Institutional Lending Compliance

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WEBINAR

This presentation is informational only and does not constitute legal advice regarding any specific situation, product or service. Consult an attorney for specific legal guidance. Due to the limited time available, this webinar will not attempt to describe the entire range of potentially applicable laws, which can vary significantly between states.

Institutional Lending Compliance

A recap 2023's top legal and regulatory developments relating to institutional loans.

Covered:

- What are institutional loans?
- How are they regulated?
- What happened in 2023?

Not Covered:

- Student loans that are not institutional loans, preferred lender list requirements, etc.
- ED regulations, such as 90-10, GE, etc. But note:
  - The 90-10 rule limits revenue recognition upon the sale or factoring of institutional loans.
  - Institutional loans are included in students' total debt under the debt-to-earnings metric of the new GE regulation.
- Various generally applicable regulatory requirements, such as deciding which states' law to apply to institutional loans to online students, maximum interest rates or fees

What is an Institutional Loan?

There is no legal definition of an “Institutional Loan.”

- There are laws that apply to extensions of credit, which is typically defined as “the right to defer payment of debt or to incur debt and defer its payment.
  - This is a very broad definition that can potentially include many instances where a debt is incurred and deferred, even if we don’t typically think of them as a loan or extension of credit.
  - States sometimes use different definitions.
- Under the Federal Truth In Lending Act (TILA), there are two types of credit:
  - Loans: where a person provides money to a person or to a third-party on the borrower’s behalf.
    - Examples include most bank-originated student loans, but also loans that may be extended by an affiliate of an educational institution rather than by the institution itself.
  - Credit Sales/Retail Installment Sales: most states have a legal framework applicable where the provider of goods or services (including educational services) allows the buyer to pay for a purchase in installments.
    - Car dealerships are the most common example. A few states don’t include “services” in their Retail Installment Sales Acts or exclude the sale of goods or services whose price is subject to approval by the state or by the federal government.

When I use the term “institutional loan” in this webinar, I’m referring to where a provider of post-secondary educational services allows a student to defer payment for their education.

What is a Student Loan?

- Under federal law, a “private education loan” is any extension of credit that is incurred for postsecondary educational expenses to attend an institution of higher education, which includes any private post-secondary program proprietary institution of higher education that “provides an eligible program of training to prepare students for gainful employment in a recognized occupation.”
  - Excluded from this definition are loans that either:
    - Have a term of 90 days or less; or
    - No interest will be charged and the term of the loan is one year or less
- Some states have adopted more expansive definitions in connection with their attempts to regulate the private student loan industry.
- Regulators have also start looking into “employer-driven debt,” which is where an employer offers to cover employees’ training costs, if the employee remains employed for some specified period of time.
  - Can be a retail installment sale if the employer is the education provider, or a loan if not.

Who Regulates Institutional Loans?

- State Regulators may include Attorney General, the relevant education regulators, and state financial services regulators.
- Under Federal law, the Consumer Financial Protection Bureau is tasked with engaging in "risk-based" oversight over any person who "offers or provides to a consumer any private education loan." It may also bring a lawsuit against anyone who violates various consumer financial protection laws.
  - Schools offering institutional loans that meet the definition of a private education loan is therefore subject to the CFPB's jurisdiction and oversight.
  - Oversight means that the CFPB can require reports and conduct periodic examinations to confirm regulatory compliance and detect and assess potential risks to consumers and to the consumer financial services market.
  - The CFPB has conducted formal compliance examinations of several schools – we'll discuss their findings shortly.
- Students can bring lawsuits under many of the laws that regulate institutional loans.

What Laws Apply to Institutional Loans?

- Truth In Lending Act – federal law that requires specific disclosures for every extension of credit and has unique requirements for private education loans.
- Equal Credit Opportunity Act – prohibits discrimination on a prohibited basis in connection with any aspect of a credit transaction. Also requires that applicants for credit be provided with a notice of the specific reasons that their application for credit was denied within 30-days.
- State consumer protection laws
  - A few states regulate retail installment sales as loans.
  - Most states, however, regulate retail installment sales separately. These laws can be very specific and technical, and can require specific disclosure language, maximum interest rates and fees, how interest must be calculated, when refunds may be required if the consumer pays early, and more.
  - Some states require retail installment sellers to register or obtain a license to offer financing.

