including deferment and forbearance), awarding borrower benefits (such as rate reduction for automated clearinghouse payments and "graduation bonuses") and transferring loan servicing.

Customer inquiries and complaints

The CFPB examiners will determine whether consumer complaints are handled in a timely manner and result in adequate resolutions; assess the effectiveness of telephone, written and online complaint portals; determine if staffing levels are sufficient; listen to live calls; and review management reports and customer complaint logs.

Collections, accounts in default and credit reporting

The examination will include review of servicing activity for education loans in default, including listening in on collection calls and possibly conducting interviews with consumers. The goal is to ensure compliance with the Fair Debt Collection Practices Act, 15 U.S.C. § 1692, particularly where third-party contractors are involved in the collection activity. Examiners will also be looking to see whether collections staff members transfer borrowers to loss mitigation personnel, whether borrowers are properly notified of past-due status, and whether the servicer notifies borrowers of formal or informal workout programs. Loan servicing records will be reviewed to ensure

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there are no violations of the Fair Credit Reporting Act, 15 U.S.C. § 1681 (including its requirements applicable to furnishers of information to credit reporting agencies), and that the lender has appropriate policies to verify the accuracy of information used to support the collection of delinquent accounts through legal action.

Information sharing and privacy

CFPB examinations will include an assessment of compliance with the Gramm-Leach-Bliley Act privacy provisions, 15 U.S.C. §§ 6802-6809, and Regulation P, found at 12 C.F.R. Part 1016, and the FCRA rules for information sharing with affiliates.

At the conclusion of the examination, findings will be summarized, along with a statement of violations and supervisory concerns. If violations are noted, the conclusions will indicate whether they are isolated or establish a pattern or practice. The report will be discussed with management, and a request for corrective action may be made. Violations are recorded in the CFPB's electronic database. A decision on whether enforcement action is appropriate will be made. Finally, a memorandum of the examination will be placed in the work papers and CFPB's official recordkeeping system, outlining planning and strategy for future examinations and possibly for interim follow-ups.

Although the CFPB's education loan examination procedures are relatively new, they should not be considered formulaic or static. Ambiguous or open-ended legal issues will be interpreted judicially as the CFPB goes about the business of conducting examinations, so lenders must be aware of current decisions to ensure compliance. For example, last August the 2nd U.S. Circuit Court of Appeals held a debt collector's representation that a debtor's student loans were ineligible for bankruptcy discharge was a "false, misleading or deceptive" practice in violation of the FDCPA. *Easterling v. Collecto Inc.*, No. 11-CV-3209, 2012 WL 3734389 (2d Cir. Aug. 30, 2012).

Although student loan debt is presumptively non-dischargeable, and in this case the debtor previously filed for bankruptcy without seeking to discharge her student loan, the appeals court noted that the bar for bankruptcy discharge is high but not impossible. Because the "least sophisticated consumer" might not seek legal advice about pursuing discharge through bankruptcy after receiving such a collector's notice, the notice was held to be noncompliant with the act.

FAIR-LENDING CONSIDERATIONS

Standards for fair-lending compliance continue to evolve. The CFPB announced in April 2012 that it will use all available legal avenues, including allegations of disparate impact, to pursue lenders (including student lenders) whose practices discriminate against consumers. A disparate-impact approach allows claims of discriminatory lending based on the effects, and not the intent, of the lending practices.

In addition to the CFPB's announcement, the U.S. Department of Housing and Urban Development in February promulgated a rule setting forth standards for disparate-impact claims brought under the Fair Housing Act, 42 U.S.C. § 3601. Under the HUD rule, once a lender's practice is shown by a plaintiff to have a disparate impact on a protected class, the lender has the burden of showing that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests. Even if the lender can satisfy this burden, a court could nevertheless find

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a violation of the FHA if another practice could serve the same purpose with less discriminatory effect.

Although the new HUD rule applies only to the FHA, given the CFPB's prior pronouncements, it seems likely that the CFPB and other regulators will import the disparate-impact standards of the new HUD rule to matters arising under the Equal Credit Opportunity Act and applicable to student lenders.

