OCTOBER 16, 2014

Annual Report of the CFPB Student Loan Ombudsman

Consumer Financial Protection Bureau

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1. Executive Summary

- Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, this annual report analyzes complaints submitted by consumers from October 1, 2013, through September 30, 2014. During this period the Bureau handled approximately 5,300 private student loan complaints, an increase of approximately 38 percent compared to that of the previous year. The largest subset of private student loan complaints handled by the Bureau relate to the lack of repayment options and flexibility in times of distress.

- While risky loan origination practices prevalent in the market in the years leading up to the financial crisis have subsided due to changes in lender and investor risk tolerance, many borrowers are still struggling to repay the loans they borrowed during this period. Many consumers who borrowed private student loans during the subprime boom graduated from college into an extremely challenging labor market. While federal student loans offer options to avoid default through several loan modification and alternative repayment programs, lenders and servicers of private student loans generally do not.

- Many complaints indicate that borrowers sought to negotiate a modified repayment plan during a period of financial distress, but lenders and servicers provided no options, leading the borrower to default. These complaints closely mirror problems found in the mortgage servicing market, as large numbers of homeowners sought to avoid foreclosure.

- Regulators and policymakers have encouraged lenders to constructively engage with borrowers to find workout solutions. Despite commitments by a number of major market participants to expand alternative repayment options, consumers continue to encounter limited or no flexibility when seeking help from their lender or servicer.

- Policymakers and market participants may wish to consider the impact of certain public policies and market features when evaluating steps to improve options for borrowers in distress, including whether changes to the treatment of private student loans in bankruptcy proceedings are reducing incentives for lenders and servicers to help borrowers avoid default.

2. About this Report

The Dodd-Frank Wall Street Reform and Consumer Protection Act established a student loan 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 third annual report meeting the requirement set forth in the Act.

This report analyzes more than 5,300 private student loan complaints and more than 2,700 debt collection complaints related to student loan debt submitted between October 1, 2013, and September 30, 2014. This report also offers analysis and discussion to address issues reported by consumers in the student loan marketplace.

Rohit Chopra
Student Loan Ombudsman
Consumer Financial Protection Bureau

3. Student Loan Complaints

From October 1, 2013, through September 30, 2014, the CFPB handled approximately 5,300 private student loan complaints.

Information about consumer complaints, including information about student loan and debt collection complaints, is available to the public, through the CFPB's Consumer Complaint Database.[1]

The database contains anonymized complaint data provided by consumers, including the type of complaint, the date of submission, the consumer's zip code, and the company that the complaint concerns. The database also includes information about the actions taken by a company in response to a complaint: whether the company's response was timely, how the company responded, and whether the consumer disputed the company's response. The database does not include consumers' identity information. The database includes web-based and user-friendly features such as the ability to filter data based on specific search criteria; to aggregate data in various ways, such as by complaint type, company, location, date, or any combination of available variables; and to download data.

The following tables are based on complaints submitted from October 1, 2013, through September 30, 2014, as exported from the public Consumer Complaint Database as of October 1, 2014.[2] Due to the lack of publicly-available data on private student loans, these tables are not adjusted for market share.[3]

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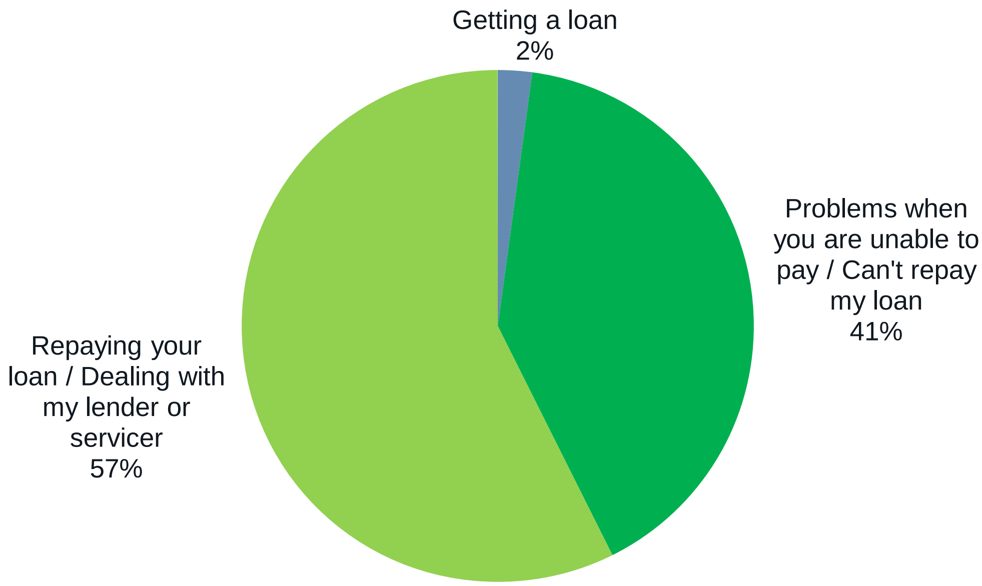
[1] Consumer Financial Protection Bureau, *Consumer Complaint Database, available at* http://www.consumerfinance.gov/complaintdatabase/.

[2] Not all complaints handled by the Bureau are published in the public Consumer Complaint Database. Complaints that do not meet the publication criteria may be removed from the database. The database lists complaints where the companies have had the opportunity to provide a response or after the companies have had the complaint for 15 calendar days - whichever comes first. The publication criteria are available at http://files.consumerfinance.gov/f/201303_cfpb_Final-Policy-Statement-Disclosure-of-Consumer-Complaint-

TABLE 1: PRIVATE STUDENT LOAN ISSUES REPORTED BY CONSUMERS FROM OCTOBER 1, 2013 – SEPTEMBER 30, 2014



Note: Prior to December 18, 2013, consumers submitting student loan complaints could select from three types of complaint categories: “Getting a loan,” “Repaying your loan,” and “Problems when you are unable to pay.” Beginning on December 18, 2013, the student loan complaint form was updated to make it easier for consumers submitting a complaint to categorize the problems they are having with their student loan. Consumers now select from the following three types of complaint categories: “Getting a loan,” “Can’t pay my loan,” and “Dealing with my lender or servicer.” This table includes complaints submitted under both the original and updated forms.

Data.pdf/. Therefore the number of complaints published in the database may be fewer than the total number of complaints handled by the Bureau.

