Consumer Finance Monitor (Season 4, Episode 31): The CFPB's Summer 2021 Supervisory Highlights: A Close Look at Student Loan Issues

Speakers: Chris Willis, Heather Klein

Chris Willis:

Welcome to the Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. I'm your host, Chris Willis, the Co-practice Leader of Ballard Spahr's Consumer Financial Services Group. And I'll be moderating today's program.

Chris Willis:

For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted the blog since 2011, 10 years now, so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those of us in the industry. So to subscribe to our blog or get on the list for our webinars, please visit us at ballardspahr.com. And if you like our podcast, let us know. Leave us a review on Apple Podcasts, Google, or wherever you get your podcasts.

Chris Willis:

Now, today, we're going to be talking about the student loan aspects of the CFPB's most recent Supervisory Highlights. And I'm joined by someone who is a significant expert on all things student lending, Heather Klein from our Philadelphia office, who is, as I said, one of our most senior, most experienced, and most knowledgeable associates about many things, including, pertinent to today, student lending. So Heather, welcome to the podcast.

Heather Klein:

Thanks, Chris. Happy to be here.

Chris Willis:

So the CFPB put out a pretty big issue of Supervisory Highlights in the summer of 2021, which is where we are right now. And there was a big piece of it about both student loan origination and student loan servicing. So I'm going to ask you to tell our listeners about some of the aspects of it. But the first thing that I noticed in the Supervisory Highlights was an advertising issue related to student lenders and the idea that there were advertisements for student loans that advertised rates that were "as low as" some percentage. And that seems like an issue that the FTC has dealt with and the CFPB has dealt with in the past. And it comes up a lot, not just related to student loans. But what was the CFPB's particular take on the as low as rate advertisements in this edition of Supervisory Highlights as it pertained to student loans?

Heather Klein:

Yeah, you're absolutely right. Regulators have a strong dislike for "as low as" advertising claims. So this is not necessarily a new finding. But the CFPB had an interesting take on it. So their finding was that in conjunction with the as low as X percent advertisement, the private student lender disclosed certain conditions to obtain that rate. They disclosed, for instance, that the borrower must make automatic payments and that the rate was available only for applications filed by a certain date. But the lender did not state that the rate would depend on the borrower's creditworthiness. And the CFPB said that the net impression of that marketing was that it was likely to mislead an applicant because a consumer would not necessarily know or understand that in order to get the as low as rate it was contingent on their creditworthiness.

Heather Klein:

Now, Chris, to you and me, that's something that we probably see as an obvious fact, that of course a rate would depend on creditworthiness, but the CFPB took issue with the omission of the creditworthiness disclaimer and concluded that the marketing as a whole was deceptive.

Chris Willis:

Now, one of the things I've always perceived about as low as advertising in the regulators minds is that they view it as a bait and switch, that they put their sort of top line for the best, most creditworthy customers out there, and then lots of people respond to the ad and get a higher rate because they have not as good credit. And so there's always discussion about how many people, how many applicants have to actually get the headline rate. Was there any discussion about that particular issue in Supervisory Highlights, or are we still left to sort of make our own judgment on that?

Heather Klein:

Yeah, we're still left to make our own judgment. The FTC had put out some very, I would say, aggressive guidance on that, that you just referenced it. But the CFPB did provide guidance in terms of how a creditor could advertise their rates and what the creditor in this instance did to fix the problem or the alleged problem. And so to resolve the issue, the creditor disclosed the range of rates and disclosed that the lowest rate was only available for the most creditworthy applicants in addition to making some other disclosures. So not really a surprising finding.

Heather Klein:

Just the other day, I was reviewing a pre-screen letter for private student lender and made the exact same observation that a range of rates would be far less risky than using an as low as representation. But it's noteworthy that the CFPB pointed this out and something that all creditors, as you noted Chris not just in the private student loan space, should be taking note of.

Chris Willis:

So let's go into the next issue that I noticed in Supervisory Highlights. And it concerns an issue that's really been in the public eye a lot. And it pertains to federal student loans, not private ones. The federal government has a program called Public Service Loan Forgiveness, and the CFPB had something to say about how federal student loan servicers presented that PSLF program to borrowers. So I want to hear about what the CFPB said, but for the benefit of our listeners can you first just tell us a little bit about what is PSLF.

