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CFPB SUPERVISION

Comments Provide Clues of Future CFPB Oversight of Private Student Loans

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Students seeking to borrow funds to finance a postsecondary education have numerous options, including loans offered by the federal government, state governments, educational institutions and private lenders. Since the financial crisis of 2008, students have been turning in increasing numbers to federal loans and, in particular, loans made available under Title IV of the Higher Education Act of 1965 (''Title IV Loans'').[1] However, to fill the gap between the cost of a postsecondary education and the amount available from federal loan programs to help fund that cost, many students continue to rely upon private and other types of lenders. These lenders soon will be subject to increased oversight by the federal government.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (''Dodd-Frank'' or ''the Act'') created the Bureau of Consumer Financial Protection (''CFPB'' or ''the Bureau''), and gave it broad authority to supervise numerous facets of the financial services industry. One such area is the private education loan market. Specifically, the Act authorizes the Bureau to enforce federal financial laws that apply to and proscribe ''unfair, deceptive, or abusive act[s] or practice[s]'' committed by ''any covered person who . . . offers or provides to a consumer any private education loan, as defined in section 140 of the Truth in Lending Act ['TILA.']'' 12 U.S.C. § 5514(a)(1)(D) and (b)(1); § 5531(a). TILA, in turn, defines private education loans as non-Title IV Loans made for postsecondary educational expenses by banks, credit unions and anyone else ''engaged in the business of soliciting, making, or extending private education loans.'' 15 U.S.C. § 1650(a)(6) and (7).[2]

Dodd-Frank requires the Bureau to prepare a report on private education loans for submission to Congress. To comply with that mandate, the Bureau solicited comments on various issues relating to private education loans. By the conclusion of the comment period on Jan.

[1] Title IV Loans include Perkins Loans (for students with exceptional financial need), Direct Subsidized Stafford Loans (for students with financial need), Direct Unsubsidized Stafford Loans (no showing of financial need required), and Direct PLUS loans (available to students in graduate or professional programs, as well as to the parents of undergraduate students).

[2] Open-ended consumer credit plans and loans secured by real property are excluded from the definition of private education loan.

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17, 2012, the Bureau had received more than 30 comments from various participants in the private education loan market, including private, for-profit lenders, state-sponsored non-profit lenders, higher education institutions, public interest groups, and trade associations and advocacy groups representing all of these participants.[3] The comments, many of which contained recurring themes, provide insight into aspects of the private education loan industry on which the Bureau may focus when exercising it supervisory function. This article discusses some of those issues.

Exhausting Lower-Cost Federal Loans

Title IV Loans and other varieties of federal loans, as well as some state-sponsored loans and institutional loans, often are the least expensive option for a student seeking to fund a secondary education. Although commenters presented contradictory data on the frequency at which students exhaust their lower-cost options,[4] one of the most consistent themes throughout the comments was the need to encourage students to maximize these options before turning to private lenders. Many commenters suggested that requiring private lenders to obtain school certification – that is, certification from schools that a student seeking a loan needs the full amount of money for which he or she has applied – before the lender may disburse the loan funds would help accomplish this goal.[5] In fact, some private lenders, including the largest, Sallie Mae, already require schools to certify loans before they will disburse funds.[6]

School certification not only ensures that students avoid over-borrowing, but also identifies for schools the students who have applied for private loans, which provides the schools with the opportunity to counsel those students about any lower-cost loans for which they may qualify. For instance, when called upon to certify a loan, approximately 40 percent of school financial aid officers require students to submit a Free Application for Federal Student Aid (''FAFSA'') to the U.S. Department of Education.[7] The FAFSA is a single application for the various lower-cost federal, state and institutional aid programs available for students. After submitting the application, students receive a report identifying the aid and loan programs, if any, for which they are eligible.[8]

Additional suggestions for assisting schools in counseling students about financial aid options include expanding the current National Student Loan Data System, which currently contains a record only of Title IV loans issued to students. Some commenters suggested that requiring all lenders to report loans into the system would benefit students by creating a single resource to which financial aid officers could refer when counseling students.[9]

Definition of a Private Education Loan

TILA defines a ''private education loan'' as any non-Title IV Loan, and, therefore, Dodd-Frank gives the Bureau regulatory authority over all such loans. Numerous commenters pointed out problems created by the breadth of the TILA definition. Specifically, TILA requires any lender issuing a ''private education loan'' to provide disclosures advising the borrower that he or she may qualify for lower-cost federal loans. Because Title IV Loans are not always the lowest cost options for all borrowers, however, providing that disclosure in certain circumstances can prove counter-productive and confusing.