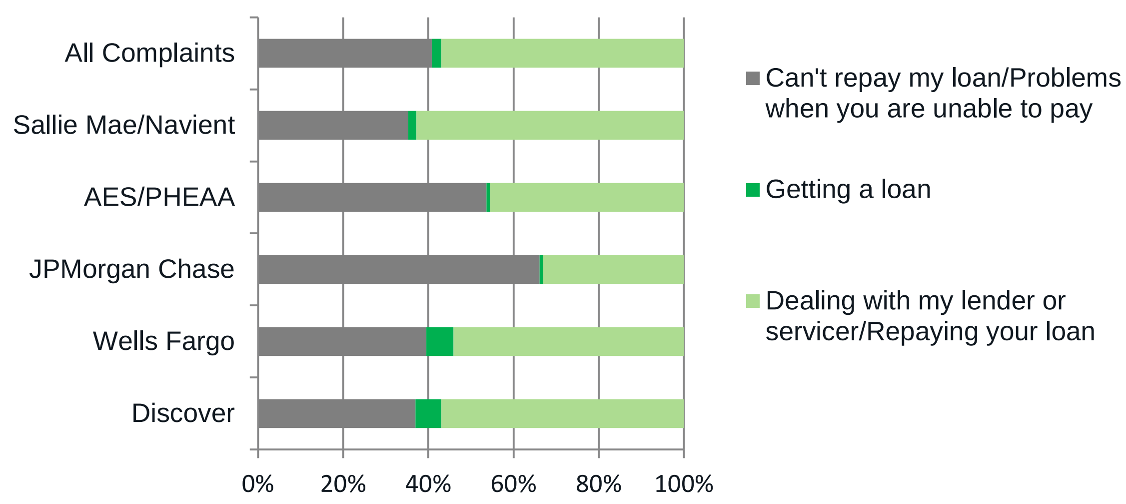
[3] Compared to mortgage market data, data on origination and servicing of student loans is quite scarce. For example, insured depository institutions generally do not provide detailed information on student loan holdings in call reports available for public inspection.

TABLE 2: COMPANIES WITH THE MOST PRIVATE STUDENT LOAN COMPLAINTS RANKED BY PERCENT CHANGE IN COMPLAINT VOLUME

Company	Oct. 2012 – Sept. 2013	Oct. 2013 – Sept. 2014	Percent Change
JPMorgan Chase	149	236	58%
Sallie Mae/Navient	1345	1996	48%
AES/PHEAA	290	358	23%
ACS Education Services	92	110	20%
Wells Fargo	204	220	8%
Citibank	93	93	0%
Discover	174	165	-5%
KeyBank	96	86	-10%

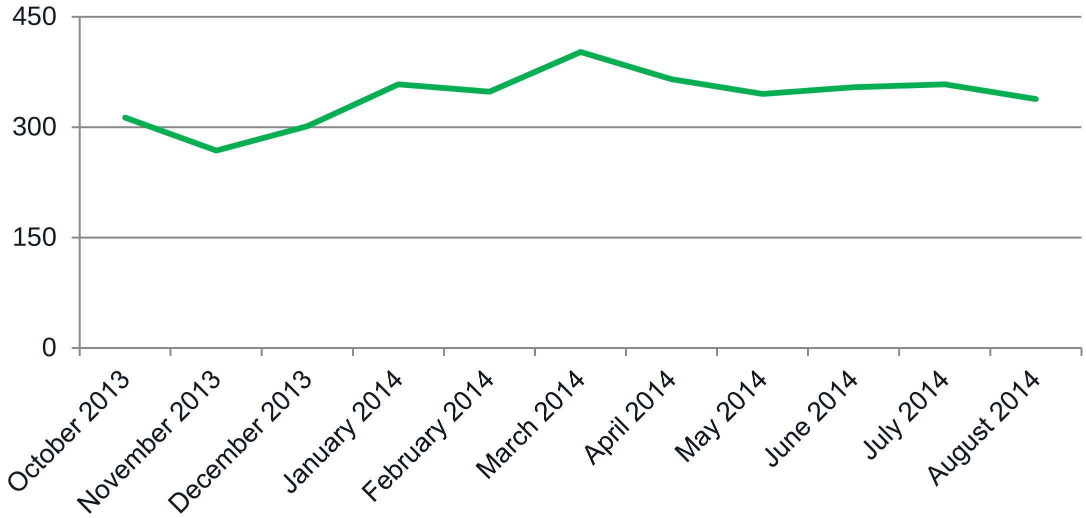
Note: This table reflects complaints where (1) the consumer identified the sub-product as a non-federal student loan and (2) the identified company responded to the complaint, confirming a relationship with the consumer. This table reflects the top companies by complaint volume.

TABLE 3: ISSUES IDENTIFIED IN PRIVATE STUDENT LOAN COMPLAINTS BY COMPANY FROM OCTOBER 1, 2013 – SEPTEMBER 30, 2014



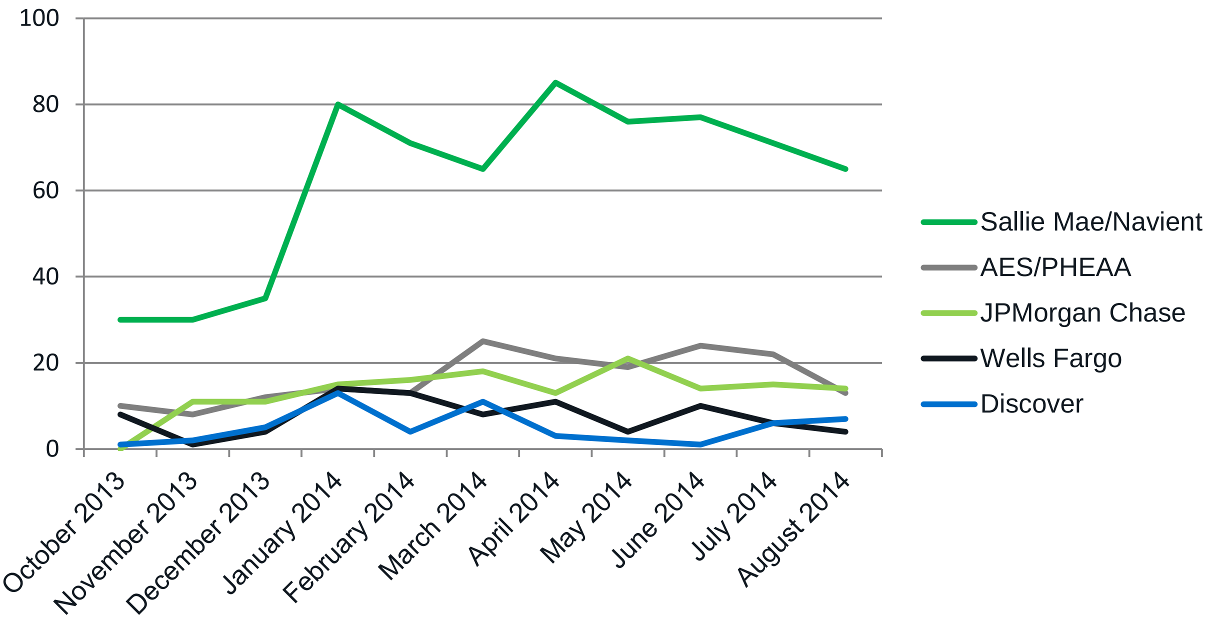
Note: This table reflects complaints where (1) the consumer identified the sub-product as a non-federal student loan (2) the consumer identified the issue and (3) the identified company responded to the complaint, confirming a relationship with the consumer. This table reflects the top companies by complaint volume.