Heather Klein:

So to qualify for PSLF, one of the first criteria is that the borrower has to have a direct loan or a direct consolidation loan, and they need to make 120 qualifying payments on that loan while working for an eligible employer and repaying under an eligible repayment plan. And then after those 10 years of qualifying payments, they can have the balance of their loans forgiven. But as you note, the program has been receiving a lot of negative press over the years and is likely to continue to do so given the fact that Richard Cordray is head of the Federal Student Aid at the Department of Education. So he's, of course, focused on this in addition to the CFPB.

Heather Klein:

But let's talk for a few minutes about what the bureau said in its Supervisory Highlights. So they had a few issues, I think four in total, but I'm going to lump two of them together because they're kind of the same issue but stated a little bit differently. And that one would be that the CFPB observed that servicers provided FFELP borrowers with information about PSLF that gave FFELP borrowers the impression that they could qualify for PSLF when in fact a FFELP borrower would need to consolidate their FFELP loans into direct consolidation loans in order to have an eligible loan to make payments on. So that was one side of the finding, that the servicers were found to give borrowers the impression, give FFELP borrowers the impression that they were eligible for PSLF.

Heather Klein:

So the other side of the coin is that servicers, allegedly, when talking to FFELP borrowers said that no, there is no way you, and I'm exaggerating here, but for the purposes of demonstrating the point, the servicers might have said something along the lines of FFELP loans are ineligible for PSLF. You know, unfortunately this is not a repayment plan that you can qualify for. And the bureau noted that in fact that could have been misleading to borrowers, to FFELP borrowers who could have consolidated their FFELP loans into direct consolidation loans in order to take advantage of PSLF.

Chris Willis:

Thanks very much for that, Heather. And I think there was also some material in the Supervisory Highlights to the effect that servicers were giving some incorrect employment or other eligibility information for being able to apply for PSLF. What did the bureau say in that regard?

Heather Klein:

So they had two findings. And one actually relates to my prior remarks about consolidation into direct loans before being considered for eligibility into PSLF. And that is that FFELP borrowers were allegedly told that they should submit an employer certification form and that that would be decisioned for a determination of whether they would qualify, well whether their, I should say, whether their employer qualified for PSLF. And the bureau noted that the servicers should have disclosed that FFELP borrowers who submit employer certification forms are going to be declined automatically because the form is coming from a FFELP borrower. So in fact, the FFELP borrower should be looking into consolidating their loan first and then proceeding with the employer certification process.

Heather Klein:

And the bureau, I think rightly, points out that in that situation a FFELP borrower may be delayed in their ultimate goal of achieving entrance into the PSLF program because there's a certain amount of time during which an employer certification form needs to be processed. You know, that's lost time when they could have been proceeding with the direct consolidation loan. And then just to wrap up the PSLF discussion. The other piece of this is that the bureau noted that servicers misrepresented the employer types that were eligible for PSLF, that rather than disclosing the full range of employers who are eligible, the servicers more generally noted that if the borrower worked for a nonprofit they qualified and other employers didn't qualify.

Heather Klein:

So what we have, just to step back for a moment, is what we've seen time and time again from the bureau, an expectation that servicers spoon-feed information about eligibility for federal student loan repayment plans to federal student loan borrowers and taking federal student loan servicers to task for omissions in that. You know, frankly it's a very, as consumer advocates have said, as the industry has said, federal student loan repayment programs are objectively extremely complicated. And one thing that I'm hoping for while Richard Cordray is head of the Federal Student Aid Office at ED is that there will be some more guidance from the office about communications that should be made to borrowers and more standardization of direction and information about all of these repayment programs, and perhaps even we'll see a simplification of the repayment programs.

Chris Willis:

I was just thinking that exact thing, Heather. I feel like Congress needs to enact sort of the student loan version of the Truth in Lending Simplification Act. So thanks for taking us through the PSLF material. Let me hit a few of the other issues that I noticed in Supervisory Highlights relating to student loans. One of them had to do with disaster forbearance and the idea that servicers sort of automatically put accounts in disaster forbearance. And that seems like a consumer-friendly practice to say, "Oh, you're in an area effected by a hurricane or an earthquake or something, so I'm going to put you on forbearance automatically." But the bureau took issue with that. Why is that?

