

Consumer Financial Protection Bureau Shaking Up Private Student Loan Industry

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SUMMARY

The Consumer Financial Protection Bureau has issued a report highlighting significant consumer protection issues in the private student lending industry and making recommendations to ensure transparency.

The Consumer Financial Protection Bureau (CFPB) is working toward its goal to make the private student lending industry more transparent, ensuring the industry's compliance with existing laws and educating the public on student loan debt. Most recently, on July 20, 2012, the CFPB issued a comprehensive report to several Senate Committees regarding the current state of the private student loan marketplace and related consumer protection issues (the "Report"). The CFPB's findings and recommendations could lead policymakers to implement significant changes in the private student loan industry.

Overview of Findings:

The CFPB's Report explains that, similar to the mortgage industry, the private student loan market grew exponentially from 2001 (less than \$5 billion) to 2008 (more than \$20 billion) due to loose underwriting standards. Although lenders have since tightened their credit standards, according to the Report, the consequences of this "boom" still linger. The Report notes that many borrowers are left with loans they did not understand and are struggling to repay. The CFPB found that a number of borrowers assumed private student loans before exhausting federal student loan options because of their lack of understanding of the education loan system. It also reported that ten percent (10%) of recent college graduates have education debt that exceeds twenty-five percent (25%) of their income. Defaults of private student loans total more than \$8 billion.

Recommendations

The CFPB made several recommendations to the Senate Committee to address these problem areas. The most controversial and potentially impactful suggestion is that the Senate Committees consider whether more flexibility should be allowed with regard to restructuring or discharging private student loan debt in bankruptcy. Although the bankruptcy standards were relaxed in 2005, the threshold for restricting private student loans remains high relative to other consumer debt. The CFPB also recommended that lenders be required to coordinate with higher education institutions prior to originating private student loans in order to obtain certification from schools that loan amounts do not exceed student need. Modernizing the definition of a private student loan under the Truth-in-Lending Act and focusing on improving education of students regarding the differences between private and federal student loans were also proposed by the CFPB.

Loan Shopping Sheet:

In accord with these objectives, the CFPB unveiled a final version of a financial aid “shopping sheet” on July 24, 2012. The shopping sheet form was developed in order to provide students with more transparency regarding the financial obligations assumed in connection with financing a college education. The shopping sheet is a one-page form that provides students with personalized information about how much one year at a particular school will cost. It factors in the estimated costs of attendance, grants, scholarships and various loan options. The CFPB has urged colleges to adopt the shopping sheet – at least 10 universities have already expressed their intention to do so – and President Obama signed an executive order requiring colleges that accept government funding for veterans’ education to provide military students with the form. As more universities commit to using the shopping sheet, it is likely that pressure to adopt the form will increase to avoid the appearance of a lack of transparency.

Given these recent developments, substantial changes to the private student loan marketplace may be on the horizon and lenders should consider proactive efforts toward working in unison with higher education institutions to get ahead of this regulatory curve.

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