For instance, students pursuing an education in certain medical professions may be entitled to finance their tuition with federal loans made pursuant to the Public Health Service Act, 42 U.S.C. § 292 (''PHSA''), which often are more cost-effective than Title IV Loans. However, because PHSA loans are not Title IV Loans, they are included within the definition of ''private education loan'' and, therefore, borrowers are required to receive a TILA disclosure advising them, incorrectly, that lower cost federal loans may be available.[10] Likewise, some state-based loans offer terms that are more attractive than certain Title IV Loans. Yet, because these state-based loans are not Title IV Loans, they fall into the definition of a ''private education loan,'' and students

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[3] Those submitting comments included: Private lenders, such as Discover Bank and Sallie Mae; state-sponsored lenders from Iowa, Kentucky, Massachusetts, North Dakota, Pennsylvania and Texas; schools, such as DeVry, Texas A&M and the University of California (''UC''); public interest groups, such as Americans For Financial Reform (''AFR''), Citizen Works, The Institute for College Access & Success (''TICAS''), and Young Invincibles; and trade groups such as the American Association of University Women, the American Securitization Forum (''ASF''), the Association of American Medical Colleges (''AAMC''), the Consumer Bankers Association (''CBA''), the Coalition of Higher Education Assistance Organizations (''COHEAO''), the Credit Union Association of New York (''CUA''), the Education Finance Council (''EFC''), the Financial Services Roundtable, the Independent Community Bankers of America (''ICBA''), the National Association of College and University Business Officers, the National Association for College Admission Counseling, the National Association of Student Financial Aid Administrators (''NASFAA''), the National Council of Higher Education Loan Programs, Inc. (''NCHELP''), the State Student Loan Group (''SSLG''), the Student Loan Servicing Alliance (''SLSA''), and the Wisconsin Credit Union League.

[4] *Compare* Submission of TICAS at p. 2 (''a majority of private loan borrowers could have borrowed more in federal loans before turning to private loans'') *to* Submission of the American Securitization Forum at p. 3 (''Students today overwhelmingly exhaust all of their opportunities for federal aid before taking out private loans.''). All citations to ''Submissions'' herein refer to comments submitted to the CFPB at docket number CFPB-2011-0037, which can be accessed though this URL: http://www.regulations.gov/#!docketDetail;dct=FR%252BPR%252BN%252BO%252BSR%252BPS;rpp=25;po=0;D=CFPB-2011-0037.

[5] *See* Submissions of AFR at p. 2; DeVry at p. 6; NASFAA at p. 4; NCHELP at 3; Pennsylvania Association of Student Financial Aid Admissions (''PASFAA'') at p. 2; TICAS at p. 3; UC at p. 6.

[6] *See* Submissions of Sallie Mae at p. 7; ASF at p. 6. *See also* Submission of SSLG at p. 5 (noting that ''[s]tate-based student loans require school certification'').

[7] *See* Submission of Sallie Mae at p. 7.

[8] To correct a common misperception among students, The Institute for College Access & Success suggests that the FAFSA include a disclosure notifying students that there is no income limit for certain types of federal loans. *See* Submission of TICAS at p. 9.

[9] *See* Submission of TICAS at pp. 3, 17.

[10] *See* Submissions of AAMC at pp. 1-2; COHEAO at p. 4; NASFAA at p. 4 (referring to the failure to exclude all federal loans from TILA requirements as ''what can only be described as an oversight''); UC at p. 1.

