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Annual Report of the CFPB Student Loan Ombudsman

Consumer Financial Protection Bureau

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1. Executive Summary

- In the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress established an ombudsman for student loans within the Consumer Financial Protection Bureau. The CFPB began accepting student loan complaints in March 2012.

- This report analyzes and discusses complaints submitted by consumers from October 1, 2012, through September 30, 2013. During this period the Bureau received approximately 3,800 private student loan complaints. Eighty-seven percent of all complaints were directed at eight companies. This is not surprising, given that the private student lending and servicing markets are highly concentrated.

- Opaque or inaccurate payment processing emerged as a significant trend in complaints received during the reporting period. It is unlawful for any private student lender to impose a penalty on a borrower making an early payment or making a payment in excess of the minimum amount due. However, borrowers remitting extra payments in order to pay off their loans more quickly find that payments are not always properly allocated.

- Just under half of all private student loan complaints received were related to consumers seeking a loan modification or other option to reduce their monthly payment in a time of distress.

- In last year's report, we noted a range of inappropriate – and potentially unlawful – practices directed at military families seeking to repay private student loans. This year's complaints suggest that some lenders and servicers have attempted to correct their deficiencies concerning the Servicemembers Civil Relief Act (SCRA); however, problems persist for many men and women in uniform repaying student debt.

- Many of the private student loan complaints mirror the problems heard from consumers in the mortgage market following the wake of the financial crisis. Recent changes to mortgage servicing and credit card servicing practices may shed some insight on possible approaches to remedy student loan servicing concerns.

2. About this Report

October 2013

The Dodd-Frank Wall Street Reform and Consumer Protection Act established an ombudsman within the Consumer Financial Protection Bureau. Pursuant to the Act, the ombudsman shall prepare an annual report and make appropriate recommendations to the Secretary of the Treasury, the Director of the Consumer Financial Protection Bureau, the Secretary of Education, and Congress. This report is the second annual report meeting the requirement set forth in the Act.

Rohit Chopra
Student Loan Ombudsman
Consumer Financial Protection Bureau

3. Introduction

The choice to finance a postsecondary education is often the first major financial decision consumers will make. The weight and impact of this choice are reflected in the spillover effects that student debt may have on borrowers' future financial decisions. With outstanding student debt approaching $1.2 trillion, the risks posed by mounting student debt for the economy and for society have gained greater significance.[1]

In March 2012, the Consumer Financial Protection Bureau began accepting private student loan complaints. In October 2012, we released our first report to Congress, documenting many of the problems faced by private student loan borrowers.[2] The report discussed some of the similarities between complaints raised by student loan borrowers and servicing issues that emerged in the mortgage market as the economy deteriorated.

This second annual report analyzes approximately 3,800 complaints submitted between October 1, 2012, and September 30, 2013. This report offers analysis, commentary, and recommendations to address issues reported by consumers in the student loan marketplace. In many cases, these complaints are similar to those submitted in the previous reporting period. Consumers experiencing financial hardship continue to encounter problems obtaining affordable repayment options on their private student loans. Consumers also continue to face obstacles when repaying their loans, including difficulty obtaining basic account information and challenges working with student loan servicers to correct payment application and other payment processing errors.

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[1] *See* Consumer Financial Protection Bureau, *A closer look at the trillion*, *available at* http://www.consumerfinance.gov/blog/a-closer-look-at-the-trillion/ (August 2013).
[2] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman*, *available at* http://www.consumerfinance.gov/reports/annual-report-of-the-cfpb-student-loan-ombudsman/ (October 2012).

Table 1: Private Student Loan Complaint Summary Statistics

Complaints received between October 2012 and September 2013	3,800
Median amount of relief (as reported by company)	$470

Note: Median amount of relief reported by company are based on those cases for which a company reports relief.

Over the past year, the CFPB has also upgraded its suite of tools offered to students, borrowers, and their families. Hundreds of thousands of consumers have viewed and utilized these resources.[3] These tools provide borrowers with information on how to choose a payment plan, determine what loans they have, and how to get out of default.

[3] For more information on tools available for consumers visit www.consumerfinance.gov/students.

4. Issues Faced by Student Loan Borrowers

Sources of Information

To identify the range of issues faced by student loan borrowers, the report relies primarily on complaints received by the CFPB. In addition to this information, we reviewed other sources of data, such as comments submitted by the public in response to requests for information on student loan affordability,[4] submissions to the "Tell Your Story" feature on the CFPB's website, and input from discussions with consumers, regulators and law enforcement agencies, and market participants.

Limitations

Readers should note that the observations discussed in this report are not based on a representative sample and should not be used to draw conclusions as to the prevalence of these issues in the marketplace. Although the market information we receive from consumers, schools, and market participants yields a broad range of input, readers should recognize the limitations of the underlying data. However, the information provided by borrowers can help to illustrate where there is a mismatch between borrower expectations and actual service delivered. Representatives from industry and from borrower assistance organizations will likely find the inventory of borrower issues helpful in further understanding the diversity of customer experience in the market.

