July 13, 2015

Richard Cordray
Director
Consumer Financial Protection Bureau
1275 First Street NE
Washington, DC 20002

Re: Request for Information on Student Loan Servicing
Docket No. CFPB-2015-0021

Dear Director Cordray,

Thank you for the opportunity to convey our concerns about student loan servicing. With 40 million Americans owing over a trillion dollars in student loan debt, and many of them struggling to repay their loans, student loan servicing deserves the urgent attention of regulators and lawmakers. We welcome this Request for Information as a step towards strong new regulations and oversight of student loan servicing by the Consumer Financial Protection Bureau and the Department of Education.

The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices, including poor loan servicing standards. CRL's views on loan servicing are informed by its affiliation with Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofits and serves more than 80,000 mostly low-income families through 25 retail credit union branches. Additionally, Self-Help has served as master servicer for $387 million of home loans originated by its two credit unions and $4.6 billion in loans to low-income families that Self-Help purchased from lenders across the country under Self-Help's home loan secondary market program.

I. Servicing Reform Is Essential to Responsible Lending

Origination is just the beginning of the lending process. Successful repayment depends in great part on the servicer, who controls every aspect of repayment, and serves as the gateway to any relief or assistance to which the borrower might be entitled.

Student loan servicing is often outsourced to a third-party company rather, than being performed by the lender the borrower selected. All federal student loans servicing is outsourced, and a percentage of private student loans servicing is outsourced as well.[1] Borrowers have little choice or control in the relationship with their servicer. Since the borrower cannot choose their servicer on the open market, market forces exert no discipline on servicers. This kind of market failure warrants close attention by regulators and lawmakers.

Securitization may complicate student loan servicing. Many private student loans are securitized, as are student loans from the FFEL program.[2] (New federal loans are no longer securitized, since the transition to the Direct Loan program in 2010 keeps them on the government's books.[3])

With student loans, as with other consumer credit markets such as mortgages and credit cards, securitization creates complexities and information asymmetries that can lead to abusive or suboptimal servicing practices.[4] Securitization is not the same for each credit product or each deal, but it often severs the link between the parties' interests in the loan's performance, and their ability to control servicing. Since the servicer may not have the same interest in ensuring successful repayment as do the investor and borrower, this can lead to consumer abuses.[5]

II. Mortgage servicing as a parallel to student loan servicing

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[1] Some private student loan originators retain servicing duties rather than outsourcing. *See* Consumer Financial Protection Bureau, Final Rule, *Defining Larger Participants of the Student Loan Servicing Market*, 78 Fed. Reg. 73383, 13386 (Dec. 6, 2013).

[2] Board of Governors of the Federal Reserve System, *Report to Congress on Risk Retention* 20-22 (Oct. 2010)[hereinafter Federal Reserve, *Risk Retention*], http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf; Consumer Financial Protection Bureau, *Private Student Loans* 18 (Aug. 2012) [hereinafter CFPB, *2012 Private Student Loan Report]* http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

[3] *Cf.* David P. Smole, Congressional Research Service, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Direct Loan Program*, CRS 7-5700 (Jun. 7, 2013), https://www.fas.org/sgp/crs/misc/R40122.pdf.

[4] Consumer Financial Protection Bureau, *Mid-year update on student loan complaints* 13-14 (June, 2015), [hereinafter CFPB, *2015 Mid-year update*] http://files.consumerfinance.gov/f/201506_cfpb_mid-year-update-on-student-loan-complaints.pdf.

[5] *See* Federal Reserve, *Risk Retention*, *supra* n.2, at 14-15. The Federal Reserve notes that in some cases, different parties to the securitization will have a different interest in how a distressed borrower is treated. Some would prefer the borrower to default immediately, and others would prefer to compromise with a loan modification and prevent immediate losses. These interests could determine the servicing strategy used with borrowers, depending on who holds the upper hand in the securitization structure and can implement their preferred servicing strategies. If the party with an interest in liquidation has power to implement its servicing strategy, servicing will push consumers towards potentially harmful defaults and block them from accessing helpful repayment assistance. But if the party with an interest in preventing immediate loss prevails then consumers might be helped to access repayment plans and modifications. The CFPB has observed this dynamic at play with "auto-defaults" on private student loans. CFPB, *2015 Mid-year update*, *supra* n.4, at 13-14.

A. Mortgage servicing failed to provide loss mitigation and contributed to the financial crisis

Although mortgages and student loans differ in key ways, the importance of servicing is common to both types of loans. When the mortgage crisis made millions of borrowers unable to pay their loans as agreed, the flaws in the servicing system were revealed. Lessons learned from the mortgage crisis – especially insufficient loss mitigation caused by a disconnect between servicers, investors, and borrowers – highlight the need for student loan servicing reform.

Like mortgages, all federal student loans are serviced by a third-party company with interests that may diverge from the loan holder, or, in the case of FFEL loans, the guarantor – the U.S. government. In the case of Direct Loans,[6] this structure is written into law: the Higher Education Act requires that loan servicing and debt collection be outsourced "to the extent practicable."[7]

Unless correctly managed, outsourcing of loan servicing can create a conflict-of-interest between the loan holder, borrower, and servicer. In the case of mortgages, the conflicts led to people losing their homes in foreclosure who should not have; in the case of student loans, they may similarly lead to borrowers defaulting instead of being placed on income-based repayment plans.