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taking advantage of them must receive a TILA disclosure incorrectly suggesting that they may not be pursuing the most cost-effective financing.[11]

In addition, some schools offer tuition payment plans that are not loans, but that charge administrative fees. The imposition of the administrative fee can trigger the need to provide the TILA disclosures. These disclosures advise students to consider borrowing from the federal government to finance their education even though the students, because they are participating in a tuition payment plan, may not need to take on debt at all.[12]

By using TILA's definition of ''private education loan'' to identify the types of loans within the Bureau's jurisdiction, Dodd-Frank gave the Bureau authority to supervise a broad range of loans, including PHSA loans, state-based loans, and certain tuition payment plans. Through their discussion of the problems created by the broad definition of ''private education loan'' in the context of TILA disclosures, the commenters appear to be suggesting that the Bureau attempt to find ways to alleviate the difficulties created by requiring low-cost lenders to comply with TILA's disclosure requirements. More generally, the commenters appear to be asking the Bureau to remain cognizant of the breadth of the definition of ''private education loan'' when exercising its enforcement function, since not all rules may be appropriate for or apply equally to all loans within the Bureau's purview.

Preferred Lender Lists

Another topic that drew considerable commentary from a wide range of industry participants is preferred lender lists. In the past, financial aid offices of schools have served as a primary source of information for students seeking to finance their education. A number of financial aid counselors would, in the course of advising students about the different financing options available to them, recommend specific lenders for students to consider. Some commenters have suggested, however, that a provision of the Higher Education Opportunity Act of 2008 (''HEOA''), which was designed to curb abuses in the student loan arena, has actually hamstrung efforts by schools to help educate their students about lower-cost loan options.

Specifically, HEOA regulates schools that enter into ''preferred'' arrangements with lenders. A ''preferred lender arrangement'' is ''an arrangement or agreement between a lender and a [school] that relates to such [school] recommending, promoting, or endorsing the education loan products of the lender.'' 20 U.S.C. § 1019(8). If a school enters into such an arrangement, it then must prepare and make available a ''preferred lender list,'' which, among other things, ''clearly and fully discloses . . . why the [school] has entered into [the] preferred lender arrangement'' and ''prominently disclose[s] the method and criteria used by the institution in selecting lenders'' for the preferred relationship. 20 U.S.C. § 1094(h)(1)(A)(ii) and (h)(1)(C).

Critically, schools that enter into preferred lender relationships take on a fiduciary duty to their students by committing to ''exercise a duty of care and a duty of loyalty to compile the preferred lender list . . . for the sole benefit of the students attending the institution, or the families of such students.'' 20 U.S.C. § 1094(h)(1)(D). Schools that enter into preferred lender relationships also must submit an annual report with ''a detailed explanation of why such [school] entered into a preferred lender arrangement with the lender, including why the terms, conditions, and provisions of each type of education loan provided pursuant to the preferred lender arrangement are beneficial for students.'' 20 U.S.C. § 1019B(c)(2)(A)(ii).

The purpose of the law is to prevent schools and lenders from colluding to direct students to loan programs that might not be in their best interest. Despite its good intentions, the act has, in practice, ended up cutting off a key source of information for students. Indeed, many schools reportedly no longer are willing to recommend specific lenders – even non-profit or state-based lenders – because doing so runs the risk that the school will be deemed to have entered into a preferred lender arrangement and have to comply with the onerous requirements governing such arrangements.[13]

Non-profit and state-based lenders have been particularly vocal about what they see as the detrimental impact of the preferred lender rules. These lenders point out that, without referrals from schools, they are left to compete for students' attention with private lenders who have much larger advertising budgets. As the

[11] *See* Submissions of SSLG at p. 4. Likewise, some campus-based loans ''are less costly than even subsidized Stafford Loans . . ., yet all the required disclosures imply that the federal loans should be exhausted first.'' Submission of COHEAO at p. 4; *see also* Submissions of Bank of North Dakota at p. 2 (''For ND residents and for those students attending school in ND, the [federal] PLUS loan interest rate is much higher than the [state-sponsored loan] rate and offers no real advantage to the student/parent.''); Brazos Higher Education Authority, Inc. (''Brazos'') at p. 2 (''[T]he current statutorily set interest rate [on a federal DirectPLUS loan] *exceeds* the fixed interest rate that is offered by many nonprofit and state agency student loan providers.''); Massachusetts Educational Financing Authority (''MEFA'') at p. 4 (''MEFA's fixed interest rate loan option has historically been below the statutorily mandated federal government parent loan rate.'').