TABLE 4: PRIVATE STUDENT LOAN COMPLAINTS BY MONTH



Note: This table reflects complaints where (1) the consumer identified the sub-product as a non-federal student loan and (2) the identified company responded to the complaint, confirming a relationship with the consumer.

TABLE 5: PRIVATE STUDENT LOAN COMPLAINTS RELATED TO REPAYMENT DISTRESS BY MONTH



Note: This table reflects complaints where (1) the consumer identified the sub-product as a non-federal student loan (2) the consumer identified their issue as “can’t repay my loan” or “problems when you are unable to pay” and (3) the identified company responded to the complaint, confirming a relationship with the consumer. This table reflects the top companies by complaint volume.

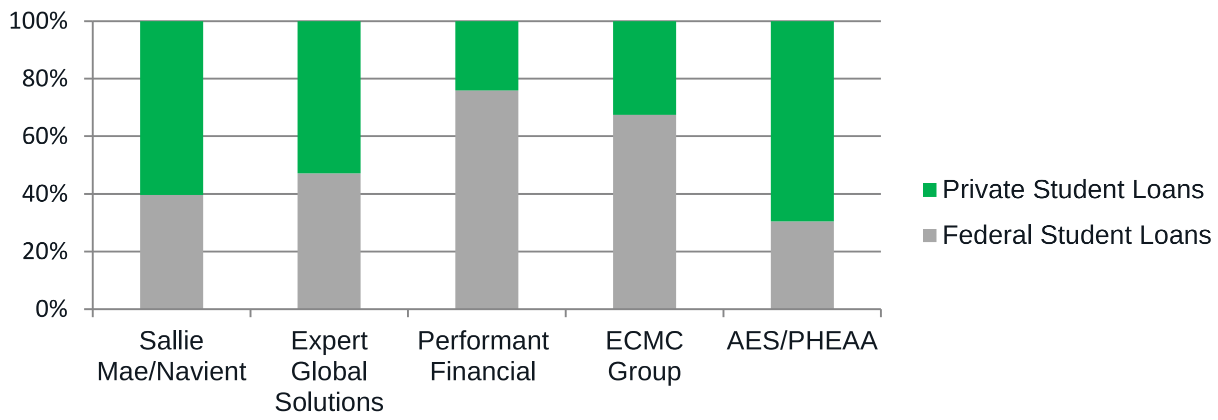
From October 1, 2013, through September 30, 2014, the CFPB handled approximately 2,700 debt collection complaints related to student loans.

TABLE 6: TOP RECIPIENTS OF STUDENT LOAN DEBT COLLECTION COMPLAINTS FROM OCTOBER 1, 2013 – SEPTEMBER 30, 2014

Federal Student Loans	Number of Complaints	Private Student Loans	Number of Complaints
Sallie Mae/Navient	139	Sallie Mae/Navient	211
Performant Financial	63	Expert Global Solutions	65
Expert Global Solutions	58	AES/PHEAA	48
ECMC Group	52	ECMC Group	25
Allied Interstate	41	Allied Interstate	25

Note: This table reflects debt collection complaints where (1) the consumer identified the sub-product as a non-federal or a federal student loan and (2) the identified company responded to the complaint, confirming a relationship with the consumer. This table also reflects aggregated complaints of subsidiary debt collection companies under the parent company.

TABLE 7: DISTRIBUTION OF LOAN TYPE FOR STUDENT LOAN DEBT COLLECTION COMPLAINTS BY COMPANY FROM OCTOBER 1, 2013 – SEPTEMBER 30, 2014



Note: This table reflects debt collection complaints where (1) the consumer identified the sub-product as a non-federal or a federal student loan and (2) the identified company responded to the complaint, confirming a relationship with the consumer. This table was not adjusted to reflect each company's relative market share. This table reflects the top companies by complaint volume. This table also reflects aggregated complaints of subsidiary debt collection companies under the parent company.

4. Issues Faced by Borrowers

SOURCES OF INFORMATION

To identify the range of issues faced by student loan borrowers, the report relies primarily on complaints handled by the CFPB. The CFPB has handled approximately 5,300 private student loan complaints between October 1, 2013, and September 30, 2014, an increase of 38 percent from the prior year.

We reviewed other information, such as comments submitted by the public in response to requests for information, 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.[4]

LIMITATIONS

Readers should note that this report does not suggest the prevalence of the issues described as they relate to the entire student loan market. The information provided by consumers helps 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.

CHALLENGES WHEN SEEKING TO AVOID DEFAULT

Since the Bureau began accepting private student loan complaints in March 2012, the largest subset of complaints stem from borrowers seeking to avoid default during a period of financial

[4] *See*, for example, Consumer Financial Protection Bureau, *Request for Information Regarding an Initiative to Promote Student Loan Affordability*, 78 Fed. Reg. 13327, Docket ID CFPB-2013-0004, (February 27, 2013).

hardship. Most frequently, borrowers submitting complaints are seeking to modify repayment terms to obtain a payment they can actually afford. While student loan industry participants have stated that they intend to increase the number of programs to assist borrowers, the increasing volume of complaints from borrowers seeking alternative repayment options suggests that lenders and servicers have yet to address the need for loan workouts in a fulsome manner.

The complaints related to loan modification challenges fall into a number of distinct themes, as outlined below.[5]

No Clear Path to Avoid Default

Borrowers report that many private student lenders and servicers do not transparently communicate consistent information on how to avoid default in times of trouble. Consumers have submitted complaints to the Bureau trying to find out if there are options to lower their monthly payment or to get a payment they can afford. Consumer complaints suggest that there is a lack of transparent information on methods to avoid default, potentially due to lenders and servicers not adequately providing information to consumers about available repayment plans or the lack of clear information available on the lender's or servicer's websites and online servicing platforms.

Investigating potential options requires borrowers to contact their lender or servicer to obtain information, and some consumers note they received conflicting information from multiple customer service representatives about eligibility criteria to enroll in alternative repayment programs.

Proactive Outreach from Borrowers Often Unsuccessful

Borrowers submitting complaints quickly sought help, but were usually rebuffed. Many of the complaints handled by the Bureau suggest that a number of borrowers are eager to protect their credit and avoid the consequences of delinquency and default. When these borrowers anticipated that they would be unable to pay, often due to difficulties securing

[5] This report cites information from specific complaints submitted to the CFPB. In these cases, the consumers have provided consent to include details from their complaints. We have redacted the specific financial institution and will generally refer to the company in question as either (1) a specialty student loan company, whose operations are primarily concentrated in originating, servicing, or collecting student loans; or (2) a very large depository institution, defined as one of the top ten US depository institutions by assets by the FFIEC.

adequate employment, they sought options for a reduced payment plan. But many of these consumers received responses from lenders and servicers that they were unwilling to offer an alternative repayment option for their loans.