Misaligned mortgage servicing incentives resulted in inadequate "loss mitigation" -- modifying mortgages so that distressed borrowers could continue to repay what they could afford, and mortgage investors could continue to receive income from the loan. As the Center for Responsible Lending's research has shown, in many cases home loan modifications would have returned more value to the investor than a foreclosure, but the servicer foreclosed anyway.[8] The mortgage borrower and the loan holder would have benefitted if the terms of the loan were modified to allow a distressed borrower to continue to pay on easier terms. The failure to provide timely loss mitigation contributed to a foreclosure crisis from which the nation has still not recovered.[9]

Mortgage servicers stood in the way of the economically rational loan modifications that would have helped both the borrower and the investor. The problem stemmed from two related factors: securitization, which reduced the ability of loan holders to oversee their interests and control the servicers; and servicers' financial incentive to foreclose instead of facilitating a loan modification. Servicing a distressed borrower and helping them access a modification was much

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[6] Since 2010, all new federal student loans must be Direct loans.

[7] 20 U.S.C. § 1087f(a)(1).

[8] Center for Responsible Lending, *Fix or Evict?* (Mar. 2011), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/fix-or-evict.html.

[9] Alan White, "Foreclosure Crisis Update," *Credit Slips* (Mar. 28, 2015) http://www.creditslips.org/creditslips/2015/03/foreclosure-crisis-update.html.

more individualized, time-consuming, and expensive than the automated processes servicers used to send borrowers to foreclosure, so servicers sent more borrowers than necessary to foreclosure instead of helping them with modifications.[10]

Due to the fragmented nature of securitization,[11] mortgage loan holders and borrowers had no effective way to assert their interests against servicers. Both investors and borrowers were "unlikely or unable to bargain for adequate servicing of defaulted loans."[12] The end result: "there is no party with the ability and incentive to monitor a servicer's actions."[13] Since servicers benefitted more from foreclosures, distressed mortgage borrowers who could have continued paying their loans with some assistance or modifications of terms were instead sent to foreclosure.

As the foreclosure crisis unfolded, state and federal lawmakers, regulators, and court settlements put several partial remedies into place to stop the flood of foreclosures and force servicers to perform their duties. These measures produced limited results. The inadequacy of voluntary, incentive-based programs like the Home Affordable Modification Program (HAMP) in changing servicer practices underscored the need for comprehensive, national servicing standards which would directly instruct servicers on standards of lawful conduct.[14]

B. Failure of loss mitigation in federal student loan servicing

As with mortgages, failure to perform adequate loss mitigation appears to be one of the key shortfalls in student loan servicing. As discussed in greater detail below, many student borrowers who could avoid default by enrollment into an income-based repayment plan may not be given adequate assistance from their servicer, in part because the servicers' financial interests are not in favor of providing the expensive, high-touch servicing needed to accomplish the task.

Student loan loss mitigation does vary in key respects from mortgage loans. Student loans are unsecured loans, and so there is no clear parallel to the foreclosure process. However, in many ways, the consequences of default on a student loan are more severe. First, the loan is early in a borrower's "credit life," and default means that any subsequent credit is either more expensive or potentially unavailable. Second, student loans are extremely difficult to discharge in bankruptcy.

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[10] Adam Levitin and Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 4-5 (2011) [hereinafter "Levitin and Twomey"].
[11] *Id.* at 6.
[12] *Id.* at 6.
[13] *Id.* at 7.
[14] *See* Comments of the Center for Responsible Lending, Consumer Federation of America, and Center for American Progress to the Consumer Financial Protection Bureau's Proposed RESPA Mortgage Servicing Rule 2-3 (Oct. 9, 2012), http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/CRL-CFA-CAP-Mortgage-Servicing-Standards-Comment.pdf.

Third, in the absence of bankruptcy rights, the federal government has super-collection powers to garnish wages and federal benefits. Also, unlike with mortgages, the Department of Education contracts directly with servicers and has (in theory) much more control over their performance. But despite these differences, experience with mortgage servicing provides a clear lesson for student loan servicing: servicers must be given proper oversight if they are to achieve the lender's goals and protect borrowers' rights.

E. Dodd-Frank and mortgage servicing reforms

In response to the clear need for nationwide mortgage servicing reform, Congress included mortgage servicing reforms in the Dodd-Frank Act. Dodd-Frank imposed specific new requirements on servicers under RESPA and TILA, and gave the CFPB the statutory authority to promulgate mortgage servicing rules under the new and existing law.[15] The CFPB responded in 2013 with mortgage servicing rules that sought to ensure that servicers would be required to provide rational modifications for distressed borrowers, as well as other protections.[16] The Bureau continues to refine the 2013 mortgage servicing rules today.[17]

The 2013 Mortgage Servicing Rule compels servicers to consider borrowers who timely apply for loss mitigation before foreclosing. The Rule does not actually require that investors offer modifications. But in practice, most if not all mortgage investors do permit modifications to eligible borrowers. Accordingly, the Rule ensures that servicers consider eligible borrowers for modification.