What Laws Apply to Institutional Loans?

- States have recently started directly regulating student loans, too.
  - Student Loan servicers must obtain a license in a growing number of states.
  - Anyone who originates or holds student loans may be required to register in a few states.
- Many states have adopted a version of the so-called “Student Loan Borrower’s Bill of Rights”
  - Add an “abusive” standard to student loan servicing.
  - Requires servicers to investigate and resolve student disputes.
  - Require forgiveness of a student loan upon the borrower’s or a cosigner’s death or total and permanent disability (defined as any disability that is expected to last longer than one year).
- A full discussion is beyond the scope of this webinar. I’ve included a summary of other potentially applicable laws to the end of these slides.

Unfair, Deceptive (or Abusive) Acts or Practices UDA(A)P

- Many states have laws prohibiting engaging in unfair or deceptive acts or practices (UDAP).
- The CFPB's authority also includes "abusive" acts or practices (UDAAP) and the financial services regulators in a few state have recently been given similar authority.
- I've defined these terms in the summary at the end of these slides.

What Happened in 2023?

- In March of 2023, the CFPB issued a bulletin highlighting that certain student loans are dischargeable in bankruptcy
- They asserted that servicers who fail to honor the discharge by resuming their servicing of discharged loans after the end of the proceeding were engaged in unfair or deceptive practices.
- There's a general belief that student loan cannot be discharged in bankruptcy. As the CFPB points out, however, many loans that meet the definition of a private education loan *can* be discharged in bankruptcy.
- Note that TILA disclosures for private education loans must describe their bankruptcy treatment, so institutional loan providers should know how they will be treated in advance.

What Happened in 2023?

- In April of 2023, the CFPB filed a “Statement of Interest” in support of a student’s lawsuit against a for-profit nursing school which, among other allegations, asserted that the school had violated the Equal Credit Opportunity Act (“ECOA”) by targeting minorities for “predatory” institutional loans. This theory of liability is sometimes called “reverse redlining”
- A 2022 lawsuit against a for-profit school also asserted that it engaged in reverse redlining.
- The theory of liability is that the school deliberately targeted potential borrowers based on their race and sex for loans that were offered on worse terms than were available to other borrowers.
- Students alleged harm from:
  - payments were required while in school,
  - The loans didn’t have income-sensitive repayment options, and
  - The loans included an acceleration clause that allowed the school to demand the entire balance if the student missed even one payment.

What Happened in 2023?

- The CFPB filed its statement of interest in support of the theory but didn't take a position about whether the school had discriminated.
- Liability under the Equal Credit Opportunity Act can be found regardless of intent under the so-called disparate impact theory of liability, which prohibits even neutral practices if they have differing effects on a prohibited basis.
  - Disparate impact is often demonstrated using statistical methods.
  - A practice with a disparate impact can be "justified" if the practice was intended to accomplish a "legitimate business need" for which there was no less-discriminatory alternative.
- The Court agreed with the CFPB and refused to dismiss the lawsuit.
- Note: if discrimination is alleged to be intentional, there is no need to prove a disparate impact.
  - In the 2022 lawsuit, the plaintiffs alleged that the school's "intentional inclusivity" showed that the discrimination was intentional.

What Happened in 2023?

- In September of 2023, the CFPB issued a Report about institutional loans entitled “Tuition Payment Plans in Higher Education.”
- This report follows the January 2022 announcement that the CFPB would use this authority to “begin examining the operations of post-secondary schools, such as for-profit colleges, that extend private loans directly to students.”
- Not a scientific survey, but they raised concerns about:
  - Inconsistent disclosures and descriptions of institutional loans
  - Automatic enrollment and forced use
  - High fees
  - Debt collection practices
  - Waivers of Rights

What Happened in 2023?