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[4] Consumer Financial Protection Bureau, *Request for Information Regarding an Initiative to Promote Student Loan Affordability*, Docket ID CFPB-2013-0004, Federal Register (February 2013).

Table 2: Private Student Loan Complaints by Company, October 2012 – September 2013

Company	Percentage
Sallie Mae	49%
American Education Services / PHEAA	11%
Wells Fargo	6%
Discover	6%
JPMorgan Chase	5%
ACS Education Services	4%
Citibank	3%
KeyBank	3%
Other Companies	13%

Issue Highlights

The CFPB received approximately 3,800 complaints between October 1, 2012, and September 30, 2013. The most common type of complaint related to borrowers attempting to adjust the repayment terms of their loans in times of hardship. Other common complaint themes included problems with debt collection practices, problems covering a range of payment processing issues, and general customer service issues.

Improper treatment of military borrowers subsiding, but not gone.[5] Last year, we published an addendum to this annual report that focused on the unique issues faced by military families in the student loan market. For example, the complaints revealed that a number of market participants were making improper demands of active-duty servicemembers seeking benefits under the Servicemembers Civil Relief Act.[6] Although complaints suggest that this problem persists in the marketplace, it is encouraging that some market participants have attempted to make process improvements in order to assist these borrowers. The CFPB will continue to work closely with bank regulators and the U.S. Department of Justice to ensure that the law is being followed and violators are held accountable.

[5] *See* Consumer Financial Protection Bureau, *Mid-year snapshot of private student loan complaints*, *available at* http://www.consumerfinance.gov/reports/mid-year-snapshot-of-private-student-loan-complaints/ (August 2013) (discussing that some lenders and servicers have addressed servicing problems facing military families but the CFPB continues to receive complaints from servicemembers having trouble accessing benefits under the Servicemembers Civil Relief Act (SCRA)).

[6] Consumer Financial Protection Bureau, *The Next Front? Student loan servicing and the cost of our Men and Women in Uniform*, *available at* http://www.consumerfinance.gov/reports/the-next-front-student-loan-servicing-and-the-cost-to-our-men-and-women-in-uniform/ (October 2012).

Significant loan modification problems persist.[7] We continue to hear from thousands of consumers who face obstacles when seeking to modify their loans' repayment terms during periods of financial hardship. Complaints from consumers seeking a loan modification comprised just under half of the student loan complaints received during the reporting period.

Although the largest subset of complaints focuses on requesting loan modifications, we have heard from consumers about a number of other servicing issues that warrant discussion.

In July 2013, the Bureau began accepting complaints concerning debt collection activities. Since then, the Bureau has heard from consumers who have defaulted and whose accounts were sent to collections because they are unable to afford their student loans.

Payment Processing Problems

While a notable number of consumers are struggling to afford their monthly student loan obligations, many consumers are in a stable financial position and attempt to pay off their loans early. Since refinance options are limited, the only way to escape high rates or poor customer service is to pay off loans more quickly. This also reduces the total interest paid over the life of the loan. Many consumers face stumbling blocks, snags, and surprises when it comes to payment processing practices.

Poor communication about payment application. Complaints reveal that the manners in which payments are processed are opaque, causing confusion and frustration for many borrowers.

Many consumers find that they are unable to verify whether payments are appropriately applied when they make additional payments in order to pay off their loans more quickly. Typically, companies will first apply payments to satisfy outstanding fees and interest and then allocate any additional funds to principal. Generally, interest accrues daily on student loans, and therefore, the amount of the payment that is applied to principal depends on when the payment is submitted.[8]

There is significant confusion about payment policies with regard to "paid ahead" or "advanced payment" status. Borrowers note that after submitting additional payments, they were placed in "paid ahead" or "advanced payment" status. This raises questions for many borrowers as to whether funds have been held in order to satisfy a future payment or whether the servicer has actually applied the payment toward the principal balance.

If the additional payment is enough to satisfy only a portion of the next installment, the "total amount due" on the next month's billing statement will reflect the additional payment by reducing the next monthly installment due. However, if the consumer remits a payment to

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[7] *See* Part 5 of this report for further discussion of regulatory and market developments.

[8] To calculate the amount of interest accruing daily, multiply the principal balance on a loan by its interest rate and then divide the product by the number of days in the year. For example, if a consumer has a loan balance of $10,000 with an interest rate of 9%, the daily interest would be: ($10,000 x 9%) / 365 = $2.47. By this calculation, the consumer's loan accrues $2.47 of interest per day.

satisfy a full future installment, the next billing statement may reflect a $0.00 minimum payment.

ANDREA CONSUMER	Account Number	Date Billed	Date Due
	123456798	10/01/2013	10/25/2013

Date Last Payment Received	Principal Paid Since Last Statement	Interest Paid Since Last Statement	Fees Paid Since Last Statement	Total Received Since Last Statement
09/01/2013	$55.27	$71.41	$0.00	$126.68
09/08/2013	$83.66	$16.34	$0.00	$100.00

Amount Past Due	Current Due	Total Principal and Interest Due	Outstanding Late Fees to Date
$0.00	$26.68	$26.68	$0.00

Loan	First Disb.	Status	Owner	Monthly Payment	Rate	Balance Due	Current Due	Total Amt.
1-01	09/01/2008	REPAY	Bank X	$126.68	9.00%	$9,381.88	$26.68	$26.68

It may be helpful to think about these processes as two separate consequences of a prepayment — the consumer will likely both reduce their principal and “pay ahead” their student loan.

