



## Private Student Lending - CFPB Reports

### Executive Summary

The Bureau of Consumer Financial Protection (“CFBP” or “Bureau”) recently released two reports addressing student loan issues. The reports include:

- *The Annual Report of the CFPB Student Loan Ombudsman*, which considers consumer complaints received by the CFPB regarding private student loans; and
- *The Next Front? Student Loan Servicing and the Cost to Our Men and Women in Uniform*, which considers servicing issues associated with Federal and private student loans held by active duty military servicemembers.

The findings in each of the reports indicate that student loan servicing issues are similar to and consistent with servicing and loan modification issues identified in the mortgage loan servicing market.

The CFPB and the Department of Education (“DOE”) jointly submitted a report to Congress in July that highlighted key attributes of the private student loan market, including the characteristics of the loans, lenders and borrowers as well as related consumer protections and fair lending issues. That report serves as a base to inform the recently released reports, and also includes recommendations to modernize the Federal consumer financial laws with regard to private student loans. A brief summary of the report is included as a part of this Regulatory Practice Letter.

### Background

The position of the CFPB’s Student Loan Ombudsman was required by Section 1035 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the “Dodd-Frank Act”) with the purpose of providing timely information to borrowers of private education loans. Section 1035 directs the Ombudsman to receive, review, and attempt to resolve informally complaints from borrowers of private education loans, including, as appropriate, attempts to resolve such complaints in collaboration with the DOE and with institutions of higher education, lenders, guaranty agencies, loan servicers, and other participants in private education loan programs. The Ombudsman must also establish a memorandum of understanding (“MOU”) with the DOE to establish and ensure coordination in providing assistance to, and serving borrowers seeking to, resolve complaints related to their private education or Federal student loans. (This MOU was completed.) The Ombudsman must make appropriate recommendations to Congress and submit an annual report evaluating the Ombudsman’s activities and effectiveness throughout the year. The Annual Report discussed herein is the Ombudsman’s first Annual Report submitted to Congress pursuant to this requirement.

The *Private Student Loans* report submitted to Congress in July 2012 by the CFPB and the DOE was required by Section 1077 of the Dodd-Frank Act.

## Description

### Ombudsman Annual Report

The CFPB Student Loan Ombudsman report is based on 2,900 private student loan complaints received by the CFPB between March 2012 and September 2012, and other information submitted to the CFPB pursuant to requests for information published in the *Federal Register*, stories submitted to the CFPB Web site, and through town halls and other forums. The CFPB indicates these complaints were mostly (approximately 95 percent) focused on servicing issues, including loan servicing and loan modification issues. The CFPB notes the issues were similar to those identified for servicing and loan modifications in the residential mortgage markets.

A sampling of the identified complaints and issues included the following points (as categorized and titled by the CFPB):

#### *Servicing Surprises*

- An inability to speak with personnel empowered to renegotiate a repayment plan.
- An inability to refinance.
- An inability to access repayment plans previously advertised.
- A finding of default even when “good faith” payments are made.
- Bankruptcy-triggered defaults.
- Unexpected checking account deductions to extract payments.
- Mishandling of payments.
- Misapplication of overpayments.
- Confusion resulting from sales of loans and/or servicing rights.
- Limited access to account information.
- Conflicting instructions provided by different servicer employees.
- Difficulty enrolling in offered incentives.
- Barriers to co-signer releases.
- Delayed payments processing timelines.
- Loss of benefits based on servicer recommended actions.

#### *Frustrations Faced by Struggling Borrowers*

- Unfair debt collection practices, such as exploiting borrower confusion.
- Inaccessibility of discharge or alternative arrangements information in cases where the primary borrower died.
- Limited understanding of the differences between Federal and private student loans regarding borrower disability.
- Collection calls received outside of permissible call timeframes.
- Lags in the corrections postings or lack of resolution for inaccurate credit reports filed by the servicer or debt collector.
- Imposition of forbearance fees.

### *Challenges Faced by Military Borrowers*

- Barriers to accessing the *Servicemember Civil Relief Act* (“SCRA”) interest rate cap.
- Errors experienced when processing the SCRA interest rate cap.
- Difficulty determining whether the SCRA interest rate cap had been applied retroactively.
- Barriers to retaining the SCRA interest rate cap throughout active duty status.

### *Other Concerns*

- Confusion between Federal and private student loan requirements at both origination and repayment.