Given the prominent role the disparate-impact theory will play in regulatory fair-lending reviews, student lenders are likely to experience scrutiny of their use of non-credit-bureau, school-based attributes when determining loan eligibility and when underwriting and pricing student loans. Lenders should analyze such attributes, which include cohort default rates, school type, student grade level and student majors, for fair-lending concerns. Lenders using such attributes should develop a legitimate, non-discriminatory business case for the use of each such factor.

EXPANSION OF OVERSIGHT TO INCLUDE NON-BANK STUDENT LOAN SERVICERS

The CFPB announced March 14 a proposed rule that would allow it to supervise non-bank student loan servicers. Servicers with more than 1 million accounts would become subject to periodic examination for compliance with federal consumer financial laws. The motivation for the supervision of student loan servicers can be found in complaints made to the CFPB student loan ombudsman, including confusion about how much is owed, frustration with lack of information about payment processing, unexpected fees and conflicting instructions from employees of the same servicer.

Student debtors also complained about the inability to obtain answers to servicing-related inquiries, reaching dead ends in their attempts to reach servicing representatives and having limited access to their account information.

The CFPB said that supervising and examining servicers with 1 million accounts or more will bring between 71 percent and 94 percent of all student loan servicers under its supervision. The CFPB estimates that there are about seven such servicers and that these large non-bank servicers handle about 49 million accounts.

The proposed servicing supervision would not include new substantive compliance requirements for student loan servicers (as the CFPB intends to follow the December 2012 examination procedures), but would subject non-bank servicers to higher levels of scrutiny than they have previously experienced. In particular, non-bank servicers should expect the CFPB's review to extend beyond statutory compliance issues to include examination for any unfair and deceptive practices in the student loan servicing process. Based on public statements made to date, it appears that the CFPB anticipates unfair and deceptive practices may be present in the areas of repayment status processing and default prevention, among other areas.

The 1 million accounts threshold for supervision set forth in the CFPB's proposal is not fixed; the agency will consider public comments about whether that threshold should be higher (such as 3 million accounts) or lower. The estimated annual expense to the affected servicers is \$24,000 for a 12-week examination, representing the costs of the personnel assigned to respond to the examiners' requests for a 10-week examination, plus two weeks of preparation time. The 10-week examination is based on a similar

The examination process is intended to help the CFPB determine whether consumer financial protection laws have been violated.

examination period for mortgage loan servicers, which the CFPB sees as parallel with student lenders in terms of the need for supervision and regulation.

CONCLUSION

Student lenders and servicers are on notice that regulators are taking the lessons of the mortgage loan servicing crisis to heart in attempting to avert a similar crisis in student lending and servicing. The CFPB has made its agenda clear, announcing compliance expectations and examination procedures for lenders and servicers while simultaneously reaching out to consumer borrowers with educational initiatives such as the federal student aid website (studentaid.ed.gov), with repayment calculators, a “know before you owe” financial aid shopping sheet, and a complaint database and student loan ombudsman. As the proposal to regulate education loan servicers indicates, we have not heard the end of the CFPB’s activities in the education loan arena.

Lenders and servicers are advised to monitor the CFPB’s announcements for updates and guidance on compliance and enforcement and to review and comment on Federal Register announcements that may affect their operations. For example, in addition to the supervisory proposal for non-bank servicers discussed above, the CFPB sought comments until April 8 on development of more affordable loan repayment mechanisms for private education loan borrowers.

Lenders must also keep an ear to the ground for judicial decisions in cases involving student loan borrowers and the primary consumer financial laws implicated in education lending, as holdings in these cases will work their way into CFPB guidance and examination procedures. Finally, especially for non-bank student loan servicers, now is the time to conduct CFPB examination readiness assessments and to examine existing policies and procedures for any gaps and regulatory risks. With \$1.1 trillion in outstanding student loan debt and ever-higher delinquency rates for these loans, CFPB supervision and enforcement of the student loan and servicing industries is poised for growth.



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