Consumers have expressed confusion when receiving a bill for $0.00 amount due, leading many to be unsure as to whether their automatic debit payment will be processed or if they need to submit a payment the following month. Frequently, consumers do not know if their additional payment was actually applied to principal or whether it was used to satisfy a future installment.

Many companies use the “paid ahead” status as a payment processing policy in order to assist borrowers in avoiding default or delinquency in the event of a future missed payment, but billing statements and online servicing platforms do not appear to clearly explain this policy. Student loan servicers generally state that this practice does not affect the application of payment toward fees, interest, or principal.

Stumbling blocks when making payments in excess of the minimum amount due. A number of private student loan borrowers note significant difficulties when submitting a single payment to cover several loans associated with the same servicer. These borrowers claim that payments are generally not applied in a way that helps them to pay off their loans with the highest rates.

The typical student loan borrower will generally take out multiple loans when paying for college, often with a new disbursement each semester. It is common for borrowers to have three or four loans bundled into a single account (“billing group”) managed by a given student loan servicer. These loans often have different balances, different interest rates, and different amortization schedules. As a result, it may be complicated for consumers to determine how to best apply their payments.

Even when the payment is accompanied by an explicit instruction, the complaints revealed that many student loan servicers elect to apply extra payments as they see fit — and not necessarily in the way that offers the greatest benefit to the borrower. Borrowers report that the policies governing the treatment of payments when applied to multiple loans within one billing group are particularly difficult to understand and navigate.

Consider a student loan borrower entering repayment with $30,000 in private student loans. This borrower has three loans, each with a balance of $10,000. One loan has an interest rate at seven percent, one at nine percent and one at 13 percent. This borrower receives one bill each month, covering all three loans. Her minimum monthly payment would be just under $400 and she could expect to pay off her loans over ten years.

After making minimum payments for a year, the borrower decides to send in an extra $100 in order to try and pay down her debt more quickly. If the borrower does not include explicit instructions on how to process her loan payment, her student loan servicer will have to decide how to apply this extra $100 across her three loans.

Since she is paying off an extra $100 in principal, she will pay off her loans faster and she will pay less interest over the lifetime of her loans. However, the amount of money she will save can vary widely depending on what her servicer chooses to do next.

	Starting Balance	Standard Monthly Payment	Extra $100 Split Evenly	Extra $100 Pro-Rated	Extra $100 Applied to Highest Interest Rate Loan
Loan 1-01 (7% interest rate)	$10,000	$116.11	$149.44	$145.72	$116.11
Loan 1-02 (9% interest rate)	$10,000	$126.68	$160.02	$158.98	$126.68
Loan 1-03 (13% interest rate)	$10,000	$149.31	$182.64	$187.40	$249.31
Total One-Time Monthly Payment		$392.10	$492.10	$492.10	$492.10
Savings at Payoff			$143.91	$149.82	$219.47

If her student loan servicer decides to divide her extra $100 evenly between her three loans, she'll save $143.91 over the life of the loan. If her loan servicer decides to apply her extra payment to her account, pro-rated based on the monthly amount due for each loan (the most common servicing practice), she will save $149.82.

By comparison, if her loan servicer credited her entire additional payment to the loan with the highest interest rate, she would save $219.47 — nearly 50 percent more than the amount she would save through pro-rated application of her $100 additional payment.[9]

Now consider a situation where a borrower submits an extra payment of $100 every month until her loans are paid-in-full. She would save more than $4,500 in accrued interest and pay off her loans in fewer than eight years — a great financial choice for consumers who can afford to take this route. But, once again, her total savings will depend on what her servicer does.

	Starting Balance	Standard Monthly Payment	Extra $100 Split Evenly	Extra $100 Pro-Rated	Extra $100 Applied to Highest Interest Rate Loan
Loan 1-01 (7% interest rate)	$10,000	$116.11	$149.44	$145.72	$116.11
Loan 1-02 (9% interest rate)	$10,000	$126.68	$160.02	$158.98	$126.68
Loan 1-03 (13% interest rate)	$10,000	$149.31	$182.64	$187.40	$249.31
Total One-Time Monthly Payment		$392.10	$492.10	$492.10	$492.10
Savings at Payoff			$4,514.98	$4,613.31	$5,403.62

If her student loan servicer decides to divide her extra $100 per month evenly between her three loans, she'll save $4,514.98. If her loan servicer decides to apply her payments to her account pro-rated based on the monthly amount due for each loan (the most common servicing practice), she will save $4,613.31. By comparison, if her loan servicer credited her entire payment to the loan with the highest interest rate, she would save $5,403.62 — nearly $800 more than she would save through the pro-rated application of her $100 payment.