- Inconsistent disclosures and descriptions of institutional loans.
  - Schools' enrollment and other materials used different and confusing terms to describe payment plans.
  - Terminology also differed among different schools.
- The CFPB was concerned that students might
  - find it hard to understand that they had a loan or the terms of their institutional loans
  - would be unable to shop for better loans.

What Happened in 2023?

- Automatic enrollment and forced use.
  - Students were sometimes automatically enrolled in “payment plans” if they had debts to their schools.
  - The CFPB highlighted complaints that schools’ disbursement schedule of Title IV or other funds sometimes forced students to enter institutional loans to bridge the time-gap.
  - The CFPB also questioned whether limiting institutional loans to only enrolled students created a “captive market” for the institutional loans.
  - Does the CFPB really understand how institutional loans are used?
- High fees
  - The CFPB noted that the fees charged to students in connection with institutional loans can sometimes be significantly higher than other private loans.
  - The CFPB noted a 2019 NACUBO report that the average maximum late fee amount is $110.
  - 30% of the schools included in the CFPB’s survey charged late fees as a percentage of the overall balance, with the average being about 10%.

What Happened in 2023?

- Debt collection practices
  - The CFPB noted that 1 in 3 schools use transcript withholding as a debt collection tactic, which the CFPB believes to be an unfair practice (UDAAP).
  - They also noted one school that reserved the right to deactivate students' ID cards, 'dismiss' students from residence halls, and suspend access to meal plans upon non-payment.
- Waivers of Rights
  - The CFPB noted that some institutional loan agreements included provisions that included mandatory arbitration clauses, waivers of the right to file a class action lawsuit or to have a jury trial, of the right to discharge the debt in bankruptcy, to retain their own attorneys, and waivers of the right to have the loan discharged in the event of their death.

What Happened in 2023?

- State Developments
  - In 2023 Nevada and Maryland enacted laws requiring registration of student loan lenders, including educational institutions and anyone who buys or takes assignment of a student loan after it is originated.
    - Colorado and Maine already have similar requirements.
  - California's Department of Financial Protection and Innovation went through several rounds of updating their draft regulations that will require student loan lenders, including schools, to register if they are not already licensed lenders. The final rules are expected soon. Note
    - The definition of a student loan under these proposed regulations will include loans that fund continuing professional education courses.
  - Kentucky enacted a law requiring a license to service student loans – like many other states' student loan servicing license laws, the law expressly applies to schools servicing their own institutional loans.
  - Colorado adopted regulations relating to the offering of income share agreements, including, but not limited to, education-purpose ISAs.

What Happened in 2023?

- State Developments
  - In NY, Governor Hochul vetoed legislation that was passed by the NY Assembly that would have required registration and annual reporting of anyone to whom students regularly owe debts incurred for post-secondary educational expenses, even if not student loans.
  - The legislation was re-introduced in January of 2024, although I don't get the sense that the legislature will have enough votes to override another veto.
  - This is a good illustration of where student loan protection might be trending.

Questions?

Additional Information

- The portion of the 90-10 Rule relating revenue recognition from the sale or factoring of institutional loans is at 34 CFR 668.28(a)(6). See, https://www.ecfr.gov/current/title-34/part-668/subpart-B#p-668.28(a)(6).
- The portion of the gainful employment rule relating to institutional loans is at: https://www.federalregister.gov/d/2023-20385/p-2067.
- The definition of "credit" varies even within different consumer financial services laws, but I chose the definition used in the Truth In Lending Act, at 15 USC §1602(f).
- TILA defines a "credit sale" as "any sale in which the seller is a creditor." 15 USC §1602(h).
- TILA defines a private education loan at 15 USC §1650(a)(8).

Additional Information

- UDA(A)P:
  - An act or practice is "unfair" if:
    - a. It causes or is likely to cause substantial injury to consumers;
    - The injury is not reasonably avoidable by consumers; and
    - The injury is not outweighed by countervailing benefits to consumers or to competition.
  - A representation, omission, or practice is "deceptive" when:
    - It misleads or is likely to mislead the consumer;
    - The consumer's interpretation is reasonable under the circumstances; and
    - The misleading representation, omission, act, or practice is material.
  - An act or practice is "abusive" if it.
    - Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or
    - Takes unreasonable advantage of:
      - A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
      - The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
      - The reasonable reliance by the consumer on the financial institution to act in the interests of the consumer.