Heather Klein:

Yeah. And I imagine that the servicer involved here had the best intent in providing a blanket natural disaster forbearance. There were some unfortunate follow-on effects as a result of this blanket forbearance. One being that some borrowers actually didn't want to be placed in forbearance because they were able to continue making their payments, and they did not appreciate having unpaid interest added to their balance during the forbearance period. And that's an issue that we've seen in other markets for consumer financial products as well. The other follow-on effects that happened included borrowers being disenrolled or unenrolled from the Auto Debit Program. Borrowers lost their interest rate reductions for making on-time payments. And these are things that, in certain instances, the borrowers complained to the servicer about, and the servicer apparently, at least in one instance, did not reverse the consequences of the unwanted automatic forbearance. And so the CFPB concluded that for consumers who explicitly did not want the natural disaster forbearance, the injuries to them were not outweighed by the countervailing benefits of having that forbearance applied. And so they directed the servicers to cease automatically enrolling consumers in the natural disaster forbearances.

Heather Klein:

And, Chris, as you noted at the outset, some of these issues are really germane outside of the student loan market as well, and especially given all of the wildfires and flooding that's going on these days. It's certainly an issue that, I think, the CFPB will be looking at as they examine lenders in other markets as well, and servicers in other markets.

Chris Willis:

And I feel like this discussion in Supervisory Highlights and the discussion you just had about these disaster forbearances, I think should cause the industry to ask itself a question. And I don't think we know the answer to the question. But is it better to just not automatically enroll anybody in a disaster forbearance ever and just make people call in and say, "Hey, my house is flooded or my house was destroyed by an earthquake," or whatever, or should the industry be exploring automatic enrollments that don't have some or all of the negative consequences that you just mentioned in this particular student loan portfolio?

Chris Willis:

So imagine, for example, an automatic forbearance that didn't accrue interest during the forbearance period, and therefore there was nothing to capitalize, or that didn't cause you to lose an on-time payment discount. Maybe even one that didn't turn off your recurring ACH payment, but with the disclosure to the customer that says, "Hey, we've turned it off for these couple of months, but it's going to turn itself back on in two months." I think we have to ask our self the question, is that worth exploring, or do we need to just stay away from it altogether?

Heather Klein:

That's a great point. And I think to take it one step further, now is a great time for servicers to be considering those questions and making those kinds of decisions so that they can formalize their procedures now when they're not in the aftermath of a natural disaster and needing to make a quick decision. They should, with the benefit of time, be looking at the systems settings that should be in place and what protections they can apply so that if they are to apply a natural disaster forbearance automatically it will not, to your point, have these negative follow-on effects.

Chris Willis:

Let's talk about another theme in the Supervisory Highlights that I feel like has been a recurring theme. As I get older, I feel like I see this over and over again. And that's the idea of handoffs of a loan from one servicer to the other. So if I think back to the subprime mortgage crisis and the mortgage servicing activity that occurred in the wake of the passage of Dodd-Frank and after the creation of the CFPB, there were specific provisions in Dodd-Frank about service or transfers between one mortgage servicer to another and the fear on the regulatory front that whatever loss mitigation or other special program that a customer was enrolled in at one mortgage servicer would not be transferred faithfully to a subsequent servicer. And now, I think the CFPB has said something similar about student loan servicing transfers. So what's going on there?

Heather Klein:

Absolutely. Yeah, you're right that servicing transfer issues are not new issues in either the mortgage space or in the student loan space. In this particular Supervisory Highlight, the bureau found that income-based repayment plans were not transferred over to the new servicer and the new servicer billed borrowers for inaccurate payment amounts and in some instances even initiated auto debits in the incorrect amount. Also, interestingly, the servicers notified consumers of the error, but for some reason did not refund or offer to refund any overpayments. Maybe, I presume, because if the payment went through, the servicer, I think perhaps justifiably, believed that they were helping the borrower by paying down their loan faster than they otherwise would. But I think in the bureau's eyes the loss of a benefit upon a servicing transfer is a common and significant error. And so the bureau is always going to be looking for those kinds of issues because their view is that every piece of loan information should be transferred onto the new platform.

Heather Klein:

And I should just take this moment to point out in the student loan space, this is an extremely ripe issue because we have a couple of federal student loan servicers who will be discontinuing their servicing of federal student loans as of the end of the year. And so the Department of Education will be tasked with transferring about 10 million accounts onto new servicing platforms, passing those accounts to other federal student loan servicers. So I'm laughing a little bit now because this issue comes up in the private student loan space, it comes up in the federal student loan space, and the Department of Education itself is going to be faced with managing a pretty large transfer in the coming months. So this is an issue that is sure to persist as that happens.

Chris Willis:

And if the CFPB encounters hiccups in the transition of servicing from those former federal student loan servicers to new ones, would you like to wager a guess as to whether any problem in that servicing transfer will be the new servicers fault versus the Department of Education's fault in the CFPB's eyes?