Consumers report that, by default, online payment platforms distribute extra payments according to other payment allocation policies, instead of applying extra payments to the loans with the highest interest rates. These consumers have submitted complaints describing how they often run into difficulty when requesting that their servicer adjust an extra payment to apply to the loan with the highest interest rate.

Snags when making small 'good faith' payments. Consumers face a similar dilemma when making underpayments — the submission of payments less than the minimum due on a

[9] Applying additional payments to the loan with the highest interest rate generally leads to the most savings for consumers over the long term. Borrowers can maximize savings by directing any payments in excess of the minimum amount due toward the loan with the highest interest rate. Once the loan with the highest interest rate is paid off, borrowers can continue to make the same monthly payment, directing the overage toward their next-highest-rate loan, repeating this process until all loans are repaid. However, there may be some cases where a borrower may want to allocate extra payments to other loans when considering other factors, such as employer loan forgiveness programs or cash flow management. In the credit card market, payments in excess of the minimum amount due must be allocated toward balances at the highest interest rate, pursuant to reforms in the Credit CARD Act of 2009.

monthly bill — because underpayments, in many cases, appear to be applied by student loan servicers in order to maximize late fees charged to borrowers.

Generally, this occurs in situations where a borrower has multiple loans in a single billing group, serviced by one student loan servicer. In these cases, a borrower is unable to pay her bill in full so she submits a partial payment – often at the suggestion of servicer personnel. At this point, the student loan servicer might make several different choices.

First, the servicer could pro-rate the payment and apply it across all loans in the billing group. This would not satisfy any of the outstanding accounts and would cause the borrower to be charged a late fee for each loan that is now past due. Alternatively, the servicer could attempt to satisfy in full as many accounts as possible, allocating payment first to the loan with the smallest balance due, and working upwards. This would have the effect of minimizing the number of accounts past due and the number of late fees charged to the borrower.

In order to illustrate this dilemma, consider the borrower described in the preceding section. She entered repayment with $30,000 in private student loans. This borrower has three loans, each with a balance of $10,000. One loan has an interest rate at seven percent, one at nine percent and one at 13 percent. This borrower receives one bill each month, covering all three loans. Her minimum monthly payment would be a little less than $400 and she could expect to pay off her loans over ten years if making only the minimum required payment.

Suppose this borrower experienced a temporary financial shock — for example, an unexpected medical bill or a car accident — and is unable to pay her bill in full for one month. After calling her servicer, she is told to make whatever payment she can afford.

She decides she can afford to make a single $250 payment by phone. The example below shows how her servicer might apply her payment in a way that maximizes late fees. She would not satisfy any of her accounts in full and would incur a late fee for each loan.

	Starting Balance	Standard Monthly Payment	$250 Payment Pro-rated	Late Fees	Past-Due Amount
Loan 1-01 (7% interest rate)	$10,000	$116.11	$74.03	$5.00	$47.08
Loan 1-02 (9% interest rate)	$10,000	$126.68	$80.77	$5.00	$50.91
Loan 1-03 (13% interest rate)	$10,000	$149.31	$95.20	$5.00	$59.11
Total		$392.10	$250.00	$15.00	$157.10

Alternatively, her servicer may satisfy as many accounts as possible in full, applying any remainder to the next account until her $250 payment is exhausted. In this case, she would be able to satisfy two of her three loans in full and apply a small partial payment to her loan with the largest balance due.

	Starting Balance	Standard Monthly Payment	$250 Payment Minimizing Late Fees	Late Fees	Past-Due Amount
Loan 1-01 (7% interest rate)	$10,000	$116.11	$116.11	$0.00	$0.00
Loan 1-02 (9% interest rate)	$10,000	$126.68	$126.68	$0.00	$0.00
Loan 1-03 (13% interest rate)	$10,000	$149.31	$7.21	$5.00	$147.10
Total		$392.10	$250.00	$5.00	$147.10

In cases where borrowers remit a single monthly underpayment, servicers' payment application policies have both negative financial and credit implications for borrowers. Should servicers divide payments between consumers' accounts, not only will this maximize late fees charged to the consumer, but the servicer may also choose to furnish information about the borrower's delinquent loans to credit reporting agencies. In the example illustrated above, due solely to the servicer's payment application policies, the borrower's credit report may reflect three delinquent loans rather than one.[10]

Timing of payment processing. Consumers submit complaints reporting that they have been charged late fees, even when they submit a payment before the due date. Consumers explain that there is a delay between the point-in-time at which the consumer initiates an online payment and when the payment is received from the consumer's bank account and posted to their loan account. This often causes frustration for consumers, as online payments for other goods or services often post quickly after the transaction, and in some cases, in real time. Consumers express frustration that payments can take up to ten days to clear their bank and post to their account, or that they are charged late fees if the payment does not post by the due date.

Access to payment histories. Many servicers provide payment histories electronically through the consumer's online account. Consumers have stated that they use their online accounts as a primary source of information and that they use the payment histories provided online to monitor and track payments.