D. Misaligned incentives in private student loans

The consumer complaints detailed in the Bureau's reports on private student loans indicate that dysfunctions similar to mortgage servicing may exist in private student loan servicing. Borrowers complain that even though they made good-faith efforts to pay what they could, servicers still put their accounts into default.[18] Similar to the mortgage context, both borrowers

[15] 12 U.S.C. § 2605 (RESPA); 15 U.S.C. §§ 1638(f), 1638a, 1639f, 1639g (TILA); 12 U.S.C. 5512(b)(1) (CFPB's general authority to promulgate rules under federal consumer financial laws, including RESPA and TILA).

[16] Mortgage Servicing Rules under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 10901 (Feb. 14, 2013; Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10695, 10897 (Feb.14, 2013).

[17] Consumer Financial Protection Bureau, Notice of Proposed Amendments to the 2013 Mortgage Rules under RESPA and TILA, 79 Fed. Reg. 741676 (Dec. 15, 2014). CRL joined the comments of the National Consumer Law Center and four other groups on the proposed amendments. *See* http://www.nclc.org/images/pdf/rulemaking/comments-servicing-cfpb-march16-15.pdf.

[18] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* 7 (October 12, 2012), *available at* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf.

and lenders/investors might have been better served if the borrowers received loan modifications and continued to pay what they could, rather than going into default and ceasing payment altogether. In other cases, performing loans were put into default and/or accelerated when a cosigner died or declared bankruptcy, even though the borrowers could pay. This economic irrationality suggests a mismatch between investor and servicer incentives, similar to mortgage servicing.

II. Under-enrollment in income-driven repayment plans: a reprisal of the foreclosure crisis?

The mortgage crisis taught us that loss mitigation is a key function of loan servicing, and that improper control over servicers' economic incentives may stand in the way of loss mitigation. Without ensuring that servicers are being properly compensated--and legally required--to provide relief to borrowers, borrowers who could have been helped will instead default.

A. Enrollment in IDR can prevent defaults

For federal student loans, income-driven repayment (IDR) plans show considerable promise to help struggling student loan borrowers. The federal government has created progressively more generous IDR plans, and is moving steadily to extend these plans to more borrowers.[19] Like loss mitigation and foreclosure prevention, IDR may help borrowers continue to repay on modified terms, preventing default that harms them and their families. IDR plans also benefit taxpayers, since these borrowers continue to pay what they can afford, instead of ceasing repayment altogether.

Recent data from the Department of Education suggest that IDR enrollment indeed helps mitigate loss and borrower distress. Delinquency rates are the lowest for borrowers enrolled in the most generous forms of IDR -- Income-Based Repayment (IBR) and Pay-As-You-Earn (PAYE). IBR and PAYE delinquency rates are much lower than for borrowers in the least generous plan, or no repayment assistance plan at all.[20] 25.1% of borrowers enrolled in no repayment plan are seriously delinquent (31-270 days), versus only 5.1% of those enrolled in IBR. The most generous plan, PAYE, does even better: only 2.3% of its enrollees are seriously delinquent. Although there may be other factors that contribute to the difference in serious

[19] Michael Stratford, *Income-Based Repayment Expansion Advances*, Inside Higher Ed, May 1, 2015, https://www.insidehighered.com/news/2015/05/01/federal-rule-making-panel-oks-plan-expand-income-based-repayment-program.

[20] Department of Education, *Portfolio Overview*, slide 37 (presented at the Dec. 1, 2014 Servicing Summit in Atlanta, Georgia), http://fsaconferences.ed.gov/conferences/library/2014/servicing/2014ServicingSummitPortfolioOverview.ppt.

delinquency between IDR enrollees and those on the standard plan, it seems clear that enrollment in IDR is one important factor that helps troubled borrowers stay current.

B. Servicers may not be properly enrolling borrowers in IBR

If IDR helps prevent default and distress, then the procedures for enrolling borrowers in IBR is essential to good student loan servicing. However, some evidence, discussed below, indicates that servicers are not adequately enrolling borrowers in IDR. Similar to mortgage servicing, they may not be correctly compensated to perform the more expensive task of reaching out to distressed borrowers and providing assistance.[21]

Although Direct Loan borrowers can apply through a Department of Education website instead of having to first approach their servicer,[22] the servicer always plays a key role in IDR enrollment -- especially for borrowers who are unaware of their options. Servicers are in the position to know if a borrower is in distress when they make late payments, and when borrowers contact them to ask about their options. Savvy borrowers may inform themselves of their repayment options, but most borrowers rely on their servicers to help them navigate a confusing system.

Despite the fact that servicers are in the best position to proactively help enroll borrowers in IBR and prevent default, borrowers are still confused – which indicates that servicers are not doing their jobs. In a series of focus groups with struggling student loan borrowers, the New America Foundation found that few borrowers had enrolled in IDR. Those who were unfamiliar with IDR were "confused, perplexed, and often suspicious" of the option.[23] The researchers found that "[t]here was a general lack of awareness about income-based repayment plans, and even those who were using them seemed to be confused about plan details."[24] The focus group participants had all apparently had contact with their servicers because they had attempted to repay at least some of the time, and all had at one point struggled with their loans, which indicates that they might benefit from IDR. But despite this, they remained "perplexed" about the option. This indicates that their servicers had failed to adequately reach out to them to educate them about IDR and encourage them to enroll.

