Student Aid Policy Analysis

Education Lending Suggestions for the Consumer Financial Protection Bureau (CFPB) and the Private Education Loan Ombudsman

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INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (P.L. 111-203)[1] established the Consumer Financial Protection Bureau (CFPB),[2] which will start operating on Thursday, July 21, 2011.

The Dodd-Frank Act gives the CFPB regulatory oversight over private student loans. It also gives the CFPB supervision and enforcement authority over most of the lenders that make private student loans, including banks with $10 billion or more in assets and all non-bank financial institutions. The legislation also establishes a Private Education Loan Ombudsman within the CFPB.

The Private Education Loan Ombudsman will provide a centralized source of assistance to borrowers of private education loans, including the informal resolution of borrower complaints. The Ombudsman will compile and analyze data on borrower complaints regarding private education loans, which will help identify patterns of abuse. This ultimately may lead to targeted enforcement activities and the introduction of new regulations.

The CFPB is required to report on the growth and evolution of the US private education loan market, the extent to which families rely on private education loans, the characteristics of private education loan borrowers,[3] the characteristics of private educational lenders, credit underwriting criteria for private education loans, the pricing of private education loans, consumer protections available to private education loan borrowers and the terms and conditions of private education loans.

The CFPB is also responsible for making recommendations for legislative changes to improve consumer protections for private education loan borrowers.

A STUDENT LENDING TO DO LIST

This student aid policy analysis paper presents the new Consumer Financial Protection Bureau and Private Education Loan Ombudsman with a set of suggestions concerning private education loans.

[1] www.gpo.gov/fdsys/pkg/PLAW-111publ203/content-detail.html
[2] www.consumerfinance.gov
[3] Borrower characteristics include the types of colleges attended; demographic characteristics such as income, education level, race, geography, age, gender and dependency status; and whether borrowers exhaust federal loan options before relying on private education loans.

1. **Hire an assistant director for oversight over private student loans.** The assistant director will report to the director of the CFPB and be the top official with responsibility for private education lending. The CFPB has not yet hired an assistant director or ombudsman, making it difficult for the CFPB to start helping students and their families. The ideal assistant director would be someone with prior consumer protection experience, such as a former staff attorney at the Federal Trade Commission or an attorney from the office of a state attorney general, and the assistant director should be familiar with education lending and its history.

2. **Require all private education loans to be school-certified.** There are two main types of private education loans, direct-to-consumer and school-certified. With a direct-to-consumer loan, the lender pays the loan proceeds directly to the borrower and the college is never notified about the loan.[4] With a school-certified loan, the lender seeks approval of the loan amount from the college financial aid administrator before disbursing the loan. This gives the college financial aid administrator an opportunity to counsel the student about smart borrowing (e.g., exhaust the less-expensive federal education loans before relying on the more-expensive private student loans), to help the student minimize his or her student loan debt and the cost of that debt. It is an effective tool for preventing students from over-borrowing. This also benefits the lender by reducing opportunities for fraud. The law stopped short of requiring all private education loans to be school-certified, but the CFPB could implement such a requirement in regulations.

3. **Create a centralized clearinghouse for tracking complaints about student loans.** This will permit analysis to identify patterns of complaints and trends. The complaints should be tracked according to type of complaint, loan characteristics (e.g., amount, term and interest rate), individual lender, lender characteristics, borrower characteristics and characteristics of the educational institution.

4. **Track data on private education loans.** There currently is a lack of accurate, comprehensive data on private education loans because there is no requirement that lenders report even basic data to a central information repository.[5] For example, there is no reliable publicly-available data concerning annual private education loan origination volume, total private education debt outstanding and loan interest rates and other terms. There also isn't any data disaggregated by education level and/or postsecondary institution. Such data would have the potential to inform public policy concerning private education loans.

5. **Establish a Private Education Loan Ombudsman.** The Dodd-Frank Act requires the designation of a private education loan ombudsman within the CFPB. It is important that the CFPB establish a private education loan ombudsman as soon as possible to help borrowers mediate disputes with their lenders.

[4] Section 480(j) of the Higher Education Act of 1965 and the regulations at 34 CFR 675.5(c)(2)(iii) defines estimated financial assistance as including private education loans, but only loans known to the college at the time the determination of the student's need is made. If the sum of the private education loans and other non-federal loans and non-federal aid exceeds the expected family contribution (EFC), the college is required to reduce need-based federal student aid by the amount of the excess.

[5] The Integrated Postsecondary Education Data System (IPEDS) data concerning private education loans is inconsistent and unreliable. Data concerning private education loans in Common Data Set (CDS) is reported voluntarily and accordingly is incomplete. There is a tendency for private education loan data to be lacking for colleges with the highest average debt at graduation.