Consumers explain that when they make payments over the phone or through the mail, information about this payment is not accessible through their online account and is not recorded in their payment history on the servicer's website. Companies have stated that loan payments made by methods other than online payments will not be reflected on borrowers'

[10] Some student loan servicers have suggested that the proration of underpayments may provide a credit benefit to borrowers who submit multiple, consecutive underpayments. Under certain circumstances, pro-rating of underpayments over consecutive months may mitigate the severity of the borrower's delinquency and prolong the period between a borrower's first underpayment and the point-in-time at which she defaults on a loan. Borrowers in these cases would likely still incur late fees for all loans in their billing group each month. This case appears to be extremely rare. The CFPB has not received input from consumers or market participants suggesting that borrowers frequently submit multiple, consecutive underpayments on private student loans, prior to default.

online accounts. Consumers suggest enhancing websites to include payments made by phone or through the mail for accurate payment histories.

Lost payments. Consumers submit complaints reporting that paper checks fail to post to borrowers' accounts. In some cases, when a consumer calls to complain that a mailed check was not processed, the servicer requests a copy of the canceled check as evidence of payment, in order to reverse late fees and accrued interest.

To receive a copy of a canceled check from the consumer's bank, the check must first have been processed by the servicer. In some instances, the check may not have been received by the servicer or it was not cashed in order to generate a canceled check; therefore the consumer is unable to prove that they submitted the payment on time.

Difficulty obtaining accurate payoff information. Consumers report that they are unable to obtain accurate payoff information from their servicers. Some consumers state that they receive different payoff amounts from different customer service representatives and are unable to receive a definitive answer. Other consumers report obtaining a payoff balance, remitting the correct payment amount and assuming their debt to be paid in full, only to discover that their payoff balance was incorrect and their account remained open with a small remaining balance. Consumers stated that they were unaware of the remaining balance until contacted by a debt collector after the loan was severely delinquent or in default.

Servicing transfer chaos. Sometimes the company servicing a borrower's student loans can change over the course of a loan's repayment period. In many cases, the owner of a borrower's loan may not be the same company as her student loan servicer. The servicer may be a third party under contract with the owner of the loan and, over time, the owner may choose to change servicers. In other cases, the owner of the loan may choose to sell the debt, at which point the new owner will elect to service the loan themselves or to contract with a new third-party servicer. Generally, the decision to change loan servicers is up to the loan holder and not the borrower. The consequences of these changes may cause significant hardship and risks for consumers.

Consumers noted many servicing interruptions following a change in servicer. Many of these consumers were unaware that their loans had been transferred to a new servicer until the point at which they encountered a problem. Consumers explain that, following a change in servicer, they experience interruptions when receiving billing statements, notices, or other routine communication. We also heard that consumers were charged late fees because borrowers mailed their payments to their old servicers. Consumers also reported that payments were not processed correctly post-transfer if the consumer mailed a check to their new servicer containing account information from the old servicer.

Consumers also report that they are unaware that payment processing policies can vary depending on the servicer. In such instances, consumers may make decisions based on the previous servicers' practices. For instance, a consumer may be able to submit payments from a debit or credit card under certain servicers' policies; however, after a servicing transfer, the consumer may be required to pay with a check or through an electronic transfer from a checking or savings account. This can cause significant disruption for consumers, as many may not have sufficient warning to modify their payment method before the next payment is due.

Other consumers submitted complaints detailing changes to their repayment plan following transfer, resulting in changes to repayment terms. These include increased interest rates, increased monthly payments, or increased late fees as compared to their prior payment schedule under their previous servicer. Changes to payment policies resulting from a change in servicer can interfere with the consumer's ability to manage her loans, especially without advance notice of the change sufficient to allow the borrower to adjust her financial routine.

5. Ombudsman’s Discussion

Based on the issues and themes described in Part Four, the ombudsman offers commentary relevant to the student loan marketplace. This discussion represents the ombudsman’s independent judgment and does not necessarily represent the view of the Consumer Financial Protection Bureau.

Overall, the total number of complaints received was higher than expected, and it appears that many loans originated prior to 2008 continue to show signs of stress. The company that received the most complaints was Sallie Mae. Given Sallie Mae’s large platforms engaged in origination, servicing, and collections, it is not surprising that it has again ranked as the top recipient of complaints. In general, the distribution of complaints by company is generally consistent with our estimates of relative market shares.

Although the complaints and input discussed in this report are not a representative sample of the marketplace, insights taken from this data do raise concerns. Since the CFPB began accepting private student loan complaints, the complaints surrounding student loan servicing have mirrored the problems heard from consumers in the mortgage market in the wake of the financial crisis.

Following the financial crisis, many mortgage borrowers faced serious challenges. Consumers had difficulty refinancing their mortgages or had problems obtaining a modification of mortgage terms. Improper payment processing sometimes led to improper foreclosure. Market participants had little incentive to offer modifications and provided poor customer service to borrowers seeking information or attempting to avoid foreclosure.