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[21] In the context of FFEL servicing, it is also possible that servicers have an additional financial disincentive to enroll borrowers in IBR. FFEL loans can be securitized, unlike Direct Loans. Recently, rating agencies have downgraded FFEL-backed securities in part because of increased enrollment in IDR plans.

[22] Letter from William Leath, Federal Student Aid, Department of Education, Dec. 21, 2012, updated Jan. 11, 2013, http://ifap.ed.gov/eannouncements/122112LSIPayAsYouEarnPlanIBRnICR.html.

[23] Jason DeLisle and Alexander Holt, *Why Student Loans are Different* at 18, New America Foundation, Mar. 2015, https://static.newamerica.org/attachments/2358-why-student-loans-are-different/StudentLoansAreDifferent_March11.7a1d0dc1b65e4892bb132e1309d51335.pdf.

[24] FDR Group, *Taking Out and Repaying Student Loans* (Feb. 23, 2015), http://www.edcentral.org/wp-content/uploads/2015/03/FDR_Group_Updated.pdf.

C. Department of Education efforts show that targeted outreach can help enroll borrowers in IDR

Starting in late 2013, Department of Education stepped into the shoes of servicers and began to conduct targeted outreach to borrowers who might be helped by IDR.[25] They targeted borrowers who were seriously delinquent or in default, had large loan balances and recently entered repayment or would soon enter repayment, or were in deferment or forbearance for financial hardship reasons.[26]

The Department's targeted campaign appears to have worked: between the third quarter of 2013 and the end of the third quarter of 2014, the enrollment in IDR steadily increased from 10.5% of borrowers to 15.3% of Direct Loan borrowers, and 22.3% of the Direct Loan portfolio to 30.4% of the Direct Loan portfolio.[27]

The Department's apparent success is encouraging, but it does not let servicers off the hook. While it is appropriate and desirable for the Department to engage directly with borrowers, servicers should be taking these basic steps to conduct targeted outreach on their own.

D. Servicer contract incentives may reduce IDR enrollment

Misaligned financial incentives between servicers and loan holders was a key driver of the failure to provide loan restructuring to homeowners and loss mitigation to investors.[28] While the economics are different for federal student loans, financial disincentives may also play a role in the failure to enroll borrowers in IDR plans.

Unlike with mortgages, the Department of Education has much more control (potentially) over student loan servicers than did the holders of mortgage asset-backed securities. The Department contracts directly with servicers for Direct Loans, and has considerable statutory oversight of FFEL servicers. It is in a much stronger position to directly oversee and impose specific, contractually binding requirements on servicers, than a fragmented ownership group of investors in mortgage securities were.

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[25] Brenda Wensil, Federal Student Aid (Nov. 1, 2013), http://ifap.ed.gov/eannouncements/110113DeptLaunchesIncomeDrivenFedStudentLoanRepaymentCampaign.html.

[26] Department of Education, *Income Driven Repayment*, slide 15 (presented at the Dec. 1, 2014 Servicing Summit in Atlanta, Georgia), http://fsaconferences.ed.gov/conferences/library/2014/servicing/2014ServicingSummitIncomeDrivenRepayment.ppt

[27] *Id.* at slide 3. Note that these figures do not include FFEL loans.

[28] *See* Levitin and Twomey, *supra* n.10.

At the same time, because of the Higher Education Act's requirement that the Department contract out servicing to private companies if "practicable," financial incentives that run counter to the borrowers' and taxpayers' interests may still create obstacles to effective servicing and default prevention.[29] As with mortgages, loss mitigation is expensive, and without proper contract design and oversight, servicers have a financial incentive to avoid loss mitigation if it loses them money.

Indeed, the CEO of a major publicly traded for-profit servicer has plainly remarked on the costs of enrolling borrowers in IDR. He stated on an investor conference call that "It's very expensive work … to enroll a borrower into something like an Income-Based Repayment program" and noted that the company does not get compensated for performing above-the-grade "on that side of the equation."[30] While this comment does not indicate that this servicer was engaged in any misconduct, it does show awareness of the increased costs involved. Proper oversight and contract design would ensure that servicing contracts require effective IDR outreach to distressed borrowers, and compensate servicers sufficiently for any increased costs in doing so.

Historically, the Department of Education's contracts with servicers were not structured properly to require and compensate outreach to distressed borrowers. Instead, the "performance-based" contracts gave the financial incentive to place troubled borrowers in deferment or forbearance, where interest continued to accrue, and to prioritize "cost containment" over providing responsive service. Student loan servicers could "aggressively cut operating expenses, provide abysmal service, and risk only marginal losses in current and prospective revenues."[31]

The Department has recently attempted to correct for some of the contractual disincentives by changing the performance-based compensation structure.[32] However, it is unclear if these measures go far enough. For example, the new contract decreases the amount paid to service loans in the grace period before payment becomes due. But the Department of Education's own successful IDR outreach to students in the grace period with large balances suggests that in some

[29] Eric Fink and Roland Zullo, *Federal Student Loan Servicing: Contract Problems and Public Solutions*, https://www.elon.edu/docs/e-web/law/faculty/fink_zullo_federal_student_loan_servicing_report_06_25_2014.pdf.

[30] Shahien Nasiripour and Joy Resmovits, *Sallie Mae Lags in Student Debt Relief Amid Ongoing Federal Probes*, Huffington Post, Sept. 3, 2013 (citing July 18, 2013 Sallie Mae earnings call), http://www.huffingtonpost.com/2013/09/03/sallie-mae-student-debt_n_3839243.html; Deanne Loonin, National Consumer Law Center, *The Sallie Mae Saga* 14 (Jan. 2014) (same), http://www.studentloanborrowerassistance.org/wp-content/uploads/File/report-sallie-mae-saga.pdf.

[31] *See* Fink and Zullo, *supra* n.29, at 11.

[32] Department of Education, *Servicer Oversight and Management*, slide 7 (presented at the Dec. 1, 2014 Servicing Summit in Atlanta, Georgia), http://fsaconferences.ed.gov/conferences/library/2014/servicing/2014ServicingSummitOversightandManagement.ppt.

cases, servicers should be performing additional work during the grace period, not less. In addition, the contracts fail to get to the heart of the matter and directly require counseling borrowers and factor any increased work involved into the compensation structure.

E. Requirement of Good Faith and Fair Dealing

Even if servicers' contracts with lenders or loan holders do not provide proper incentives to achieve the lenders' goals, servicers still have a contractual obligation not to engage in conduct that deprives borrowers of their rights under their contracts with lenders. In any contract, the parties have an implied duty of good faith and fair dealing towards each other in the performance of their contractual duties.[33] This means that servicers, who are the agents of the lender or loan holder, must not engage in conduct that interferes with borrowers' abilities to obtain their benefits under the loan contract or successfully perform their own contractual obligations. Lenders, and their agents the servicers, have a duty to perform their servicing functions in good faith. For example, placing a borrower in forbearance where interest accrues, when she should really be on an IDR plan, clearly violates the duty of good faith.

IV. The parallel to credit cards

Credit card reforms provide a useful template for student loan servicing improvements. From the late 90s-on, credit card holders faced a variety of unfair and deceptive practices.[34] In response, Congress enacted the CARD Act in 2009.[35] Just prior to the CARD Act, the Federal Reserve, Office of Thrift Supervision, and National Credit Union Administration also promulgated rules under the FTC Act imposing reforms on the credit card industry ("the UDAP

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[33] Rest. Contracts (2d) § 205.

[34] Like mortgages and some private student loans, credit card debt is often securitized. Some credit card servicing problems may stem from or be exacerbated by securitization, just as with mortgages and private student loans. However, the securitization structures differ. With credit cards, typically only the "receivables" (amount due from the consumer) are securitized. The account, and servicing of the account, remain with the issuer. Because the credit card ABS investor does not necessarily have visibility or control over what the issuer does, the issuer may engage in riskier underwriting and conduct that maximizes its own profit, but hurts consumers and investors. One pre-CARD Act example in credit cards was "rate-jacking" or "re-pricing" -- increasing the interest rate suddenly and applying it retroactively to existing credit card balances. Although rate-jacking was profitable for the credit card servicer/issuer, it was unfair to consumers and caused some of them to default, which also hurt credit card ABS investors. *See* Adam J. Levitin, *Skin in the Game: Risk Retention Lessons from Credit Card Securitization*, 81 Geo. Wash. L. Rev. 813 (2013); Mark Furletti, *An Overview of Credit Card Asset-Backed Securities* 10 (Federal Reserve Bank of Philadelphia Payments Card Center Discussion Paper, Dec. 2002); Adam J. Levitin, *Rate-Jacking*: *Risk-Based and Opportunistic Pricing in Credit Cards*, 2011 Utah L. Rev. 339 (2011).

[35] Pub. L. No. 111-24, 123 Stat. 1734 (May 22, 2009).

Rule").[36] In addition, the longstanding Fair Credit Billing Act provided servicing protections to credit card holders.

The CARD Act is widely considered to be a success by regulators, academics and consumer advocates.[37] Just one year after the CARD Act took effect, the CFPB noted that it had already reduced late fees, over-limit fees, and deceptive practices like unforeseen interest rate hikes.[38] Subsequent research by regulators and academic economists has demonstrated that these gains are holding up over time.[39] The CARD Act has saved consumers almost $12 billion per year, without increasing interest charges or access to credit.[40] And instead of harming the industry, the CARD Act actually improved bank safety and sound by eliminating unfair practices that caused more risk by leading to mass defaults in times of economic stress.[41]

The remedies provided by the CARD Act and UDAP Rule provide many parallels to student loan servicing. These include:

Universal Default and Repricing. Prior to the CARD Act credit card servicers would sharply raise interest rates on outstanding balances because a consumer was late on a payment by even one day, defaulted or was late on an entirely separate loan, or even simply if her credit score went down. They would also demand immediate repayment of the entire balance if the consumer closed the account.