> I've exhausted all of my forbearance options, which unfortunately are the only options with private loans. At this point, I don't know what to do. I am not asking for the world here - I am simply asking for a little HELP making these payments. I have made a good faith effort, for the most part, to repay my debt. I feel that I should be offered repayment OPTIONS, just like Federal Loans. I am 26 years old, and still living with my parents because of this debt.

As noted earlier, borrowers frequently complain that despite repeated attempts to request a lower monthly payment, lenders are often unwilling to constructively work with the borrower on a loan modification. One borrower who submitted a complaint with the Bureau received a response from her lender, a very large depository institution, noting that it does not currently offer any assistance through alternative repayment options. The institution also responded that she must pay her high monthly payment or default.

Consumers also stated that they need affordable repayment options that allow them to successfully repay their loans without the financial assistance of co-signers or third parties, such as family members. However, many consumers receive responses from their lender or servicer that no reduced payment options are available for their loans and that they should contact their co-signer to submit a payment or the loan will default.

Options are Too Little, Too Late

When options do exist, they often provide assistance for just a short period of time. Complaints from private student loan borrowers suggest that a more commonly-utilized method to work with borrowers in distress is the use of short-term forbearance options, often for a non-renewable period of three months.

In some cases, borrowers submitting complaints note that these forbearance options are often too short in duration to truly avoid default.[6]

> [Very large depository institution] who provided all 6 of my private loans amounting to $53,000, now tells me I owe $750 a month and that is without considering my monthly payments to federal loans. I called to ask what my options are since $750 is not a realistic monthly payment considering I am just out of college and my other expenses I accrued in order to move and settle. The people I spoke to gave me options of paying the $750 monthly or pay the $750 this month and enter into forbearance. I asked if there was a way to set up a payment plan that I could afford, as I understand these are my debts and I fully accept the responsibility to pay them completely. The representative said that the fee was set and that there was nothing he could do to alter the monthly payment. I repeated to him that this was not a feasible option and I could not afford that amount and I would be left unable to pay. He repeated my option of the initial payment then APPLY for forbearance. This is no solution to me as forbearance is just a way for interest to accrue as I am left after the [time] forbearance extension with the likely reality that $750 will be still be a payment I cannot afford.

In other cases, lenders and servicers provide options only after the loan is placed in default. In rare cases, borrowers who submitted complaints are offered the option to enroll in a reduced payment program. However, these plans were generally offered only *after* the borrower had defaulted. Some borrowers have noted that if this option had been made available earlier in the process, they could have avoided default altogether.

> I have no options left in regard to lowering my payment, forbearance, deferment or delaying my payments. I work full time as a teacher, but my student loan payment is more than a third of my income. My [specialty student loan company] just told me that there is nothing I can do but let my private loans go into default and to try to work something out with the collections agency. I have no qualms about paying a monthly fee that I can afford, but currently the money just does not exist.

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[6] Some financial institutions purport that regulations prevent them from offering longer-term forbearances. This assertion is inaccurate. Insured banks are able to offer concessions to borrowers so long as accurate accounting is utilized. *See* Section Five of this report for further discussion on the joint statement by prudential regulators.

Even with short-term forbearance options, consumers may experience unusual processing delays, unclear requirements, and unaffordable fees. Consumers report that they are sometimes instructed to complete an application in order to postpone payments due to a financial hardship. We heard from consumers who experienced difficulty in applying to temporarily postpone payments. They described an array of processing delays which then led to missed payments or default before the servicer approved or denied the application.

For example, some consumers reported that they completed an application only to find out later that this benefit is not available for their loans. Some consumers complained that they did not submit payments after completing the application under the belief that no payments were required, only to find out that the application was denied and their account was past due or possibly in default.

> I was told that I was eligible for a forbearance, however . . . [specialty student loan company] continues to tell me it is "processing" the forbearance. I have called in numerous times and even escalated the situation to speaking with a manager last when I was told the matter would be taken care of within 3 to 5 business days which have again passed and my account still shows as past due.

We have previously highlighted the practice of requiring consumers to pay a fee in order to postpone payments or apply for forbearance.[7] Consumers continue to complain that lenders may require a "good-faith" payment in order to apply for temporary forbearance programs. These payments can be approximately $50 per loan as a precondition to place the loan in forbearance for a three-month period. Consumers continue to complain that they cannot afford the forbearance fees or their required monthly payment and subsequently default on their loans.

[7] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* (October 2012), *available at* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf.

I have a private consolidation loan through [specialty student loan company]. . . I called . . . to see what options I had regarding delaying the payment on the loan. The customer service agent . . . told me I could put the loan into a forbearance for 3 months. She told me in order to do this I would have to pay a $50 processing fee. She gave me a confirmation number . . . and told me that I would not have a payment due until [date]. Around [date], I received an email from [specialty student loan company] saying my private loan was past due, even though I thought it was in forbearance. I called [specialty student loan company] on 4 separate occasions over the following days. Each time I waited on hold for approximately 20 minutes, was eventually told that I had to speak to someone in collections, and each time, rather than being transferred, I was hung up on. Today, I finally got through to collections, and they told me that I am not eligible for a forbearance, and that "their employee made a mistake." I told them repeatedly that I had a confirmation number and that the payment I made for the forbearance was deducted from my checking count. I told the representative that I did nothing in error, and I thought they should honor the forbearance.

Catch-22 for Continuing School

Many lenders' in-school deferment policies force borrowers to choose between finishing school and repaying a loan. Generally, private student lenders allow a borrower to postpone payments while enrolled in school full-time. However, many lenders limit this benefit to a certain number of months, usually between 48 and 66 months, so long as the borrower remains enrolled in a full-time program. After this period expires, the borrower is required to begin making payments even if the borrower is still enrolled full-time.

Generally, most private student lenders do not offer additional in-school forbearance if the consumer requires additional time to obtain a degree or if the consumer returns to school to obtain a graduate degree. Consumers complain that they are unable to begin making payments while enrolled in school and request additional forbearance in order to complete their program of study. As a result, consumers report that they were sent to collections or defaulted before graduating from school.

I took out a private student loan from [very large depository institution] about 5 1/2 years ago and the deferment status for the loan has expired. I called the company to see if I could qualify for an extension in the deferment or if they could somehow lower my monthly payment. I was denied both because: I had exhausted the deferment period and [very large depository institution] does not offer any options to lower the loan amount. I am not working, I am back in school, and unable to work because of the rigorous curriculum. In no way shape or form am I trying to wiggle my way out of paying back my loan. I only need some assistance until I get on my feet.

5. Ombudsman’s Discussion

Based on the issues and themes described in Section 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.

COMPLAINT PROCESS LEADING TO CHANGES IN THE MARKET

Since the CFPB began accepting private student loan complaints in March 2012, average monthly complaint volumes continue to increase each year. These complaints are largely submitted from consumers who borrowed private student loans prior to the onset of the financial crisis.