The similarity between private student loan complaints and problems uncovered in the mortgage servicing industry suggests that many student loan servicers are not taking proactive steps to avoid a similar breakdown. Although these complaints are not a representative sample, the issues raised in the complaints suggest that a number of legacy processes must be modernized.

Spurring Loan Modifications

As noted above, the largest number of complaints comes from consumers who struggle to obtain a loan modification. The inability of lenders and servicers to initiate alternative repayment plans that would benefit both the creditor and the borrower continues to be a sign that this market functions poorly.

This is of great concern to many investors and policymakers. Investors – particularly equity holders in large financial institutions and bond holders in asset-backed securities – have expressed two noteworthy concerns. First, borrowers who are stymied in their good-faith efforts to honor their debt obligations will be less likely to seek additional products and services, such as mortgages and auto loans, with the same financial institution. Second, the inability for lenders and servicers to deploy creative workout options not only reduces overall collections, but may also be a symptom of broader operational dysfunction.[11]

During the past year, CFPB officials have convened market participants to determine ways to increase the level of loan modification activity. In last year's report, we acknowledged that lenders may face challenges when seeking to restructure debt obligations. Specifically, we noted that many lenders needed greater clarity on the accounting treatment of certain repayment plans from prudential regulators before offering new plans to borrowers.

However, in July 2013, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System issued a joint statement encouraging financial institutions to work constructively with private student loan borrowers in financial distress. Prudential regulators made clear that they "will not criticize financial institutions for engaging in prudent workout arrangements with borrowers who have encountered financial problems, even if the restructured loans result in adverse credit classifications or troubled debt restructurings in accordance with accounting requirements."[12]

Given this development, we expect that lenders and servicers will be able to deploy a number of new modified repayment programs to borrowers by the beginning of 2014. We will monitor the sector closely to determine whether lenders and servicers are making satisfactory progress.[13]

Eliminating Servicer Hurdles to Refinance and Repayment

Last year, we noted that many borrowers are troubled by their inability to refinance their student loan obligations in order to take advantage of their improved creditworthiness following graduation and job attainment, as well as today's low interest rate climate. Over the course of the year, CFPB officials have met with a wide range of investors, entrepreneurs, and securities analysts to discuss the refinance market.

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[11] Portfolio lenders affiliated with very large depository institutions have generally been slow to deploy workout programs that may be in the best interest of both their investors and their customers. This raises questions as to whether existing investors might seek to restructure operations or otherwise discipline management in these institutions.

[12] Banking Agencies Encourage Financial Institutions to Work with Student Loan Borrowers Experiencing Financial Difficulties, *available at* http://www.fdic.gov/news/news/press/2013/pr13065a.pdf (July 2013).

[13] We expect to share these results with the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Department of the Treasury, and the Department of Education, as well as other policymakers, investors, and members of the public.

While much more needs to be done to ensure that pricing in the market accurately reflects risk, there appears to be significant growth in the nascent refinance market. However, many borrowers respond to their high-rate obligations by seeking to make extra payments to retire the debt. It is quite troubling that borrowers who obtain a refinanced student loan, as well as others seeking to pay off their loans early are facing hurdles, particularly in payment allocation.

As noted earlier in the report, there are a number of other outstanding concerns about the ability of borrowers to obtain accurate information about their accounts, as well as the impact of poorly-executed loan transfers.

Investors and policymakers have a strong interest in ensuring the proper functioning of the servicing market. Neither the industry nor policymakers have adopted a uniform, comprehensive framework establishing student loan servicing standards, but this is certainly worthy of serious consideration.

Recent changes to mortgage servicing and credit card servicing practices may shed some insight on possible approaches to remedy student loan servicing problems.

(A) Mortgage Servicing

The Dodd-Frank Wall Street Reform and Consumer Protection Act added new provisions to correct deficiencies in the mortgage servicing industry. This year, the CFPB implemented these provisions through new mortgage servicing rules that will become effective in January 2014. These rules were implemented to give consumers better access to information about their mortgages and give consumers the tools to correct servicing problems. Some of the provisions include:

Notice of transfer of loan servicing. Under the Real Estate Settlement Procedures Act ("RESPA"), as implemented by Regulation X, if a lender transfers a loan's servicing rights to a new servicer, a consumer must receive a notice from the old servicer no less than 15 days before the effective date of transfer and from the new servicer not more than 15 days after the effective date of transfer, with limited exceptions.[14] In addition, there is a 60-day period during which the consumer cannot be charged a late fee for mistakenly sending a payment to the old servicer.[15]

Student loan servicers might consider providing notices prior to and following a change in servicer so that the consumer can monitor the transition to ensure that there are no servicing interruptions. As discussed in the previous section, many consumers were unaware of the servicing change until problems arose. This will also enable consumers to modify payment arrangements and submit payments to the correct servicer in order to avoid future payment-processing delays or errors.

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[14] 12 C.F.R. § 1024.21(d); *see also* Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1024.33(b)(3)).

[15] 12 C.F.R. § 1024.21(d)(5); *see also* Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1024.33(c)).

Timely transfer of documents to new servicer. According to the new mortgage servicing rule under RESPA, mortgage servicers will be required to maintain policies and procedures reasonably designed to facilitate the transfer of information during servicing transfers.[16] These policies should be tailored to ensure timely transfer of all documents and information in the possession of the servicer to the new servicer.

Private student loan borrowers have reported that, following a change in servicer, they are no longer able to access previous billing statements, account histories, or other routine communication. Student loan servicers might consider taking steps to ensure timely transfer of all documents and information, preventing gaps in consumers' documentation and facilitating the new servicer's ability to abide by the terms and obligations of the borrower's promissory note.

Payoff statements. According to the new mortgage servicing rule under the Truth in Lending Act, a servicer must provide a payoff statement in writing – specifying the amount needed to pay the loan in full – within seven business days after receiving the consumer's request.[17]

Student loan borrowers may receive inconsistent or conflicting estimates of payoff balances and may be unable to determine how much they owe in order to satisfy their debt. Student loan servicers might consider taking steps to introduce greater consistency in the handling of payoff requests, providing borrowers with a timely payoff statement in writing, and honoring this estimate for sufficient time so as to eliminate processing errors when applying final payment to borrowers' accounts.

Error resolution and dispute review procedures. Generally, mortgage servicers must respond to written requests from consumers if the consumer believes that they have been subject to a servicing error or other improprieties, such as improper charges for late fees.[18]

Once the mortgage servicer receives a written request to correct an error, the servicer must provide a written response acknowledging receipt.[19] Then the servicer must conduct an

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[16] Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. §§ 1024.38(a), (b)(4)).

[17] Mortgage Servicing Rules under the Truth in Lending Act (Regulation Z), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1026.36(c)(3)).

[18] 12 C.F.R. § 1024.21(e) (detailing existing qualified written request requirements); *see also* Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1024.35)).

[19] 12 C.F.R. § 1024.21(e); *see also* Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1024.35(d)).

investigation and provide a written notice that the error has been corrected or that no error has occurred, along with the rationale behind the determination and supporting documentation.[20]

Student loan borrowers may receive conflicting information or incomplete information from customer service representatives. Servicers might consider establishing more robust error-resolution procedures in order to reduce consumer dissatisfaction and ensure that accurate information is provided to consumers.

Continuity of contact. Many mortgage consumers complained that they were unable to contact a service representative who could address their problems. According to the new mortgage servicing rule under RESPA, mortgage servicers must maintain policies and procedures designed to provide a contact representative or team of representatives designated to help the consumer manage their mortgage.[21] This will give the consumer continuity of contact and the ability to access information on their mortgage without being transferred to multiple customer service representatives.

Student loan borrowers may be transferred from representative to representative without the ability to contact personnel empowered to handle their situation. Borrowers complain that they endure long telephone conversations with several representatives and are often unable to find a solution, necessitating several follow-up conversations. Student loan servicers may consider designating one contact or team of representatives to assist student loan consumers, thereby improving customer service standards.

Records retention. Under the new mortgage servicing rule under RESPA, mortgage servicers are required to retain records of the mortgage loan until one year after the date the loan is discharged or servicing is transferred.[22] Records required to be preserved include account payment histories of all transactions debited or credited, any notes created by the servicer containing borrower communications, and copies of any documents provided by the consumer to the servicer.[23]

As we have seen in the student loan complaints, consumers are unable to access payment histories after a servicing transfer and are unable to obtain copies of historical notices, billing statements, and other routine communications. Servicers might benefit from more disciplined records management processes.

Early intervention for borrowers nearing default. Under the new mortgage servicing rule under RESPA, mortgage servicers must make a good faith effort to establish live contact with a borrower no later than the 36th day following a borrower's missed payment or

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[20] 12 C.F.R. § 1024.21(e)(3); Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1024.35(e)).

[21] Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), *available at* http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/ (to be codified at 12 C.F.R. § 1024.40(a)).

[22] *Id.* (to be codified at 12 C.F.R. § 1024.38(c)(1)).

[23] *Id.* (to be codified at 12 C.F.R. § 1024.38(c)(2)).

delinquency.[24] Following the 45th day of delinquency, a servicer must provide written notice of delinquency.[25]

We have heard from student loan consumers that they were unaware that they had defaulted on their loans, that some consumers believed that their loans were still in deferment or forbearance or had not yet entered repayment following a grace period. Follow up communications after the first missed payment may allow borrowers to prevent their loans from entering default.

(B) Credit Cards

On February 22, 2010, several provisions of the Credit Card Accountability, Responsibility, and Disclosure Act ("CARD Act") took effect. These provisions included a number of changes to servicing and payment processing. These provisions might also provide insight for student loan servicers seeking to improve transparency for their customers.

