

California proposes student loan servicing rules; licensing, borrower protection, and recordkeeping mandates to siphon Department of Education compensation

The California Department of Business Oversight (DBO) has released [proposed regulations](#) pursuant to the state's [2016 Student Loan Servicing Act](#). The legislation, approved by the Governor September 29, 2016, authorized the Commissioner of the DBO to exercise rulemaking authority beginning January 1, 2017. All servicers of private and federal student loans must comply with the Act and its final regulations starting July 1, 2018.

The proposed regulations, to be codified at Subchapter 15 to Chapter 3 of Title 10 of the California Code of Regulations, implement the licensing, borrower protection, and recordkeeping provisions of the Act. The proposed regulations are subject to comment [until November 6](#). No public hearing is currently scheduled; however, interested persons may request a hearing at least 15 days prior to the close of the comment period.

In conjunction with the proposed regulations, the DBO has also released its [Notice of Rulemaking Action](#) (Notice) and [Initial Statement of Reasons for regulations under the California Student Loan Servicing Act](#) (Statement). The DBO expects that compliance with the proposed regulations will benefit California's economy by increasing the amount of borrowers' discretionary income, stimulating investment, lowering defaults, and increasing borrower credit scores.

In its Notice, the DBO states that the proposed regulations further the legislature's objective to "promote meaningful access to, and reliable information about, student loans, federal alternative repayment and loan forgiveness options, and quality customer service and fair treatment." The Notice emphasizes that the regulations require trained customer service representatives to "encourage borrowers to enroll in an affordable, income-driven, alternative repayment plan, rather than forbearance which increases borrowers' debt load."

The Statement cites an Obama administration estimate that, as of January 2015, there were roughly [4,156,000 federal student loan borrowers in California](#). The Statement also cites the findings of the September 2015 CFPB Student Loan Servicing Report as providing the "backdrop" for the state's legislation and rulemaking. In particular, the Statement emphasizes that the Report identified servicers' lack of facilitating enrollment in alternative payment plans and loan forgiveness options as a predominant source of complaints.

However, the [CFPB Consumer Complaints](#) data would seem to belie the need for the Act and the excessive regulations. That data indicate that in the roughly five years that the Bureau has been receiving complaints, only 3834 complaints were received from California borrowers—roughly one complaint for every 1,084 borrowers. Of this total, 3359 complaints (87.6%) were "closed with explanation." Furthermore, the data indicate that only a small number of student loan borrower complaints in California were entitled to relief. Only 365 out of the 3834 complaints (9.5%) were closed with some sort of relief—and only 117 complaints (3.1%) were "closed with money relief."

The Regulations provide that licensees must pay a \$300 application fee, a \$100 fee for investigation of the applicant, and the costs of the examinations, conducted at least once every 36

months. All remaining costs and expenses incurred in the administration of the Act are to be recovered by the Commissioner's annual assessment—a pro rata share based upon the licensee's servicing activities in the state—with notices distributed to licensees on or before September 30th of each year.

Until such time as the DBO's student loan servicing oversight is functioning, it is impossible to know the full cost of the new regulations and requirements. Nonetheless, it is clear that the cost will be borne largely by federal student loan servicers as the DBO currently notes that approximately 93% of the total student loan debt is made up of federal student loans. Since the most a federal student loan servicer can earn is \$2.85 per borrower per month (the amount paid for borrowers who are current on their loans) it seems likely that the cost imposed on federal student loan servicers will effectively result in the Department of Education paying DBO administrative expenses. Despite this reality, the Notice maintains that "some or many of the requirements of the proposed rules may not add additional expense, or add absorbable expense." In a further expression of uncertainty, the DBO admits that it "is unknown whether services will have to hire additional staff to comply with the [Regulations]."

Licensing

The DBO has designated the Nationwide Multistate Licensing System & Registry (NMLS) for the processing of applications, amendments, surety bonds, notices, fees, filings, and supporting documentation. In a notable addition to the plain text of the Act, the regulations allow "any information or material" submitted to NMLS to be shared "with any governmental agency" including but not limited to the California Attorney General, the California Department of Justice, the U.S. Department of Justice, the U.S. Department of Education, the Consumer Financial Protection Bureau, the Federal Bureau of investigation, state, local or federal agencies, state attorneys general, and county district attorney's offices.