While issues facing private student loan borrowers in distress remain a persistent problem, the Bureau’s complaint process has yielded substantial benefits. The complaint process has not only helped to remedy errors from individual consumers, but analysis of the complaints by the Bureau and the industry may also be contributing to increased customer service and a level-playing field for companies that follow the law. In other cases, complaints submitted to the CFPB have led to formal actions taken by federal agencies, which also led to noteworthy changes.

PAYMENT PROCESSING

In last year's annual report,[8] we reported that many consumers experienced difficulty when lenders and servicers improperly processed their private student loan payments.

For example, many consumers who wished to pay down their loans more quickly found that student loan servicers allocated payments in ways that might maximize the amount of total interest the borrower would pay, slowing him or her down on the path to being debt-free. To assist borrowers, the CFPB published a sample letter that consumers could send to their servicer requesting that any excess funds be applied to the loan with the highest interest rate, facilitating faster repayment of debt.[9] We also requested additional information[10] from student loan servicers on their payment processing policies and learned that some servicers have inadequately invested in information technology systems to accept standing payment instructions.

Since publication of last year's annual report, some servicers notified the Bureau that they have changed their payment allocation policies and now allocate payments from borrowers in excess of the scheduled payment amount toward the loan with the highest interest rate, absent alternative instructions. Other industry participants noted that they plan to upgrade borrower-facing systems to allow borrowers to easily specify how they wish to allocate a payment across various loans.

However, we continue to receive complaints that some servicers remain unwilling to update their servicing platforms to honor standing payment instructions without requiring the borrower to instruct them each month to request an accurate payment allocation.

[8] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* (October 2013), *available at* http://www.consumerfinance.gov/reports/annual-report-of-the-cfpb-student-loan-ombudsman-2013/.
[9] Consumer Financial Protection Bureau, Consumer Advisory, *Stop getting sidetracked by your student loan servicer* (October 2013), *available at* http://www.consumerfinance.gov/blog/consumer-advisory-stop-getting-sidetracked-by-your-student-loan-servicer/.
[10] Consumer Financial Protection Bureau, *Summary of Payment Processing Key Findings* (February 2014), *available at* http://files.consumerfinance.gov/f/201402_cfpb_letter_payment-processing.pdf/.

FDIC Order to Sallie Mae and Navient

In last year's report, we also noted the problems faced by borrowers who make a payment below the total amount due for all of their individual loans managed by a single servicer. In some cases, borrowers reported that they called their servicer to explain that they would be unable to make a payment for all of their loans, and the servicer advised them to pay as much as they could. These complaints noted that payments were allocated in a manner that maximized late fees, and there was no clear method to target payments to individual loans.

The Federal Deposit Insurance Corporation (FDIC) addressed related practices regarding private student loan payment processing in an enforcement action this year.[11]

The FDIC determined that Sallie Mae and Navient violated federal law prohibiting unfair and deceptive practices in regards to student loan borrowers through the following actions:

- Inadequately disclosing its payment allocation methodologies to borrowers while allocating borrowers' underpayments across multiple loans in a manner that maximizes late fees; and
- Misrepresenting and inadequately disclosing in its billing statements how borrowers could avoid late fees.

The FDIC ordered Sallie Mae and Navient to cease all unfair and deceptive practices in its payment processing practices, make restitution of approximately $30 million to victims, and pay civil money penalties.[12]

AUTO-DEFAULTS AND CO-SIGNER RELEASE

In April 2014, the Bureau published a report[13] detailing complaints related to "auto-default" provisions included in many private student loan contracts. These provisions provide lenders with the ability to immediately place borrowers into default and demand the entire amount due upon the death or bankruptcy filing of a co-signer.

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[11] Federal Deposit Insurance Corporation, *FDIC Announces Settlement with Sallie Mae for Unfair and Deceptive Practices and Violations of the Servicemembers Civil Relief Act* (May 2014), *available at* http://www.fdic.gov/news/news/press/2014/pr14033.html/.
[12] *Id.*
[13] Consumer Financial Protection Bureau, *Mid-year Update on Student Loan Complaints* (April 2014), *available at* http://www.consumerfinance.gov/reports/mid-year-report-on-private-student-loans-2014/.

The report noted that industry participants were exercising this option even if the primary borrower was successfully repaying the loan. Borrower complaints identified at least seven large depository institutions and specialty student loan market participants, including four of the top ten bank holding companies by assets, acting as the marketer, lender, loan originator, loan servicer, or the current loan holder. When borrowers submitted a complaint with the CFPB, industry participants noted that the terms of the loan permitted such action. However, the business justification for these auto-defaults upon death or bankruptcy of a co-signer often seemed questionable.

For example, we heard from consumers that had been making timely payments on their loans for several years and requested that their servicer remove their co-signer from their loan. In some of these cases, the co-signer had been deceased for several years. Generally, the servicer would then request a copy of the co-signer's death certificate and for the consumer to complete a co-signer release application. After submitting the required documentation to their servicer, some consumers reported that they received phone calls from a debt collector demanding the full balance of their loan or that a debt collector filed a claim against the deceased co-signer's estate. Some consumers stated that they told the debt collectors that their co-signer had been deceased for many years and the estate had closed.

Although many lenders offer a borrower the opportunity to release his or her co-signer, information or applications to release co-signers are often not easily accessible through lenders' and servicers' websites. To help borrowers in obtaining a co-signer release, the Bureau published sample letters that consumers may use to request a co-signer release or more information on a co-signer release policy.[14]

Since the publication of the Bureau's report, certain market participants alerted the Bureau that they intend to suspend triggering auto-defaults until an account is carefully reviewed. In addition, others informed the Bureau that they intend to make co-signer release policies more transparent.

[14] Consumer Financial Protection Bureau, *Consumer Advisory: Co-signers can cause surprise defaults on your private student loans* (April 2014), *available at* http://www.consumerfinance.gov/blog/consumer-advisory-co-signers-can-cause-surprise-defaults-on-your-private-student-loans/.

Although we have continued to receive complaints related to auto-defaults, it is encouraging that some market participants have attempted to make improvements. We encourage all institutions to closely monitor these types of complaints to identify potential issues of concern.

MISTREATMENT OF MILITARY FAMILIES

According to the Department of Defense, more than 40 percent of servicemembers cited the goal of repaying education debt as a reason for enlistment.[15] In October 2012, we published an addendum to this annual report that focused on the unique issues faced by military families in the student loan market.[16] The report noted a number of challenges related to military-related benefits and highlighted complaints related to inappropriate handling of Servicemembers Civil Relief Act (SCRA) rate reduction requests.

For example, one servicemember who submitted a complaint to the Bureau saw his request to his servicer rejected multiple times because his military orders did not include an end date. This is neither a requirement of the SCRA, nor feasible for many commissioned officers to obtain, as their orders usually do not delineate an end date. Another servicemember with multiple loans sought to reduce the rate on his highest-rate loans, but, simultaneously, the servicer proceeded to increase the rates on other loans that had interest rates lower than 6 percent.

