

Servicers And The Expanding Student Loan Law Landscape

By Kathryn Ryan and Magda Gathani (April 4, 2023)

Student debt has long been an area of national concern, predating the Biden administration's efforts to reduce it, and the matter's subsequent landing in the U.S. Supreme Court.

As a result of the ensuing scrutiny, student loan servicers are now subject to ever-increasing regulatory and licensing requirements as states respond to pressure from consumer groups with legislation. This has included many states proposing and enacting[1] student loan servicing bills of rights.[2]

More recently, the California Department of Financial Protection and Innovation modified proposed regulations under its student loan servicing statute, which would amend so-called education financing products to include private student loans that are not traditional loans, and expand borrower protections.

Current and prospective student loan servicers must now navigate a complex set of state requirements that not only include student loan servicing laws, but also encompass general consumer loan servicing laws, debt collection laws and compliance obligations ranging from disclosure requirements, vendor management obligations and privacy laws. Servicers are managing this mounting scrutiny while grappling with repeated pandemic-related waivers over the past few years.

Student Loan Servicing Laws

While the number of states considering and adopting student loan servicing laws continues to grow, the scope and requirements of these student loan servicing laws vary significantly and can cover a broad base of servicers.

State laws do not define "servicing" uniformly, but generally, receiving and applying payments and performing other services related to student loans qualifies as servicing. These requirements may apply even if a company hires subcontractors to directly communicate with borrowers.

In California, simply maintaining accounts and communicating with borrowers regarding the loan on behalf of the owner during a period when no payment is required qualifies as servicing.[3] Entities that "facilitate" these activities must also hold a license.[4]

In Connecticut, which also has a specific student loan servicing licensing regime, a company must obtain a license if it is engaged in servicing, which means receiving and applying payments, and "performing other administrative services with respect to a student education loan."[5]

The Connecticut Department of Banking has already indicated that as a result of the broad definitions in the statute, educational institutions that provide education loans to students by either extending credit or loaning money, and subsequently, either directly or indirectly receive or apply payments from borrowers to such loans engage in licensable activity.[6]



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However, the Connecticut regulator stated that it will not take a no-action position on student loan servicer licensure by an educational institution that only acts indirectly as a student loan servicer and contracts out the direct servicing of loans to licensed student loan servicers or entities exempt from licensure.[7]

Consumer Loan Servicing Laws

Regardless of whether a state has enacted a student loan servicing law, an added complexity in the state space is that nondepository companies may also be subject to consumer loan servicing requirements.

These laws require licensure where a company accepts payments on behalf of borrowers for transmission to the lender or investor. Some states require licensure to the extent that the company "accepts" and "remits" payments to the lender or creditor, but the statutes fail to further define what constitutes acceptance or remittance.

For example, under the Maine Consumer Credit Code, a loan servicer notification filing is required for companies that undertake direct collection of payments from or enforcement of rights against borrowers arising from consumer credit transactions.[8]

Since student loan servicers undertake direct collection of payments from — or enforcement of rights against — student debtors, and student loans are consumer credit transactions, they would need to file notification, and comply with other requirements of the Maine Consumer Credit Code.

Debt Collection Laws

Even in states without student loan or general loan servicer licensing regimes, a student loan servicer may nevertheless be required to comply with state debt collection statutes.

While many states define collection agencies requiring a license as those entities that are directly engaged in collecting debts on behalf of others, where debt may be delinquent or performing depending on the state, some states have extended their licensing requirements to also apply to those entities indirectly engaged in collection activities.

As a result, student loan servicers must evaluate if a debt collection license is required. Depending on the specific activities, it is possible that a student loan servicer may not only be required in a particular state to obtain a student loan servicer and/or a consumer loan license, but also a debt collection license.

However, certain state debt collection laws exempt debt collectors regulated under student servicing statutes, which further adds to the complexity of operating in this space.