The CARD Act prohibited repricing outstanding balances, with some exceptions, as did the UDAP rule.[42] The banking regulators reasoned that consumers lacked sufficient control and information to avoid repricing or universal default, which placed unfair power in the hands of the credit card servicer.[43] The UDAP Rule and the CARD Act also prohibited accelerating

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[36] 74 Fed. Reg. 5498 (Jan. 29. 2009). Since the banking regulators' rule was based on their unfair and deceptive trade practices authority, it may provide a useful parallel for legal support for a Bureau rule on similar student loan servicing abuses.
[37] Some concerns remain after the CARD Act. Most notably, the Act's "fee harvester" provisions, intended to protect against very high-fee cards that largely targeted subprime consumers, were undermined by an industry lawsuit and the CFPB's repeal of part of the rule. Other concerns, like deferred-interest plans and add-ons, were not addressed by the CARD Act.
[38] Consumer Financial Protection Bureau, *CARD Act Fact Sheet* (Feb. 2011), http://www.consumerfinance.gov/credit-cards/credit-card-act/feb2011-factsheet/.
[39] Consumer Financial Protection Bureau, *CARD Act Report* (Oct. 1, 2013), http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf; Sumit Agarwal, et al., *Regulating Consumer Financial Products: Evidence from Credit Cards*, 130 Quarterly Journal of Economics 111-64 (Nov. 2014).
[40] *Id.*
[41] Joshua Frank, Center for Responsible Lending, *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* 2 (May 2012), http://www.responsiblelending.org/credit-cards/research-analysis/Unsafe-Unsound-Report-May-2012.pdf.
[42] 74 Fed. Reg. at 5521-23; 15 U.S.C. § 1637(i).
[43] 74 Fed. Reg. at 5522-23.

repayment of the entire balance after account cancelation if the consumer had rejected a rate increase.[44]

Parallel to student loans: According to the Bureau's recent report, private student loan contracts contain "universal default" and "auto-default" clauses that immediately accelerate payment of the loan due to events that have little bearing on the borrower's ability to repay as agreed.[45] These clauses reprise the same unfair conduct at the heart of the CARD Act and bank regulator's UDAP rule. For example, some contracts allow the loan to be placed the loan in default and accelerate payment because a cosigner dies or declare bankruptcy, even though the borrower has been repaying as agreed.[46] Or the student loan may be placed in default because the borrower was delinquent on an unrelated account with the same lender, such as a credit card, even if the student loan is in good standing.[47] As the Bureau notes, securitization means that the student loan servicer might interpret these contract provisions in an irrational way that does not financial benefit the loan holder and is unfair to the borrower.[48]

Just as with credit cards, universal default clauses are unfair in student loans because they are unrelated to the performance of the loan, and the consumer has no power to stop them from happening, even if they are paying as agreed.

Late fees and slow payment crediting. In the decade leading up to the CARD Act, credit card issuers began to charge increasingly more and larger late fees.[49] The fees morphed from a proportionate, risk-based penalty, into a source of revenue extracted by unfair and deceptive practices.[50] Issuers engaged in a variety of tricks that consumer could not have anticipated or prevented in order to maximize their fee revenue. They also engaged in billing practices that made it harder for consumers to pay on time, thus incurring additional late fees – for example, by mailing a statement shortly before the payment due date.[51]

In response, the CARD Act imposed a requirement that penalty fees (including, but not limited to late fees) be "reasonable and proportional" to the consumer's action.[52] The CARD Act also imposed billing and payment processing requirements that allowed consumers to more easily pay on time avoid late fees and finance charges. For example, the payment due date must be the

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[44] 74 Fed. Reg. at 5533-33; 15 U.S.C. § 1637(i)(4).
[45] Consumer Financial Protection Bureau, *Mid-year Update on Student Loan Complaints* 12 (June 2015), http://files.consumerfinance.gov/f/201506_cfpb_mid-year-update-on-student-loan-complaints.pdf.
[46] *Id.*
[47] *Id.* at 13.
[48] *Id.* at 14.
[49] National Consumer Law Center, *Truth in Lending* 7th Ed. (2010) at § 7.5.1 [hereinafter NCLC, *TILA Manual*] .
[50] Joshua Frank, Center for Responsible Lending, *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* 2 (May 2012).
[51] NCLC, *TILA Manual supra* n.49, at §7.7.1.
[52] 15 U.S.C. § 1665d(a).

same day each month, and servicers must give borrowers until at least 5pm to pay on the due date.[53] Payments must also be posted promptly after they are received.[54]

Parallel to student loans: Student loan borrowers are also subject to unfair late fees caused by servicer practices. The FDIC has sanctioned one student loan servicer for late fee practices that purposefully sought to maximize fee revenue at the expense of borrowers.[55] The FDIC sanctioned the servicer for charging late fees after confusing disclosures about how long the grace period would last.