[12] *See* Submission of COHEAO at p. 2. *But see* TICAS at p. 4 (expressing ''growing concerns about fees charged by colleges and their vendors for . . . tuition payment plans'').

[13] Several commenters raised this concern. For instance, The Institute for College Access & Success reported that two thirds of colleges will not recommend lenders or will simply give students, without commentary, lists of lenders who have made loans to students attending that school in the past. *See* Submission of TICAS at p. 7. The Student Loan Servicing Alliance suggests that ''almost all schools have declined to make any recommendations regarding private education loans to their students, inasmuch as they are unwilling to comply with the complex and confusing regulations around preferred lender lists.'' Submission of SLSA at p. 2. *See also* Submissions of Bank of North Dakota at p. 1-2; Brazos at p. 2; COHEAO at p. 3; DeVry at p. 3; EFC at p. 2; Kentucky Higher Education Assistance Authority (''KHEAA'') at p. 2; Maryland Independent College and University Association at p. 2; and UC at p. 2. Other commenters, however, provide data that calls into question the idea that reticence by schools to recommend lenders is as prevalent as some suggest. For instance, Sallie Mae reports that 69 percent of private, non-profit colleges and 64 percent of four-year institutions made lender lists available to students in 2011. *See* Submission of Sallie Mae at p. 8. And the Credit Union Association of New York submits that many schools continue to maintain close relationships with select lenders. *See* Submission of CUA at p. 2 (''[C]redit unions have become increasingly frustrated by what appears to be a system driven by educational institutions which have close relationships with a handful of lending institutions.'').

State Student Loan Group put it, the preferred lender rules have resulted in a situation where non-profit and state-based lenders ''no longer have a level playing field with federal PLUS Loans or other private lenders.''[14] The group also points out that the rules can lead to anomalous results. For instance, a school can suggest that a student take out a Title IV Loan, but for fear of violating the preferred lender rules, cannot recommend that the student consider a state-based lender that may well offer loans with terms superior to Title IV Loans.[15]

The Iowa Student Loan Corporation summed up the problem as follows: the preferred lender rules have created the ''unintended consequence'' that many schools no longer are willing to provide adequate financial counseling to their students.[16] This problem has led some commenters to suggest that the Bureau attempt to reverse the unintended consequences by exempting schools from following the preferred lender rules when they promote economical state-funded loan options.[17]

The Effectiveness of TILA Disclosures

Lenders offering private education loans must provide several rounds of disclosures to students under TILA. There is disagreement among the commenters about the effectiveness of those disclosures.

Some in the industry have generally criticized the disclosures as confusing, redundant and too lengthy.[18] One commenter discussed the results of a survey of students indicating that the disclosures do not appear to be accomplishing their intended result. Despite the disclosures, many students surveyed still did not fully understand how much they had borrowed or the terms of their loans and experienced ''repayment shock'' when it came time to start repaying them.[19]

In addition to these general criticisms, some commenters pointed out what they see as specific flaws in the required disclosures. Sallie Mae noted that, because it has found that students who make modest monthly payments on their loan while they are in school are less likely to default, it offers lower interest rates to students who agree to make in-school payments.[20] However, TILA requires Sallie Mae to use the highest interest rate it offers in the section of the required disclosure that provides a loan repayment schedule example, which creates the false impression that there is no advantage to making in-school payments.[21] The Institute for College Access & Success criticized the disclosure rules for failing to require lenders who offer variable rate loans to illustrate monthly payments at the highest possible variable rate.[22] The Credit Union Association suggested that the effectiveness of disclosures could be improved by requiring schools and lenders to disclose the value of a diploma in financial terms, so students can engage in a cost-benefit analysis of a proposed loan.[23]

By contrast, other commenters, such as the Consumer Bankers Association, believe that the disclosures are effective.[24] The Pennsylvania Association of Student Financial Aid Administrators expressed its view that the disclosures ''have helped promote informed borrowing. They have helped co-borrowers to understand their responsibilities. Overall they have resulted in increased levels of transparency.''[25] One commenter noted that the disclosures were tested extensively and found effective by the Federal Reserve Board before they were put into effect.[26] Given these disparate views, it is difficult to predict what if any actions regarding disclosures the Bureau may take.