Obligations Beyond Licensing Requirements

In addition to licensing requirements, student loan servicers must also be mindful of a host of other obligations that state laws impose upon them.

In fact, some states have implemented student loan servicer bills of rights that may not require licensure, but still impose substantial requirements upon servicers. A disclosure requirement is a common obligation.

For example, Washington regulations require that a student loan servicer post on its website information regarding repayment and loan forgiveness options, and the availability of a student loan advocate to provide assistance.[9]

The student loan servicer must also provide this information by email or in writing to the borrower at least once per calendar year, or provide a toll-free telephone number where a borrower can obtain the information.[10]

Many student loan and general loan servicer state laws also regulate the timing and content of the communication to borrowers, and impose an affirmative duty to timely respond to communication from borrowers.[11]

States further regulate how student loan servicers may apply partial payments and overpayments in cases when a borrower has multiple loans or accounts.[12] Credit reporting requirements,[13] notification in the event of sale, assignment or transfer, or servicing of the student loan,[14] restrictions on fees,[15] and limitations on advertisements[16] are other common elements.

Additionally, student loan servicers are required to maintain a robust vendor management program that includes periodically reviewing vendor compliance with servicing laws, reviewing reports from subcontractors regarding consumer complaints, and developing a transition plan in the event of servicing violations by subcontractors.[17]

Student loan servicers that use subcontractors should consider defining expectations for appropriate collection activities, and measure performance against these expectations by requiring routine reporting of consumer complaints and other servicing metrics.

Student loan servicers are now also facing a wave of privacy laws that demand their attention. For example, the Gramm-Leach-Bliley Act and Regulation P, which apply to financial institutions, including servicers, require a privacy notice, and limit sharing by financial institutions.

Additionally, servicers should also assess whether various state privacy laws, such as the California Financial Information Privacy Act, apply to their activities, and, as a result, they may need to evaluate the personal information they collect, the methods by which they collect it and whom they share it with.

Other important steps include revisiting or drafting a privacy notice and developing procedures for accommodating consumers that opt in or opt out of the sale of their personal information, depending on the state law.

However, certain state privacy laws exempt financial institutions subject to the GLBA, so student loan servicers should pay close attention to any exemptions that they may avail themselves of. Nevertheless, the fast-evolving state privacy legislation should compel student loan servicers to monitor new requirements.

Student loan servicers, and even those peripherally involved in the process, should consider revising their policies and processes, to make certain they are in compliance with the licensing and regulatory requirements of any state in which they conduct business.

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[1] As of March 14, 2023, 14 states and the District of Columbia enacted student loan servicing laws, and three states have pending student loan servicing bills that would create new licensing obligations for student loan servicers.

[2] Student loan servicing laws do not apply to servicers of student loans offered by the Department of Education. However, student loan servicing laws indisputably apply to servicers of private student loans.

[3] Cal. Cal Fin Code § 28104(k)(2).

[4] Cal. Cal Fin Code § 28104(k)(3).

[5] Conn. Gen. Stat. § 36a-846(13).

[6] Ct. Dept' of Banking, Consumer Credit Division, Memorandum re: Servicing of Institutional Financing, p. 1 (May 19, 2021).

[7] *Id.* at p. 2.

[8] Me. Rev. Stat. Ann. tit. 9-A, §§ 1-301(12); 6-201.

[9] Wash. Admin. Code § 208-620-950(4).

[10] *Id.*

[11] See e.g., Colo. Rev. Stat. § 5-20-108(2)(a).

[12] See e.g., Colo. Rev. Stat. § 5-20-108(4).

[13] See e.g., 110 ILCS 992/5-65(c), (d).

[14] See e.g., Colo. Rev. Stat. § 5-20-108(5).

[15] See e.g., 110 ILCS § 992/5-15.

[16] See e.g., Ky. Rev. Stat. § 286.12-080(3).

[17] See e.g., 110 ILCS 992/5-5(c).