The Bureau has also noted that borrowers are sometimes charged late fees even if they submit a payment before the due date[56], and are sometimes given inaccurate information about whether they will owe a late fee, for example, after applying for a forbearance.[57] Borrowers also complain that their payments take inordinately long to post to their accounts, leading to unwarranted late fees and interest charges.[58]

Allocation of payments. Credit cards may have balances with several different interest rates. For example, the cardholder may have one portion of the balance at a low rate for introductory offers or balance transfers, and another portion of the balance at the normal APR for purchases after the introductory period has expired. Prior to the CARD Act, credit card servicers would allocate payments first to the lowest rate balance.[59] This practice charged consumers more interest than if the payment had been allocated to the highest rate balances first. The CARD Act reversed this practice, requiring that payments in excess of the minimum be allocated first to the highest interest rate balance.[60]

Parallel to student loans: Similar to credit cards, borrowers may have multiple student loans with different interests rates grouped together in one account. Just as with credit cards, private student loan servicers manipulate allocation of payments for their own revenue maximization.

For example, just as with credit cards, student loan servicers sometimes allocate payments first to the highest interest loan.[61] In addition, servicers manipulate the allocation of underpayments and

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[53] 15 U.S.C. §§ 1637(o)(1) and 1666c(a).
[54] 15. U.S.C. § 1666c(a).
[55] *In the Matter of Navient Solutions, Inc. et al.*, FDIC 13-0382b and 0383k (FDIC May 2014), https://www5.fdic.gov/EDOBlob/Mediator.aspx?UniqueID=668ab68c-7c2d-48e5-b880-1e329828a004.
[56] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* 13 (2013) [hereinafter CFPB, *2013 Annual Report*], http://files.consumerfinance.gov/f/201310_cfpb_student-loan-ombudsman-annual-report.pdf
[57] Consumer Financial Protection Bureau, *Mid-year snapshot of private student loan complaints*, section 4, (Jul. 2013)[hereinafter CFPB, *2013 Mid-year snapshot*], http://files.consumerfinance.gov/f/201308_cfpb_complaint-snapshot.pdf.
[58] CFPB, *2013 Annual Report*, *supra* n.56, at 13.
[59] NCLC, *TILA Manual*, *supra* n.49, at §7.7.7.1.
[60] 15 U.S.C. § 1666c(b)(1).
[61] CFPB, *2013 Annual Report*, *supra* n.56, at 11.

overpayments to maximize late fees and interest. As the Bureau reported in 2013, "in the event that a payment is less than the full amount owed, the servicer will distribute the payment among all the loans on a pro rata basis, creating a deficit in all loan accounts and resulting in late fees for all accounts."[62] The FDIC settlement with a major student loan servicer also involved allocation of underpayments that ended up charging borrowers more fees than necessary.[63] On the flip side, borrowers also complain that their overpayments or prepayments are not properly applied to their accounts to reduce their principal or to reduce their highest interest loans.[64]

Billing errors. The Fair Credit Billing Act (FCBA) provides credit card consumers with a remedy for disputes with their servicer.[65] The FCBA gives consumers the right to challenge the servicer's failure to correctly apply a payment to the account, or any computational or accounting error. [66] The FCPA also provides some limited protections for ensuring that a consumer receives a periodic statement at the correct address.[67] However, these provisions have been narrowly construed by some courts to include only the original extension of credit, and not any subsequent finance charges.[68] Student loan servicing reform could take a cue from the FCBA, but broadly apply it to finance charges as well as the original extension of credit.

Parallel to student loans: Student loan borrowers consistently report difficulty getting accurate information from servicers, resulting in an inability to correct billing errors or assert their contractual or statutory rights. For example, the Bureau's recent report on servicemembers experience with student loan servicers indicates their difficulties correcting incorrect billing statements that improperly neglect to reduce their interest rate under the Servicemembers Civil Relief Act.[69] Borrowers from the nonmilitary population also report difficulty correcting billing errors.[70]

V. The limitations of comparisons to consumer financial products

Although the regulatory approaches to mortgages and credit cards provide useful insight for student loan servicing reforms, the comparison has its limits. Unlike mortgages and credit cards, with student loans the federal government is the lender, and has direct, contractual control over the servicers. Accordingly, the federal government has greater responsibility for, and greater

[62] *Id.*
[63] *Id.*
[64] CFPB, *2013 Annual Report*, *supra* n.56, at 8-10.
[65] 15 U.S.C. §§ 1666 and 1666a.
[66] 15 U.S.C. § 1666(b)(4).
[67] 15 U.S.C. § 1666(b)(6).
[68] NCLC, *TILA Manual*, *supra* n.49, at § 7.9.4.
[69] Consumer Financial Protection Bureau, *Overseas & Underserved: Student Loan Servicing and the Cost to our Men and Women In Uniform* (Jul. 2015) [hereinafter CFPB, *Overseas*], http://files.consumerfinance.gov/f/201507_cfpb_overseas-underserved-student-loan-servicing-and-the-cost-to-our-men-and-women-in-uniform.pdf.
[70] *See, e.g.,* CFPB, *2013 Annual Report, supra* n.56, at 19-20.

power over, the federal student loan servicers. It need not rely on market incentive structures to correct servicing problems. Instead, it can directly instruct servicers how to perform their duties to achieve the goals of the federal financial aid program. If this proves too difficult to achieve, then bringing servicing in-house to be performed by a government agency should be seriously considered.[71] The HEA requires outsourcing the servicing contracts only "to the extent possible."[72] If private servicers prove too expensive, or they cannot comply with their contracts and governing regulations, then it is no longer "possible" to retain them.