Credit Reports And Default Rehabilitation

Some commenters noted that the Department of Education is permitted to remove negative credit references from the credit reports of students that have rehabilitated defaulted federal loans. Non-federal lenders, however, are prohibited by the Fair Credit Reporting Act from doing the same, which provides students who have defaulted on private education loans one less incentive to attempt to rehabilitate them.[27] Similarly, some private lenders note that banking regulations provide them with less flexibility than federal lenders to modify loan payments for borrowers who have or are at risk of defaulting on student loans.[28] The commenters appear to be suggesting that the Bureau consider enforcing existing law in ways that will allow private lenders to assist students who have defaulted on their loans or are struggling to repay their debt using methods currently unavailable to them.

Net Price Calculators And Financial Aid Letters

The HEOA requires ''each institution of higher education that receives Federal funds under title IV'' to make available on its webpage a net price calculator ''to help current and prospective students, families, and other consumers estimate a student's individual net price at such institution of higher education.'' 20 U.S.C. § 1015A(h)(3). College Access & Success notes that some schools bury the calculator in hard-to-find locations on their webpage or include private loans (under the label ''self-help'') among possible funding sources, thereby showing a supposedly misleading ''net price.''[29] Similarly, some schools include private loans in their financial aid offer letters, which can create the false impression that private loans are financial aid.[30] These both would appear to be issues that the Bureau could seek to address through regulation.

Conclusion

It remains to be seen which of the various issues raised by the commenters the Bureau will include in its report to Congress and which will eventually become the subject of supervision or regulations by the Bureau.

[14] Submission of SSLG at p. 3.
[15] *See id.*
[16] *See* Submission of Iowa Student Loan Liquidity Corporation at p. 3.
[17] *See* Submission of Bank of North Dakota at p. 2.
[18] *See* Submissions of DeVry at p. 3; ICBA at p. 2.
[19] *See* Submission of Young Invincibles at p. 7.
[20] *See* Submission of Sallie Mae at p. 10. Other commenters also noted that students who make in-school payments default less frequently. *See* Submission of DeVry at p. 6; KHEAA at p. 5.
[21] *See* Submission of Sallie Mae at p. 10.
[22] *See* Submission of TICAS at p. 9.
[23] *See* Submission of CUA at p. 2.
[24] *See* Submission of CBA at p. 4.
[25] *See* Submission of PASFAA at p. 1.
[26] *See* Submission of CBA at p. 4.
[27] *See* Submissions of COHEAO at p. 8; Sallie Mae at p. 22.
[28] *See* Submission of Discover Bank at p. 5.
[29] *See* Submission of TICAS at p. 11.
[30] *See* Submission of TICAA at p. 7.

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The comments do, though, provide clues as to the areas where the Bureau may focus. Among other things, the comments suggest that the Bureau may:

- Consider options for encouraging or requiring all lenders to obtain school certification before disbursing loan proceeds;
- Look into the possibility of exempting non-Title IV federal loans as well as lower-cost loans by non-profit and state-based lenders from TILA's disclosure requirements;
- Attempt to carve non-profit and state-based lenders out of the preferred lender rules, so that schools can refer students to those lower-cost lenders without taking on substantial compliance burdens; and
- Investigate the possibility of exempting private lenders from laws that prohibit them from purging negative references from the credit reports of students who rehabilitate defaulted loans.

Regardless of the actions the Bureau eventually takes, the comments submitted to the Bureau provide valuable insight into issues in the private education loan market that should be addressed to help encourage responsible lending and borrowing.