The regulations also establish increased bonding requirements for larger servicers. All servicers must maintain a surety bond of at least \$25,000 under the text of the Act. The regulations have increased this requirement to: \$50,000 for those with an aggregate loan value of more than 50 million but not more than 100 million; \$75,000 for those with over 100 million but not more than 250 million; and \$100,000 for those with over 250 million.

The regulations also require each applicant to submit copies of its policies and procedures demonstrating how it will comply with certain borrower protections. Those protections include: providing information regarding repayment and loan forgiveness options via website and written correspondence; responding to qualified written requests; and inquiring how a borrower wishes to apply overpayments.

Borrower Protections

The regulations have elaborated on the Act's requirements regarding online account access, customer service, and the provision of entitlements information. All servicers provide on their websites "complete, detailed information and account records for each student loan borrower" via a secure log in system accessible to the borrower only. The system must be available at all

times except for periods of routine website maintenance. The account records must include a consolidated report for each borrower and a loan history for each loan serviced.

A consolidated report must include: a borrower name; the number of student loan(s) serviced; and the cumulative balance owing for the borrower. The consolidated report must also show, for each loan: whether the borrower has applied for or is repaying under an alternative repayment plan and listing the plan chosen; whether the borrower has applied for, or qualifies for; any loan forgiveness benefit; a loan number; the type of loan; the origination amount; the terms; the balance; and the payment status. A loan history must include information and dates regarding: disbursements; interest accruals; fees; late charges; any miscellaneous charges; and payments received.

Other borrower protections provided by the regulations include the requirements that servicers credit any electronic payment on the day “electronically paid by the borrower” if posted before a servicer's cut-off time posted on its website and that servicers credit physical payments on the day received. The information available on the secure log in system must reflect payments within three business days of the date of payment. Servicers must also apply co-signer payments only to the specific loans for which the payor has co-signed.

Each servicer must prominently post on its homepage a toll-free telephone number that borrowers may call to discuss their student loans with a live person. Those live persons must also be trained by the servicer to discuss alternative payment plans and loan forgiveness benefits. Here the DOB has made clear that, given “the substantial negative consequences of forbearance,” the representatives must be trained in the difference between forbearance and alternative repayment plans, be able to answer questions regarding the difference, and encourage borrowers to elect an alternative repayment plan instead of forbearance.

Servicers must also post a plain language description of repayment and loan forgiveness options available for federal student loans on its website, with links to specified Department of Education resources. This same repayment and loan forgiveness information must also be sent to each borrower with the servicer’s toll-free customer service telephone number, at least once per calendar year. The regulations propose even more restrictive requirements for servicers of private student loans. In addition to providing a plain language description of private student loan alternative repayment arrangements on its website and mailing an annual notice, a servicer of private student loans must also establish policies and procedure that ensure the provision of accurate private student loan repayment arrangement information and consistent presentation of those arrangements to similarly situated borrowers. All communications, for federal and private loans, must be conducted according to the borrower’s preferred method.

Recordkeeping

Servicers are required to maintain a current student loan servicing report consisting of the aggregate of all of the information required for borrowers’ individual consolidated reports. The servicer must also maintain loan servicing records for each individual loan, including, at a minimum: the borrower’s consolidated reports and loan history; the borrower’s application; disclosure statements sent to the borrower; the promissory note or loan agreement; the complete

loan history; any qualified written requests; borrower instructions for how to apply overpayments; and statements of account sent to the borrower.

If the servicer sells, assigns, or transfers any servicing rights, records must also include the contract and delivery schedules detailing which loan were sold, assigned, or transferred. All records must be kept for a minimum of three years after the loan serviced has been paid in full, assigned to collection, or sold, assigned, or transferred. Those records must be kept in a format that does not allow for changes to the stored document according to national industry standards, and reproductions must include authentication identifying any reproduction as an exact, unaltered copy of the original record.