VI. Consistent violation of servicemembers' rights

Servicemembers are entitled to special protections in student loan servicing, but have faced seemingly intractable difficulty getting servicers to implement them.

Under the Servicemembers Civil Relief Act, active duty servicemembers may have their student loan interest rates (public or private) lowered to 6%.[73] Servicemembers also have the right to defer their federal loans during active duty.[74] These rights promote the financial "readiness" of servicemembers – the soldier's ability to organize her domestic financial affairs to allow her to perform her job duties and deploy quickly.

The Federal Deposit Insurance Corporation and Department of Justice sued one major servicer for SCRA violations in 2014. Prior to this, the CFPB issued several reports on the subject. All servicers should have immediately reformed their practices towards servicemembers in light of these warnings. But as the recent CFPB report noted, obtaining SCRA protections "continues to be an unnecessary struggle" for borrowers, even after these settlements, and "[s]ervicers still do not appear to understand the elements of the SCRA."[75] As a result, servicemembers have been forced to engage in time-consuming and distracting correspondence with servicers to attempt to obtain their rights. At a time when they should be focusing on getting ready for deployment, servicemembers are doing battle with their student loan servicer instead. As the CFPB notes, this ultimately impacts financial and military readiness.

The implications of servicers' continued struggle to correctly apply SCRA rights may go further than just the violation of individual servicemembers' rights. It may be a litmus test indicating that servicers lack the information technology, personnel training, and procedures in general to

[71] Moving federal student loan servicing to the U.S. Postal Service, IRS, or Treasury has been proposed by Eric Fink and Roland Zullo, *Federal Student Loan Servicing: Contract Problems and Public Solutions* § 3.2.2, https://www.elon.edu/docs/e-web/law/faculty/fink_zullo_federal_student_loan_servicing_report_06_25_2014.pdf.
[72] 20 U.S.C. § 1087f(a)(1).
[73] 50 App. U.S.C. §527.
[74] CFPB, *Overseas, supra* n.69, at 6. Although servicemembers may benefit from deferment, in many cases they may be better served by enrolling in an income-based repayment plan instead. *Id.*
[75] *Id.* at 4. We note that there is no indication in the CFPB's 2015 report that the servicer that was the subject of the 2014 action is not in compliance with its settlement agreements with the Department of Justice and the FDIC or was the servicer at issue in the consumer complaints included in the report.

handle any deviations from the norm that require more intensive customer service handling. This could impact not only SCRA rights, but also the treatment of any other borrower requiring special assistance, like resolution of an error or placement on an IDR.

VII. Mandatory arbitration and HEA preemption

Student loan servicers have shielded themselves from the legal consequences of their errors and missteps by imposing mandatory arbitration on private loans, and invoking preemption on federal loans. This prevents consumers from receiving effective relief through the legal system.

Private student loan servicers often use mandatory arbitration to shunt borrowers into the biased private arbitration system, where their rights and remedies are limited. Many private student loan promissory notes contain arbitration clauses.[76] Even though a servicer is not a party to the original loan agreement, servicers have been able to invoke the lender's mandatory arbitration clause and force the borrower out of court.[77]

Federal student loan servicers have also been able to shield themselves from consumers in court. They have in some cases successfully invoked preemption under the Higher Education Act to get lawsuits based on state-law claims dismissed.[78] After preemption, the consumer's claim is completely terminated – they do not even have access to the lesser remedy of arbitration, as they would against a private student loan servicer.

Given servicers' ability to evade accountability in court, it is imperative that regulators and law enforcement agencies step in to protect students.

VIII. Conclusion

Improving student loan servicing is vital to ensuring the integrity of the higher education finance system. Without improvement, borrowers will not be able to access the relief to which they are entitled, and may face default or additional finance charges that they could have avoided. They will continue to face unfair and deceptive practices that result in extra fees and interest charges, and slipshod practices that make it more difficult to manage their accounts responsibility. The

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[76] Christine Hines, Public Citizen, *Righting a Financial Wrong* 3-4 (Feb. 27, 2014), https://www.citizen.org/documents/righting-a-financial-wrong-forced-arbitration-report.pdf; Christine Hines, Public Citizen, *Between a Rock and a Hard Place: Courthouse Door Shut for Aggrieved Private Student Loan Borrowers* (Jul. 2012), https://www.citizen.org/documents/private-student-loans-predatory-lending-arbitration-report.pdf.

[77] *Fensterstock v. Education Finance Partners*, 2012 WL 3930647, 5 (S.D.N.Y.) (S.D.N.Y.,2012)

[78] *Chae v. SLM Corp*. 593 F.3d 936, 938 (9th Cir. 2010). Other courts have not interpreted the Higher Education Act to preempt so broadly as did *Chae. See* William J. Cox, *The Student Borrower: Slave to the Servicer?*, 27 Loy. Consumer L. Rev. 189, 216-17 (2015).

CFPB, together with the Department of Education, bank regulators, and state authorities, should work to create a fair and effective student loan servicing system.

Thank you for the opportunity to provide our comments, and for your continued dedication to protecting student loan borrowers.

Sincerely,

The Center for Responsible Lending