6. **Restore bankruptcy protections for borrowers of private education loans.** The CFPB should recommend repeal of the bankruptcy exception to discharge for private education loans.[6] This will put pressure on education lenders to be more accommodating for borrowers who are experiencing financial distress. The exception to discharge should be repealed for all private education loans, regardless of whether the lender making the loans is for-profit or non-profit. While some lenders have argued that bankruptcy discharge should be permitted only after a good-faith effort to repay the loans over a five-year period, it is unclear why private education loans should be treated any differently than credit card debt under the US Bankruptcy Code. The anti-abuse provisions in the US Bankruptcy Code are sufficient to prevent able-bodied students from discharging their debts immediately after graduation. But if a five-year period is deemed necessary, then it should be encoded both prospectively and retrospectively, such as requiring the circumstances that prevent the borrower from repaying the debt to either have lasted for a continuous period of at least 60 months or be expected to persist for a continuous period of at least 60 months.

7. **Require lenders to send borrowers loan statements at least quarterly while the students are enrolled in college.** The statements should show the loan balances (including all accrued but unpaid interest in addition to capitalized interest and the outstanding principal balance) and the loan's current interest rates, as well as the total interest the accrued since the previous statement. The statements should be provided to the borrower at least once a quarter and preferably monthly while the student is enrolled in college, instead of waiting until the student graduates. This will help prevent surprises when the students graduate. It may also help students minimize their debt by increasing their awareness of the debt. It will benefit lenders by reducing delinquency and default rates.

8. **Ban discrimination in credit underwriting for private education loans.** Currently there do not appear to be any federal laws banning discrimination in private education lending, while federal education loans are protected by a loose patchwork of anti-discrimination requirements. Protected categories should include race, color, national origin, religion, gender, marital status, sexual orientation, age and disability status.[7] The discrimination ban should apply both to loan approval and the setting of interest rates and fees.

9. **Monitor education lender advertising.** The CFPB should monitor education lender advertising to help identify and respond to abusive advertising practices. Due to a lack of prior experience with loans, some students demonstrate a greater degree of vulnerability to misleading advertising. Accordingly, the CFPB in its watchdog role should take steps to *proactively* protect students from harm, such as monitoring education lender advertising for problematic practices. These problematic practices, some of which are identified in section 140 of the Truth in Lending Act (15 U.S.C. 1650), should include the misrepresentation of loan terms (especially those terms that relate to the cost of the loan) and comparisons of private education loans with federal education loans. The CFPB should also monitor education lender advertising for the omission of material information about loan terms. For example, a comparison of monthly loan payments without a

[6] The CFPB's authority is limited to private education loans. As such, the CFPB cannot recommend a repeal of the bankruptcy exception to discharge for all education loans, including both federal and private education loans.
[7] The Equal Credit Opportunity Act (ECOA) [15 USC 1691 et seq] applies to private student loans and bans discrimination on the basis race, color, religion, national origin, sex, marital status or age. The CFPB will have enforcement authority over the ECOA.

concomitant comparison of total loan payments might be considered to be misleading, since the repayment term in years may be manipulated to mislead borrowers into believing that one loan is less expensive than another.

10. **Establish an advisory board.** The CFPB should establish an advisory board of students, families of students, college financial aid administrators, non-profit consumer groups, a representative of the private student loan industry and other external experts on private education loans to serve as a source of ideas and recommendations regarding private education loans.

11. **Improve financial literacy training for college students.** Promoting financial literacy for college students will help them make smarter borrowing decisions. The CFPB should consult with the President's Advisory Council on Financial Capability for ideas on ways to improve financial literacy.

RECOMMENDED READING LIST

The following are a variety of reports about private education loans that are relevant to the mission of the CFPB.

- Matthew Reed, *Critical Choices: How Colleges Can Help Students and Families Make Better Decisions about Private Loans*, The Project on Student Debt, July 13, 2011. www.projectonstudentdebt.org/pub_view.php?idx=766

- Mark Kantrowitz, *Improving Borrower Satisfaction and Compliance by Adopting a Better Communication Strategy*, December 23, 2010. www.finaid.org/educators/20101223lendercommunications.pdf

- Deanne Loonin, *Too Small to Help: The Plight of Financially Distressed Private Student Loan Borrowers*, National Consumer Law Center, April 9, 2009. www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf

- Mark Kantrowitz, *Growth in Cumulative Education Debt at College Graduation*, July 30, 2009. www.finaid.org/educators/20090730cumulativedebt.pdf

- Mark Kantrowitz, *Characteristics of Private Student Loan Borrowers Who Do Not Use Federal Education Loans*, June 7, 2009. www.finaid.org/educators/20090607private_vs_federal_loans.pdf

- Mark Kantrowitz, *Characteristics of Borrowers with Excessive Debt*, May 11, 2009. www.finaid.org/educators/20090511excessivedebt.pdf

- Mark Kantrowitz, *Analysis and Evaluation of Iowa Student Loan Practices*, September 19, 2008. www.finaid.org/educators/20080919iowaag.pdf

- Deanne Loonin, *Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers*, National Consumer Law Center, March 2008. www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf

- Deanne Loonin, *No Way Out: Student Loans, Financial Distress and the Need for Policy Reform*, National Consumer Law Center, June 2006. www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf