Comment submitted by
The Center for Responsible Lending[1]

To the Consumer Financial Protection Bureau

Re: Request for information regarding an initiative to promote student loan affordability

Docket No. CFPB-2013-0004

April 8, 2013

Thank you for the opportunity to share information about increasing the affordability of existing private student loan debt. Policymakers should explore ways to help distressed private student borrowers obtain loan modification and refinancing, especially given the inability to discharge student loans in bankruptcy. The Center for Responsible Lending has closely monitored efforts to assist distressed homeowners through programs such as HARP and HAMP. These programs may provide lessons applicable to student loans.

Student loan modification should not take the place of enforcement actions against predatory private student loans

First, no student loan modification or refinancing program should take the place of enforcement actions against predatory private student lenders. Some lenders have engaged in a variety of unfair, deceptive and abusive practices, trading on students' hopes to better themselves through education. These abuses include:

- Misleading students into borrowing private student loans before exhausting their federal loans.[2]
- Knowingly making loans with an extremely high default rate.[3]
- Arbitrarily changing amortization schedules to the detriment of borrowers and applying payments in a manner intended to maximize revenues for themselves, rather than reduce balances for borrowers.[4]
- Engaging in "rent-a-bank" schemes to evade state consumer protection laws.[5]
- Using arbitration clauses in an attempt to immunize these abuses from redress.[6]

[1] The Center for Responsible Lending (CRL) is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofits and serves more than 80,000 mostly low income families through 30 retail credit union branches in North Carolina, California and Chicago.

[2] National Consumer Law Center, *Paying the Price: The High Cost of Private Student Loans and the Dangers for Borrowers* 17-18 (Mar. 2008).

[3] Public Citizen, *Between a Rock and a Hard Place: Courthouse Doors Shut for Aggrieved Private Student Loan Borrowers* 8-9 (Jul. 2012).

[4] *Kuehn v. Citibank, N.A.*, 2012 WL 6057941 (S.D.N.Y. December 6, 2012).

[5] *Ubaldi v. SLM Corp.*, 852 F. Supp. 2d 1190, N.D. Cal. (2012).

For-profit colleges have engaged in especially abusive practices. In attempts to evade the "90-10" rule, they directly made private loans with high default rates to especially vulnerable students.[7] These colleges have also pushed distressed borrowers into forbearance in order to manipulate their books for investors and regulators.[8]

Any loan modification or refinancing solution should preserve consumers' private rights of action for such abuses; and the Bureau and other regulators should pursue abusive lenders and servicers and stop these unfair practices.

Strong oversight and enforcement action against private student lenders is especially important now, since the volume of private student loans could increase in the near future. Private student lending sharply decreased after the credit crisis, but economic conditions may be priming it for a rebound. College costs continue to rise, while some sources of federal aid, such as subsidized graduate school loans and Parent PLUS loans, have been restricted. Private student loans could fill the breach. In addition, the secondary market for private student loans may be strengthening: Sallie Mae's recent issuance of private student loan-backed securities suggests that investors, seeking opportunities in a low interest rate environment, are still willing to buy student loan-backed securities.[9] This demand could drive increased originations of student loans and degrade underwriting standards, similar to mortgages and student loans the early- and mid-2000s. The Bureau should stay vigilant as the private student loan market grows.

Modification and refinancing lessons

In designing a private student loan modification program, policymakers should keep in mind the lessons learned in the mortgage arena. CRL has closely followed HAMP, the federal government program that modifies loans for borrowers in distress and at immediate risk of foreclosure; and HARP, which refinances underwater mortgages into lower rates and safer loans. Although both HAMP and HARP have their shortcomings, and mortgages differ from student loans in important ways, the programs illustrate some important lessons learned in modifying consumer debt.

First, financial incentives alone may not be sufficient. HAMP is a voluntary program that provides financial incentives for servicers to modify loans through interest rate reductions, extensions of payment terms, and, in some cases, principal reduction. Although HAMP has

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[6] *Between a Rock and a Hard Place, supra* n. 3.

[7] National Consumer Law Center, *Piling it On: The Growth of Proprietary School Loans and the Consequences for Students* 24-28 (Jan. 2011).

[8] Senate Committee on Health, Education, Labor and Pensions, *For Profit Higher Education: The Failure to Safeguard the Federal Investment* 151-59 (July 30, 2012), available at http://www.help.senate.gov/imo/media/for_profit_report/PartI.pdf. Sallie Mae has also been accused of the same practice in other contexts. *See In re SLM Corp. Securities Litigation*, 2012 WL 209095 (S.D.N.Y. January 24, 2012).

[9] Ruth Simon, *Student-Loan Securities Stay Hot,* Wall Street Journal (Mar. 3, 2013).

provided meaningful relief to over a million homeowners[10] and should be extended, financial incentives alone were not effective -- they could not reform the servicer practices and misaligned interests that were preventing modifications. The CFPB should study the student loan market to determine whether underlying incentives and dysfunctions are preventing rational modification and refinancing. If so, the problem will not be responsive to governmental financial incentives alone.

Second, study the servicers. Mortgage servicers received greater fees for foreclosures than for modifications in many cases. The resulting misaligned incentives created a roadblock to rational loan modifications that would have benefitted both the borrower and investors. As our research demonstrates, in many cases home loan modifications would have returned more value to the investor than a foreclosure.[11] But even with the incentives provided by HAMP, many borrowers did not receive modifications. This dysfunctional system resulted in harm to borrowers and to investors.[12]

The consumer complaints detailed in the Bureau's October 2012 report indicate that dysfunctions similar to mortgage servicing may exist in student loan servicing. Specifically, consumers complained that even though they made good-faith efforts to pay what they could, servicers still put their accounts into default.[13] Similar to the mortgage context, both borrowers and lenders/investors might have been better served if the borrowers received loan modifications and continued to pay what they could, rather than going into default and ceasing payment altogether.

Corporate relationships may also create misaligned incentives that impede modifications. For example, Sallie Mae, one of the largest loan servicers, also owns the debt collector Pioneer Credit Recovery.[14] This kind of relationship poses the risk that in cases where one company provides both servicing and collections for the same loan, it may not prioritize modification efforts as much as would be good for borrowers and economically rational for investors. The Bureau should investigate whether such conflicts of interest create obstacles to borrower relief.

Servicer infrastructure, capacity, and culture matter as well. In the mortgage context, servicers were ill-prepared to process the flood of distressed borrowers and mitigate losses. They lacked the capacity to provide the kind of high-touch, responsive customer service necessary to work successfully with distressed borrowers and modify their loans.[15] They did not

[10] Treasury Department, *Making Home Affordable Program Performance Report* (Jan. 2013), *available at* http://www.treasury.gov/initiatives/financial-stability/reports/Documents/January%202013%20MHA%20Report%20Final.pdf.

[11] Center for Responsible Lending, *Fix or Evict?* (Mar. 2011), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/fix-or-evict.html.

[12] Adam Levitin and Tara Twomey, *Mortgage Servicing*, 28 Y. Journal on R. 1, (2011).

[13] Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* 7 (October 12, 2012), *available at* http://files.consumerfinance.gov/f/201210_cfpb_Student-Loan-Ombudsman-Annual-Report.pdf.

[14] Sallie Mae Corporation, *Pioneer Celebrates 10 Years as Part of Sallie Mae* (Aug. 23, 2012), https://www.salliemae.com/about/news_info/newsreleases/Pioneer%20Celebrates%2010%20Years%20as%20Part%20of%20Sallie%20Mae.aspx.

[15] *Mortgage Servicing*, *supra* n.12.

prioritize maintaining documents or communicating well with consumers. These shoddy practices impeded an orderly response to distressed borrowers, and in some cases, slid into unfair or deceptive practices such as robosigning. The Bureau's October 2012 report indicates that the student loan servicing industry is likewise failing to provide appropriate customer service to borrowers and that the industry may lack the proper infrastructure and organization to successfully process modifications.

Third, impose rules on servicers to correct misaligned incentives and infrastructure dysfunctions. Any effort to modify student loans must be paired with meaningful, legally enforceable standards for servicers that can overcome economic disincentives to modifications. Otherwise, modifications may not be performed at the rates they should. The standards should also address poor servicer practices that frustrate consumers' attempts to manage their obligations, receive information, and be treated fairly.

A rule akin to the Bureau's Mortgage Servicing Rule should be considered for student loans.[16] The Mortgage Servicing Rule compels servicers to consider borrowers who timely apply for loss mitigation before foreclosing. The Rule does not actually require that investors offer modifications, but in practice, most if not all mortgage investors do permit modifications to eligible borrowers. Accordingly, the Rule ensures that servicers consider eligible borrowers for modification. For student loans, a similar servicer rule would require that servicers apply an objective framework to consider borrowers for modifications who timely apply, rather than sending them to collections.