The Ombudsman states the complaints and input provided the CFPB “are not and should not be interpreted as a representative sample,” but suggests “the insights from these data do raise concerns. Specifically, the breadth of potential servicing errors and the inability to easily modify a loan bear an uncomfortable resemblance to experiences faced by homeowners in the mortgage market.” Similarities include: inappropriate application of payments, timeliness in error resolution, and inability to contact appropriate personnel when facing economic hardship. (The Ombudsman notes that many of the complaints were for loans originated prior to the financial crisis and new originations may not be subject to the same practices.)

A variety of short term suggestions were discussed in the report, including:

- Updating commonly-used terminology to better distinguish private student loans from Federal student loans.
- Employing consistent definitions of similar terms among all private student lenders and servicers.
- Changing systems and settings or making “relatively simple” process improvements, such as online updates to applicable interest rates and data sharing capabilities between schools, lenders and servicers.
- Instituting debt management programs through college financial aid offices, alumni associations and third-party counselors, in addition to use of the CFPB’s online student loan tools (*Financial Aid Shopping Sheet* and *Student Debt Repayment Assistant*) and complaint portals.
- Exploring opportunities for creating a refinancing market for private student loans, including efforts to increase the participation of small financial institutions, or develop new businesses with investors and entrepreneurs.

Based on the findings in the report, the Student Loan Ombudsman made the following recommendations:

- Recommendation for the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House Committee on Financial Services, and the House Committee on Education and the Workforce:
  - Identify opportunities to spur the availability of loan modification and refinance options for student loan borrowers.
- Recommendations for the Secretary of the Treasury, the Director of the CFPB, and the Secretary of Education:
  - Assess whether efforts to correct problems in mortgage servicing could be applied to improve the quality of student loan servicing.

- Continue initiatives to increase adoption of the Income-Based Repayment program applicable to Federal student loans. Borrowers who are able to refinance their Federal student loans are expected to be better able to pay their private student loans. The CFPB notes the DOE is working with the Department of Treasury to streamline this process.

## Servicemember Student Loan Report

Servicemembers are granted additional consumer protections including provisions under the *Servicemembers Civil Relief Act*, such as interest rate reductions for men and women in uniform who acquired student loan debt before they went on active duty, and other benefits such as special loan deferral programs, principal reduction options on certain loans for service in hostile areas, and loan forgiveness on certain Federal loans for public service. The CFPB's Student Loan Ombudsman and Office of Servicemember Affairs state that the complexities of these protections and benefits, together with loan servicing problems, have created difficulties for military personnel to manage their debt.

Following the release of the Ombudsman's Annual Report, the two CFPB Offices released a joint report on student loan servicing issues unique to military servicemembers, which includes experiences for both Federal and private student loans. The findings reported generally mirror the servicing issues reported by non-military private student loan borrowers and documented in the Student Loan Ombudsman Annual Report. In addition, servicemembers were found to be adopting less favorable repayment plans, resulting in excess debt, and experiencing difficulties when requesting or attempting to retain protections under the SCRA. More specifically, servicing errors were found to prevent servicemembers from accessing their full range of protections, benefits were awarded inconsistently by servicers and were frequently misapplied to servicemembers, and current law may force servicemembers to forgo SCRA benefits in order to receive other benefits.

The servicemember report is based on findings obtained through analysis of consumer complaints and stories submitted to the CFPB, information provided through town halls and forums, and program guidelines.

In conjunction with the release of the servicemember student loan report, the CFPB announced that it had entered a partnership with the Department of Defense to create better awareness of the rights and options for servicemember student loan borrowers. The partnership is to include training Judge Advocate Generals and Education Service Officers, and working with personal financial counselors on military bases. The CFPB also announced the release of a new information guide for servicemembers with student loans, and has posted new questions to its *Ask CFPB* Web page.

## Private Student Lending Report

In July 2012, the Bureau and the DOE jointly submitted a report to Congress summarizing their review of the private student loan market and related consumer protection issues (as required by Section 1077 of the Dodd-Frank Act). Key findings highlighted in the report include:

- Over the past ten years, the private student loan market grew from less than \$5 billion in 2001 to more than \$20 billion in 2008 and declined again to less than \$6 billion in 2011.
- During the growth period of 2005 to 2008, private student lender underwriting standards loosened and school financial aid offices were less involved in the lending process.
- Since 2008, underwriting standards have tightened and include features such as co-signers and school certifications regarding student financial need.
- Many borrowers do not fully understand the differences between Federal and private student loans and do not exhaust their Federal borrowing limits before turning to private loans.
- A significant percentage of private student loan borrowers attended for-profit colleges.
- Loan defaults have increased since the 2008 financial crisis.
- Private student lenders are generally heterogeneous, though small programs also exist to target specific sectors.