Heather Klein:

Yeah, of course it would be the new servicers fault. You know, hopefully the Department of Ed will provide the necessary guidance to its existing servicers in order to assist with making it a successful transition. But any issues that arise are not only going to be looked at by the CFPB, but also by the Department of Education and viewed negatively.

Chris Willis:

So let's hit the last issue that I thought I saw in the Supervisory Highlights pertaining to student lending and that's payment allocation. I feel like payment allocation is always an issue regardless of financial product and it just comes up literally all the time just with different flavors, for example. So what was the flavor of the payment allocation issue that the CFPB told us about in this most recent Supervisory Highlights?

Heather Klein:

Yes, you're right that this comes up frequently. And I think this is maybe the third time that the bureau noted it just in the context of student loan servicers in its Supervisory Highlights. They cite some supervisor highlights from prior years in which they also mentioned payment allocation issues. So in this issue, the CFPB found that the servicers engaged in an unfair practice by failing to follow borrowers' explicit standing instructions regarding payment allocation. And as a result, there were accounts that contained at least one inaccurately applied payment. And as a result, borrowers either paid more over the life of their loans, for instance if there was a partial payment and it was applied incorrectly to a lower interest rate loan rather than a higher interest rate loan.

Heather Klein:

Or the bureau notes that borrowers may have lost or experienced loss or delayed borrower benefits such as co-signer release. For instance, if... I'm going to back up. Most, backing up again. To qualify for co-signer release, there's the obligation to make a certain number of on-time payments in full. And so if a servicer allocated a payment across all of the borrower's loans, for instance, and it fell short, then that might have caused a borrower to lose their eligibility for co-signer release. I'm just going to pause here and think about whether there's anything else I should say about this or anything I should say in general.

Chris Willis:

I don't think you need to say anything else. So I'm going to ask you one follow-up question, and then I think we're going to be done, okay?

Heather Klein:

Mm-hmm (affirmative).

Chris Willis:

So Heather, sometimes payment allocation issues involve the allocation of a payment between say fees and principal and interest, but here it sounds like you're talking about allocation between multiple student loans. Is that right?

Heather Klein:

That's how it's described in the... I'm going to start that answer again. Yeah. So to clarify, and I should've mentioned this at the outset, so for those listeners who are not student loan dorks like myself, it's important to keep in mind that most students take out multiple loans over the course of their education, and then those loans are serviced under one account, for the most part, on a servicer's platform. So when we talk about payment allocation in the student loan context, we're almost always talking about how a single payment is allocated across multiple loans when a borrower makes a monthly payment and the servicer is applying it across the loans that are residing on that borrower's account.

Chris Willis:

Yeah, and that sort of allocation is more unique to student lending than it is to say credit cards or installment loans or things like that because there you don't have this multi-loan feature that we do frequently have, as you noted, in the student loan context.

Heather Klein:

Thanks for pointing that out. I should have mentioned that before. Thanks.

Chris Willis:

So Heather, thanks very much for sharing your insight into all these student loan issues that were in the Supervisory Highlights. Before we sign off, are there any sort of overall parting comments you'd like to leave our audience with about your general takeaway from the Supervisory Highlights pieces about student lending?

Heather Klein:

So at the risk of sounding like a broken record, we have this laundry list of issues in the Supervisory Highlights affecting not only federal student loan servicers but also private student loan servicers and private student lenders. And as we know, the bureau under the leadership of acting director Dave Uejio and then the expected incoming director Rohit Chopra are very much concerned with student loan issues, and they're going to be concerned with these issues spanning the private and federal markets and spanning origination and servicing and collections, which we, admittedly, didn't really see that much of note in the student loan space in this issue. But we are just at the beginning, I would say, of seeing all that is to come in what the CFPB has in store over the next few years in the student loan space.

Chris Willis:

Thanks very much, Heather. I'm sure the audience really appreciates hearing your views on this. And I know I learned a lot from talking with you about this episode of Supervisory Highlights. So thank you for being with us. And thanks to our listeners for downloading and listening to today's episode. Be sure you visit us on our website ballardspahr.com where you can subscribe to our podcast in Apple Podcasts, Google, Spotify, or your favorite podcast platform. And don't forget to check out our blog consumerfinancemonitor.com for daily insights about the financial services industry. If you have any questions or suggestions for our podcast, please just email us at podcast@ballardspahr.com. And stay tuned each Thursday for a great new episode. Thank you all for listening.