The Mortgage Servicing Rule also imposes measures to correct the infrastructure problems that too often resulted in poor servicing practices. It requires that mortgage servicers put procedures into place to correct errors, maintain documents, and ensure that consumers receive information about their accounts promptly. Likewise, student loan servicers should be required to maintain adequate infrastructure to properly manage accounts and respond promptly and accurately to troubled borrowers. A good student loan servicer rule would help ensure that servicers engage responsively with distressed borrowers and provide them with the help and information they need.

Fourth, modifications must actually provide relief. Any modification must be calibrated to avoid re-default and ensure affordability for consumers in the long term. Our research on home loans indicates that modifications must significantly reduce monthly payments in order to prevent re-default.[17] Likewise, HAMP performance data demonstrates that modifications must reduce monthly payments. HAMP modifications provide significantly greater monthly payment and more principal reductions than non-HAMP modifications; as a result, HAMP modifications have almost half the re-default rate of non-HAMP modifications.[18]

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[16] 78 Fed. Reg. 10695 (Feb. 14, 2013).

[17] *Fix or Evict*, *supra* n. 11 at 6.

[18] Laurie S. Goodman, Lidan Yang, Roger Ashworth, Brian Landy, *Modification Effectiveness: The Private Label Experience and Their Public Policy Implications*, Amherst Securities Group LP, at 12 (May 30, 2012), available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Goodman_et_al_%20Modification_Effectiveness.pdf; Peter McNally et al., *Principal Reduction Helps to Reduce Rates in the Long Run*, Moody's ResiLandscape (Moody's Investors Service), Jan. 20, 2012. *See also* OCC Mortgage Metrics Report,

A successful student loan modification program would also reduce monthly payment amounts and principal where appropriate to make the modified loan truly affordable to the borrower.

Fifth, create flexible solutions and provide access to data. HARP, the federal government's program to spur underwater refinancing, has steadily increased in effectiveness over time: over 1 million HARP refinancings were performed in 2012 alone.[19] This effectiveness can in part be attributed to regulators' willingness to correct program flaws as they become visible. Regulators have adjusted HARP by increasing eligibility for the program, streamlining the application process, and removing some of the barriers to competition that favored refinancing by the original lender over new lenders. HAMP has similarly evolved towards greater effectiveness by expanding eligibility, increasing incentives for principal reductions, and giving participants second chances at modifications. These tweaks have improved both HAMP and HARP's reach. Likewise, a student loan modification program should be flexible and open to change as experience with the program exposes its flaws and opportunities for expansion.

One key requirement to flexible solutions is providing access to data. The Bureau and other regulators should publish any available data about private student loan modifications in order to allow the public and other regulators to assess the effectiveness of the program and suggest needed changes.

Sixth, consider both market-based and direct solutions. HAMP and HARP both depend in varying degrees on incentivizing market behavior, rather than providing direct government assistance. Market-based proposals could also spur refinancing or modifying student loans. Ideas include awarding lenders financial incentives for modifying loans; using tax credits to spur refinancing and the creation of a secondary market; encouraging states and municipalities to issue tax-exempt bonds to fund student loan refinancing; and giving banks Community Reinvestment Act credit for refinancing or modifying private student loans.

At the same time, policymakers should consider direct relief for student borrowers. Direct relief by federal and state governments may be a more efficient route to affordable private student loans. For example, for the existing balance of private student loans, the simple and effective solution may be to offer refinancing or consolidating into federal student loans. This could lower interest rates and provide students with income-based repayment plans and the other protections of federal loans.

To conclude, we support the goal of reducing the burden of private student loans through refinancing and modification. Rather than assuming that governmental financial incentives alone will fix

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Disclosure of National Bank and Federal Savings Association Mortgage Loan Data, Third Quarter 2012 available at http://www.occ.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics-2012/mortgage-metrics-q3-2012.pdf (calculations on non-HAMP modifications take total modifications and subtract out HAMP modifications by category); Ioan Voicu et al., Furman Ctr. for Real Estate & Urban Policy, *Performance of HAMP Versus Non-HAMP Loan Modifications – Evidence from New York City* (2011), available at http://furmancenter.org/files/publications/paper_mods_performance_102311_1.pdf (finding that HAMP mods have lower re-default rates even after controlling for payment reduction, interest rate reduction and term extension).

[19] Federal Housing Finance Agency, *Refinance Report* (Dec. 2012).

the problem, the program must take into account the relevant economic forces and industry characteristics in order to provide meaningful relief.