Timely posting of payments. Under the CARD Act, credit card companies must credit all payments received by 5 p.m. on the day they are received.[26] If they are received by 5 p.m. on the due date, the payment is generally considered to be on-time. Also, a credit card issuer may not consider a mailed payment late if the issuer does not accept mailed payments on the due date. For instance, if the due date falls on a weekend or holiday and payment is received by 5 p.m. on the next business day, the issuer must credit that payment as an on-time payment.[27]

Some student loan borrowers reported payment processing delays and, in some cases, late fees assessed to an account if the payment was not processed promptly. Servicing standards in other markets already prescribe that payments should be promptly processed on the day received and considered as an on-time payment if received by 5 p.m. on the due date.

Furthermore, some student loan companies offer to expedite payment processing for a fee. This allows consumers to submit a payment close to or on the due date and have it be posted on-time. Student loan servicers may consider improving processes for payment posting and may wish to evaluate whether a fee-based model for expedited payment is appropriate, given its notable absence in other markets.[28]

Billing statements. Credit card companies must have reasonable procedures designed to ensure that billing statements are mailed or delivered at least 21 days before a payment is due.[29] In addition, credit card companies must disclose on the billing statement how long it would take the consumer, including how much it would cost, to pay the full balance on the card by paying

[24] *Id.* (to be codified at 12 C.F.R. § 1024.39(a)).
[25] *Id.* (to be codified at 12 C.F.R. § 1024.39(b)).
[26] 15 U.S.C. § 1666c(a).
[27] 15 U.S.C. § 1637(o)(2).
[28] *See* 15 U.S.C. § 1637(l) (providing that for credit card accounts "the creditor may not impose a separate fee to allow the obligor to repay an extension of credit or finance charge, whether such repayment is made by mail, electronic transfer, telephone authorization, or other means, unless such payment involves an expedited service by a service representative of the creditor."); 12 C.F.R. § 1026.10(e).
[29] 15 U.S.C. § 1666b(a).

only the required minimum payments.[30] The statement must also disclose the monthly payment required to repay the full balance in three years, and the resulting total cost to the consumer, assuming no additional transactions.[31]

If consumers receive billing statements near the payment due date, they may be unable to successfully remit timely payment, incurring late fees. Student loan servicers might consider implementing reasonable procedures designed to ensure the mailing or delivery of statements 21 days before the payment due date. This would ensure borrowers have enough time to collect funds and make arrangements to meet their monthly payment obligations. Servicers should also consider adopting a similar cost comparison between the minimum monthly payment and an expedited payment plan on student loan statements.

[30] 15 U.S.C. §§ 1637(b)(11)(B)(i) and (ii).
[31] 15 U.S.C. § 1637(b)(11)(B)(iii).

6. Recommendations

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires the ombudsman to make appropriate recommendations to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House Committee on Financial Services, the House Committee on Education and the Workforce, the Secretary of the Treasury, the Director of the Consumer Financial Protection Bureau, and the Secretary of Education.

Determine whether recent efforts to improve the servicing of mortgage and credit card obligations might also be applicable to the student loan market.

The Dodd-Frank Wall Street Reform and Consumer Protection Act and the Credit CARD Act of 2009 both sought to correct deficiencies and improve transparency of servicing practices in the mortgage and credit card markets. Like consumers in the credit card market prior to the CARD Act, student loan borrowers face difficulties dealing with student loan servicers, particularly when making payments in excess of the minimum amount due. Also, in many cases, partial payments are allocated in ways that might damage a borrower's credit profile, while maximizing late fees and penalties collected by the lender or servicer.

Given that some participants in the student loan servicing industry do not appear to have adequate means to accept payment application instructions through online servicing platforms or monthly payment coupons,[32] confusion and additional burdensome paperwork is far too common.

While some individual student loan servicers have indicated they are looking to make a number of improvements, many in the industry have been dilatory in making progress. As Congress prepares to reauthorize student loan programs under the Higher Education Act, it may be useful to assess whether certain reforms to the servicing of credit cards and mortgages (such as clear

[32] Earlier this year, the CFPB proposed supervising "larger participants" of the nonbank student loan servicing market. The CFPB already has supervisory authority over depository institutions with over $10 billion in assets and their affiliates, as well as nonbanks that offer or provide private education loans. Examination activity to date suggests that complaints regarding payment allocation, as well as other issues highlighted in this report, may impact a substantial number of consumers.

guidelines for payment application, records retention, etc.) might also be applicable to the student loan market.

Unfortunately, significant problems unraveled in the mortgage servicing market that led to negative externalities for the broader economy. If industry fails to correct deficiencies in the student loan servicing market, policymakers may need to act to avoid further negative consequences for the economy.

7. Contact Information

TO REACH THE CFPB'S STUDENT LOAN OMBUDSMAN:

Email: students@consumerfinance.gov

Mailing Address:

Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

TO FILE A COMPLAINT:

Webpage: http://www.consumerfinance.gov/complaint
Toll-Free: (855) 411-CFPB (2372)
Español : (855) 411-CFPB (2372)
TTY/TDD: (855) 729-CFPB (2372)
Fax: (855) 237-2392
Mailing Address:

Consumer Financial Protection Bureau
PO Box 4503
Iowa City, Iowa 52244

PRESS & MEDIA REQUESTS

Email: press@consumerfinance.gov