Many servicers quickly sought to identify the root cause of these errors, to enhance training, and to upgrade IT systems, in order to ensure that these potential violations would stop. Since the publication of the report, the number of SCRA-related complaints has fallen substantially.

Department of Justice Settlement with Sallie Mae and Navient

While some market participants closely monitored servicemember complaints and made appropriate process improvements, others allowed these issues to persist. The CFPB referred certain complaints from military customers of Sallie Mae and Navient to the Department of Justice, which enforces the SCRA.

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[15] Department of Defense, *News Briefing on Efforts to Enhance the Financial Health of the Force with Secretary Panetta* (October 2012), *available at* http://www.defense.gov/transcripts/transcript.aspx?transcriptid=5139/.
[16] Consumer Financial Protection Bureau, *The Next Front? Student loan servicing and the cost of our Men and Women in Uniform* (October 2012), *available at* http://www.consumerfinance.gov/reports/the-next-front-student-loan-servicing-and-the-cost-to-our-men-and-women-in-uniform/.

The Department of Justice launched an investigation, which determined that Sallie Mae's and Navient's "conduct was intentional, willful, and taken in disregard for the rights of servicemembers."[17] The FDIC, which jointly participated in the action against Sallie Mae and Navient, determined[18] that the companies were:

- Unfairly conditioning receipt of benefits under the SCRA upon requirements not found in the law;
- Improperly advising servicemembers that they must be deployed to receive benefits under the SCRA; and
- Failing to provide complete SCRA relief to servicemembers after having been put on notice of these borrowers' active duty status.

The order provides for $60 million in relief to approximately 60,000 servicemembers to address these violations.[19] The CFPB will continue to monitor student loan complaints carefully and make appropriate referrals in order to ensure that market participants follow the law.

LENDING PRACTICES BY FOR-PROFIT COLLEGES

A substantial portion of student loan complaints received by the CFPB come from borrowers who were previously enrolled in for-profit colleges. Historically, a greater share of students at for-profit colleges relied on private student loans than their peers at public and private not-for-profit schools. For example, from 2007 to 2008, 46 percent of students at for-profit, four-year schools borrowed a private student loan, compared to 25 percent of students at private non-profit, four-year schools.[20] However, private student loan availability for these programs significantly decreased (on a percentage basis) during and after the financial crisis of 2008, more significantly than it did for other school types.[21]

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[17] Department of Justice, *United States v. Navient Solutions, Inc., Navient DE Corporation and Sallie Mae Bank* (May 2014), *available at* http://www.justice.gov/crt/about/hce/documents/salliecomp.pdf/.
[18] *See* Federal Deposit Insurance Corporation, *FDIC Announces Settlement with Sallie Mae for Unfair and Deceptive Practices and Violations of the Servicemembers Civil Relief Act* (May 2014), *available at* http://www.fdic.gov/news/news/press/2014/pr14033.html/.
[19] *Id.*
[20] Consumer Financial Protection Bureau, *Private Student Loans* (July 2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/.
[21] *Id.*

Many lenders pulled back from the proprietary sector due to the perceived risk of making loans to students in these schools and programs. When bank-funded, private student loans became unavailable to students at for-profit schools, some proprietary programs began lending directly to their students in response.[22]

In February 2014, the CFPB announced a public enforcement action against ITT Educational Services, accusing the for-profit college of predatory lending. As ITT students were increasingly no longer able to obtain private student loans from banks and other private lenders, the school began to facilitate lending to its students through other means. In the complaint, the CFPB alleges that ITT exploited consumers and pressured them into predatory loans.

The complaint further alleges that ITT knew that most of its students would ultimately default on their private student loans, projecting a default rate for its students of 64 percent. Defaulting on private student loans can have serious consequences for consumers.

For private student loan borrowers who default early in their lives, the negative impact on their credit report can make it more difficult to pass employment screenings or buy a home. It can make it difficult to get any kind of loan for years and even affect a borrower's job prospects. And, because private student loans are difficult to discharge in bankruptcy, the debt can be very difficult to recover from.

Similarly, in September 2014, the CFPB announced a lawsuit against another for-profit chain, Corinthian Colleges, for a predatory private student lending scheme, alleging that the chain of colleges allowed employees to routinely deceive and illegally harass private student loan borrowers.

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[22] Consumer Financial Protection Bureau, *Private Student Loans* (July 2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/.

LITTLE PROGRESS BY MARKET PARTICIPANTS TO ADDRESS DISTRESSED BORROWERS

As noted in this report, the most common issue reported by borrowers is the inability to negotiate alternative repayment options with lenders and servicers when facing distress.[23] For a substantial share of private student loan borrowers who graduated in a time of extremely challenging labor market conditions found the economic landscape was meaningfully different than when they first made the decision to borrow. Although the labor market has recovered substantially since the recession, job prospects for many young graduates remain limited. One recent analysis estimated that more than one in four recent college graduates was either unemployed or underemployed.[24]

While market participants have addressed some of the root causes of consumer complaints, the lack of availability of transparent loan modification options and complicated enrollment procedures persist as pain points in the market.

In May 2013, the CFPB published a report that analyzed public comments on ways to spur greater loan modification activity.[25] Since that time, policymakers and regulators have urged market participants to work constructively and proactively with borrowers to identify appropriate loan workout arrangements.

Prudent workout arrangements are consistent with safe and sound lending practices and are generally in the long-term best interest of both financial institutions and borrowers. 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. These 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

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[23] In this report, references to loan modifications, loan workouts, and alternative repayment options for borrowers in distress are distinct from private student loan refinancing, where a borrower refinances a loan to a new one with a lower interest rate to take advantage of market interest rates or improved creditworthiness.

[24] Sheirholz et. al, *Class of 2014: The Weak Economy is Idling Too Many Young Graduates*, Economic Policy Institute (May 2014).

[25] Consumer Financial Protection Bureau, *Student Loan Affordability* (May 2013), *available at* http://www.consumerfinance.gov/reports/student-loan-affordability/.

restructurings in accordance with accounting requirements under generally accepted accounting principles."[26]

In January 2014, CFPB Director Richard Cordray, Education Secretary Arne Duncan, along with senior officials from the Department of the Treasury and federal financial regulatory agencies, convened a meeting of the largest lenders and servicers of private student loans to identify opportunities to accelerate the rollout of alternative repayment plans. Several participants noted that they were exploring new ways to assist borrowers.

But analysis of complaints and other market data suggest that lenders and services are not making significant progress. There are several factors which may contribute to continued volumes of complaints related to private student loan modification or the lack thereof.

BORROWER EXPECTATIONS BASED ON FEDERAL LOAN OPTIONS

Prior to 2010, students could borrow both federal and private student loans from the same lender. Many borrowers submitting complaints with the CFPB note that they have been able to enroll in loan modification programs to prevent default on their federal student loan. These options include various income-driven plans, as well as term extensions and graduated repayment plans.