The study included CFPB recommendations to modernize the Federal consumer financial laws with regard to private student loans, including the following:

- Require lenders to obtain an affirmative certification from the institution of higher education that the loan amount does not exceed the student need.
  - The DOE separately suggested that institutions of higher learning be required to determine if a borrower has exhausted his eligibility for Federal student aid and certify a borrower's need for a private education loan.
- Consider modifications to the U.S. Bankruptcy Code that would permit greater flexibility for restructuring payment options.
- Clarify the definition of a private student loan to incorporate products currently in use, and to exclude other Federal education loans.
- Explore how to facilitate greater transparency of existing private student loan obligations, similar to the National Student Loan Data System ("NSLDS") applicable to Federal student loans, giving consideration to making the system comparable to and compatible with the NSLDS.
- Determine whether additional data is needed to enhance consumer decision-making and lender underwriting, such as post-graduation outcomes for employment and wages by program of study, to better inform a consumer's decision regarding which school to attend or continue attending.
  - The CFPB suggests that additional data for outcomes might also dissuade lenders from using other indicators, such as cohort default rates ("CDR") and graduation rates in underwriting decisions, and might give "the public and Federal regulators greater confidence that underwriting is in compliance with the nation's fair lending laws."

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## Commentary

The CFPB notes that the combined Federal and private student loan market exceeds \$1 trillion with approximately 15 percent of the debt attributable to private student loans. The market is continuing to grow owing in large part to new originations necessitated by escalating college tuitions and related costs. The CFPB says the growth is also related to the poor economic environment since the financial crisis, which has negatively impacted default rates and caused deferred and accrued interest balances to increase outstanding credit.

The private student loan reports underscore the breadth of the CFPB's focus on consumer lending activities, the importance of consumer complaints data to serve as a guide to CFPB investigations/examinations, and the Bureau's comprehensive examination approach to protecting consumers through key lending regulations (including the *Truth-in-Lending Act* ("TILA"), the *Equal Credit Opportunity Act* ("ECOA"), the *Fair Credit Reporting Act* ("FCRA"), the *Fair Debt Collection Practices Act* ("FDCPA"), the *Federal Trade Commission Act* ("FTCA"), and the *Consumer Financial Protection Act*).

The reports also distinguish nonmortgage servicing as no less important than mortgage servicing and, interestingly, as affected by similar issues. Notably, for the first seven months of consumer complaint data, the most commonly communicated borrower concern was difficulty negotiating a repayment plan, which brings to mind issues related to recent mortgage loan modifications. In addition, borrowers identified concerns in the areas of payments processing, complaint and error intake and resolution, points of contact and financial counseling, all of which were also concerns identified in mortgage loan servicing and addressed by the CFPB's recent proposed rule (see Regulatory Practice Letter 12-17). Given this focus on servicing and the similarity of issues, it is reasonably likely that the proposed mortgage servicing standards could be applied, in some form and to the extent practicable, to the servicing of private student loans. At a minimum, such standards will likely be reflected in the expectations of examiners.

Similarly, the recent Settlement Agreement between the five largest mortgage servicers and the 49 State Attorneys General, the Department of Justice and the Department of Housing and Urban Development ( see Regulatory Practice Letter 12-06), which included mortgage servicing standards specific to servicemembers under the SCRA, will serve to focus examiner attention on these consumer protection provisions and their application to student loans, consistent with the concerns identified in the Ombudsman/Office of Servicemember Affairs joint report.

Although the recommendations in the reports are not directed specifically to lenders or servicers, some issues could be addressed voluntarily and immediately by lenders or servicers without action by Congress or any Federal agency, including: identifying refinancing and/or loan modification options for certain private student loans; developing and/or reviewing policies and procedures associated with payments processing, SCRA administration, and default servicing (including single point of contact); enhancing complaint and error intake and resolution processes; obtaining certifications from schools regarding student need; and updating or modifying systems processes.

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