For example, the Pay As You Earn plan available on many federal student loans allows for borrowers to cap their payments at ten percent of their discretionary income (as calculated by a federal formula).[27] Certain borrowers can also utilize extended repayment options that lengthen the repayment term, sometimes from ten to 25 years.[28]

In addition, prior to entering repayment, federal student loan borrowers generally participate in "exit counseling" facilitated by their institution of higher education.[29] Federal student loan borrowers also receive information on periodic billing statements which provide information and instructions on how to lower student loan payments and enroll in a different repayment

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

[27] 34 CFR 685.209.

[28] 34 CFR 685.208.

[29] *See*, for example, 34 CFR 682.604 (FFEL) and 34 CFR 685.304(Direct Loan). This counseling typically does not include information specific to repaying private student loans.

plan. However, at no point is a private student lender required to provide a borrower with information on alternative repayment plans or options if the borrower begins to experience a financial hardship.

Many servicers manage both federal loans and private loans for individual borrowers, and some are not effectively communicating that certain programs are available for some loans and not for others, which may be contributing to borrower frustration and driving complaints submitted to the Bureau.

COMPLEXITIES STEMMING FROM SECURITIZATION

While securitization is often closely associated with the mortgage market, securitization activity in the student loan market has also been notable. While many issuers offered securities backed by government-guaranteed student loans, the share of student loan asset-backed securities whose underlying assets consisted of private student loans increased rapidly in the years prior to the financial crisis.

Lending practices in the private student loan market in the years preceding the financial crisis shared many characteristics with those of subprime mortgage lending. A strong investor appetite for asset-backed securities created incentives for originators to increase volumes quickly, leading to significantly-reduced credit quality.[30] Many private student loan borrowers found that their loans were sold to new parties. Unsurprisingly, many private student loan complaints mirror the problems heard from consumers in the mortgage market as economic conditions began to deteriorate.

In effect, a lender had an incentive to increase loan volumes that were ultimately sold to investors, with less incentive to assure the creditworthiness of those loans. This dynamic provided the means and the incentive for lenders and issuers of student loan asset-backed

[30] For example, high investor demand for student loan asset-backed securities allowed issuers to create structures with very low collateralization ratios. A collateralization ratio is the ratio of trust assets (loans sold to the trust and other cash accounts) to trust liabilities (notes sold by the trust). As a result of these factors, $100 in student loans could generate immediate cash proceeds from securitization of $105 or more. Generally speaking, after such a transaction, the buyer assumed all of the risk that the borrower would fail to repay the loan.

securities to originate and securitize greater and greater amounts of loans. In 2006, issuance of private student loan asset-backed securities topped $16 billion.[31]

Although the market has reduced risky lending following the financial crisis (private student loan underwriting has tightened substantially since 2008),[32] many student loan borrowers continue to struggle with high-rate, high-balance student loans made prior to the crash.

Not only did this securitization boom fuel many of the risky loans that continue to experience distress today, but securitization may also add significant complexity when seeking to launch loan modification programs. In many cases, the same market structure that precipitated a boom in private student lending has left borrowers with few or no options in times of financial distress.[33] This factor closely resembles loan modification challenges identified in the subprime mortgage market in the wake of the housing crisis. More than five years ago, the Director of the Federal Housing Finance Agency testified that implementing the federal government's home loan modification program on loans that back private-label, mortgage-backed securities was especially challenging due to these complexities, such as engaging trustees and gaining investor consent.[34]

There does not appear to be evidence that trustees governing securitized pools of private student loans and servicers are actively engaged with one another to identify creative solutions that would increase loan modification activity. If servicers and trustees are successful, complaint volumes may subside.

DISTORTED INCENTIVES DUE TO CHANGES IN THE BANKRUPTCY CODE

In 2005, the Bankruptcy Code was amended so that all loans made for a qualified education expense became exempt from discharge in bankruptcy absent "undue hardship" to the debtor. The change in the Bankruptcy Code raised the threshold to discharge student loans in bankruptcy proceedings compared to other forms of unsecured consumer debt.

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[31] Consumer Financial Protection Bureau, *Private Student Loans* (July 2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/.

[32] *Id.*

[33] For example, some lenders whose business relied on an originate-to-securitize model are no longer participating in the market. While these lenders may no longer be operating, trustees may have authority to initiate certain modification programs. However, the complexity of undertaking such an effort should not be understated.

[34] Federal Housing Finance Agency, *Statement of Director Lockhart before the House Financial Services Committee* (June 2009), *available at* http://democrats.financialservices.house.gov/media/file/hearings/111/fhfa_directors_testimony_final.pdf/.

Industry participants from many of the nation's largest financial institutions have noted that rolling out new loan modification programs is challenging, particularly when dealing with a third-party servicer. In certain cases, these institutions have simply determined that it is in their financial interest to only permit the borrower to use some short-term forbearance options rather than solutions that are renewable or longer-term. This is because recoveries on defaulted private student loans are relatively high compared to other unsecured consumer debt obligations, due in part to the 2005 changes to the Bankruptcy Code.

In other words, the expected present value of payments in a modified payment plan, less any one-time costs with modifying the loan, may be less than the expected present value of a borrower self-curing or through recovery by third-party debt collectors and litigation. As noted earlier, prudential regulators have encouraged financial institutions to work constructively with borrowers on loan workout programs so that borrowers may avoid default, but the special protections provided to lenders in the 2005 changes to the Bankruptcy Code may be providing a countervailing incentive.

When deciding how to approach distressed private student loans, loan owners might consider the potential effects of the negative customer experience for a new graduate associated with lack of assistance in times of distress, including the possibility of loss of goodwill that may affect future demand for products from particular institutions. This may prove to undermine a financial institution's ability to serve that customer with other products that yield higher margins. If the changes to the Bankruptcy Code are discouraging constructive engagement between financial institutions and customers seeking to find suitable repayment arrangements, there may be larger economic consequences for all parties over the long run.

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 changes to the Bankruptcy Code might motivate lenders to constructively work with borrowers to modify loan terms.

In 2005, the Bankruptcy Code was amended so that all loans made for a qualified education expense became exempt from discharge in bankruptcy absent a showing of "undue hardship" to the debtor.[35] According to a 2012 report to Congress published by the Consumer Financial Protection Bureau and the Department of Education, historical pricing data suggests that changes in the Bankruptcy Code did not lead to lower prices and only modestly expanded access to credit for borrowers with lower credit scores.[36] Both the CFPB Director and the Secretary of Education recommended that Congress examine whether the 2005 Bankruptcy Code changes met their desired policy goals and determine whether changes are needed.[37]

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[35] Prior to the 2005 changes, the treatment of private student loans in bankruptcy proceedings was similar to that of other unsecured consumer credit products.

[36] *See* Consumer Financial Protection Bureau, *Private Student Loans* (July 2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/; *see also* Ang, Xiaoling, and Jiménez, Dalié, *Private Student Loans and Bankruptcy: Did Four-Year Undergraduates Benefit from the Increased Collectability of Student Loans*, SSRN Scholarly Paper, Rochester, NY: Social Science Research Network (August 2, 2014), *available at* http://papers.ssrn.com/abstract=2332284/.

[37] *See* Consumer Financial Protection Bureau, *Private Student Loans* (July 2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/.

While the 2012 report did not specifically explore the impact of changes to the Bankruptcy Code on alternative repayment options, the impact of the changes to the Bankruptcy Code is likely leading to higher recoveries on post-default collections of private student loans, as compared to other consumer loans. This may be leading to an unintended consequence, whereby investors and lenders now have less incentive to work constructively with borrowers to avoid default through loan workout programs.

One potential option for exploration is to determine whether the special bankruptcy protection afforded to lenders may be limited to those lenders that offer certain loan modification options. For example, without pursuing a bankruptcy filing, federal student loan borrowers can seek income-driven repayment plans that are similar to a Chapter 13 repayment plan.

If loan holders could only retain their special bankruptcy protection if they offer meaningful loan modification options, then these loan holders would have a stronger, short-term, economic incentive to offer borrowers a greater array of options to avoid default.

Providing incentives for market participants to encourage student loan borrowers to successfully repay and avoid default can also help to ensure that these borrowers will be able to fully participate in the economy even if they encountered economic challenges early in their working lives.

Determine whether lenders and servicers provide adequate and timely disclosures to borrowers about repayment options, particularly in times of financial hardship.

In last year's annual report, we included a recommendation that policymakers should determine whether recent efforts to improve the servicing of mortgage and credit card obligations might also be applicable to the student loan market.[38] As Congress seeks to reauthorize student loan programs under the Higher Education Act, we noted that it may be useful to assess whether certain reforms to the servicing of credit cards and mortgages (such as clear guidelines for payment application, records retention, etc.) might also strengthen student loan servicing. In

[38] *See* Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* (October 2013), *available at* http://www.consumerfinance.gov/reports/annual-report-of-the-cfpb-student-loan-ombudsman-2013/. The 2013 *Annual Report of the CFPB Student Loan Ombudsman* is also discussed in Section Five of this report.

addition, it may be worthwhile to also focus closely on the adequacy of disclosures regarding repayment options.

The Higher Education Opportunity Act of 2008 (HEOA) mandated significant changes to provide additional information to private student loan borrowers. The changes under HEOA changed the disclosure requirements under the Truth in Lending Act (TILA) for private education loans.

In 2009, the Federal Reserve Board of Governors finalized a rule implementing amendments to the Truth in Lending Act that required certain special disclosures for private student loans, which must be provided at different times in the loan origination process.[39] These disclosures offer important substantive information critical to making an informed borrowing decision.[40] However, these disclosures do not contain specific information on alternative repayment options for borrowers in times of distress.[41] In contrast, federal student loan disclosures provide information to borrowers about a number of available repayment plans.[42]

Given that many private student loan borrowers will not anticipate financial hardship, further analysis might reveal whether supplemental counseling, disclosures shortly before entering repayment, or inclusion of information in routine communications, such as periodic billing statements or late notices, may enhance borrower awareness of all repayment options, particularly in times of distress.

In the mortgage market, servicers must contact delinquent borrowers about the delinquency and the possible availability of loss mitigation options.[43] Servicers must also consider and respond to a borrower's application for a loan modification if it arrives before a certain period of time before a scheduled foreclosure sale.[44]

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[39] Truth in Lending, *Final Rule*, 74 Fed. Reg. 41194 (August 14, 2009) (codified at 12 CFR 226).
[40] In 2009, Regulation Z was amended following the passage of the Higher Education Opportunity Act (HEOA) by adding disclosure and timing requirements that apply to lenders making private education loans.
[41] *See* Board of Governors of the Federal Reserve System, *Press Release* (July 2009), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20090730a.htm/ (providing sample private education loan disclosure forms).
[42] *See*, for example, U.S. Department of Education, Plain Language Disclosure for Direct Subsidized Loans and Direct Unsubsidized Loans, William D. Ford Direct Loan Program, *available at* http://www.direct.ed.gov/dlplain.pdf/.
[43] 12 CFR 1024.39; 12 CFR 1024.40; 12 CFR 1026.41.
[44] 12 CFR 1024.40(b).

If private student lenders and servicers are unable to overcome the challenges they face to offer and effectively communicate repayment options to borrowers in distress, the Bureau may wish to study the effectiveness of the current disclosure framework implemented five years ago and determine whether additional disclosures and servicer obligations are warranted.[45]

Assess the impact of the tax treatment of principal forgiveness on loan modification activity.

Some industry participants have noted that loan modifications that involve principal forgiveness can require the lender or servicer to report the amount of forgiveness as taxable income to the borrower. Industry participants are concerned that borrowers may encounter additional distress if the forgiveness leads to a large one-time tax bill or significant burden on unemployed consumers.

In 2007, Congress passed the Mortgage Forgiveness Debt Relief Act, which generally allows homeowners to exclude income from discharge of debt on their principal residence.[46] Before this temporary exemption, distressed homeowners had to include canceled debt as income on their tax returns. But through this temporary exemption, mortgage lenders were allowed to forgive portions of an underwater mortgage without burdening consumers with an increased tax liability that they may be unable to handle.

Without this temporary tax exemption, many industry participants have noted that providing principal reductions may actually lead to financial distress for student loan borrowers due to a heavy tax levy.[47]

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[45] The Dodd-Frank Act granted rulemaking authority to the Consumer Financial Protection Bureau, pursuant to, among others, TILA and Title X of the Dodd-Frank Act. The Dodd-Frank Act included a number of amendments to TILA for which the CFPB issued rules to implement. The Bureau has not issued rules or revisions to the disclosure requirements related to private education loans.

[46] This temporary exemption expired in December 2013 and has not been renewed.

[47] Some borrowers may meet the IRS definition of "insolvency," limiting the amount of canceled debt included in income under certain circumstances. *See* Internal Revenue Code § 108(a)(1)(B).

7. Contact Information

TO REACH THE CFPB'S STUDENT LOAN OMBUDSMAN:

E-mail:	students@cfpb.gov
US Mail:	Consumer Financial Protection Bureau 1700 G Street NW Washington, DC 20552

TO SUBMIT A COMPLAINT:

Webpage:	consumerfinance.gov/complaint
Toll-Free:	(855) 411-CFPB (2372)
Español :	(855) 411-CFPB (2372)
TTY/TDD:	(855) 729-CFPB (2372)
Fax:	(855) 237-2392
US Mail:	Consumer Financial Protection Bureau PO Box 4503 Iowa City, Iowa 52244

PRESS & MEDIA REQUESTS

E-mail:	press@consumerfinance.gov