See: https://www.consumerfinance.gov/compliance/supervision-examinations/unfair-deceptive-or-abusive-acts-or-practices-udaaps-examination-procedures/

Additional Information

- The Equal Credit Opportunity Act (ECOA) is at 15 USC §1691, and states that:

> It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction-
>
> (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);
>
> (2) because all or part of the applicant's income derives from any public assistance program; or
>
> (3) because the applicant has in good faith exercised any right under this chapter.

- Regulation B interprets the ECOA and is available here https://www.consumerfinance.gov/rules-policy/regulations/1002/.

Additional Information

- The CFPB's bulletin about the dischargeability of certain student loans in bankruptcy is here: https://www.consumerfinance.gov/compliance/supervisory-guidance/cfpb-bulletin-2023-01-unfair-billing-and-collection-practices-after-bankruptcy-discharges-of-certain-student-loan-debts/
- The CFPB's "Statement of Interest" in support of a student's lawsuit against a for-profit nursing school which, among other allegations, asserted that the school had violated the Equal Credit Opportunity Act ("ECOA") by targeting minorities for "predatory" institutional loans is available here: https://www.consumerfinance.gov/compliance/amicus/briefs/roberson-v-health-career-institute-llc/

Additional Information

- The CFPB's "Tuition Payment Plans in Higher Education" report is available at: https://www.consumerfinance.gov/data-research/research-reports/tuition-payment-plans-in-higher-education/
- The CFPB's announcement of its intent to supervise institutional loan providers is at: https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-examine-colleges-in-house-lending-practices/

Potentially Relevant Laws

- In addition to TILA and the ECOA, other potentially relevant consumer protection laws that institutional loan providers should be aware of include:
  - The Electronic Fund Transfers Act (EFTA). 15 USC 1693.
    - Prohibits a creditor from requiring repayment of a loan via a recurring electronic funds transfer
    - Requires that anyone who obtains authorization for recurring electronic funds transfers must obtain such authorization "in writing" and must provide a copy of the authorization to the consumer.
  - Fair Credit Reporting Act (FCRA). 15 USC 1681.
    - Prohibits anyone from obtaining a credit report about a consumer without a "permissible purpose." Permissible purposes include having the consumer's written consent and in connection with a credit transaction initiated by the consumer. Prohibits reuse of credit information for any other purpose.
    - Requires that furnishers of information to credit reporting agencies comply with very specific requirements relating to the "accuracy" and "integrity" of the furnished information and imposes specific dispute resolution requirements.

Potentially Relevant Laws

- Fair Credit Reporting Act
  - Requires creditors to implement "red flags" rules designed to prevent, detect, and mitigate the effects of identity theft on victims.
  - Prohibits users of credit reports from opening new credit accounts if a fraud or "active duty" alert is contained in a credit report.
- Debt Collection Laws - When collecting past-due accounts, institutional lenders should be aware of both the Federal Fair Debt Collection Practices Act (15 USC §1692) and of potentially applicable state debt collection laws.
  - The Fair Debt Collection Practices Act (FDCPA) generally does not apply to anyone collecting a debt that they originated. Except that it may apply if the creditor uses a false name when collecting a debt
  - States' debt collection laws vary widely. Many expressly apply to creditors collecting debts owed to them.

Potentially Relevant Laws

- Federal Trade Commission Holder in Due Course Rule (FTC Holder Rule). 16 CFR 433.1.
  - A creditor in a retail installment transaction must include a provision in the consumer contract that states that the buyer can assert against any assignee of the contract and claims or defenses that could be asserted against the seller.
  - Some states impose a similar requirement and some states' education codes impose such a requirement on institutional loan providers.
- There are many other potentially applicable laws. This is not a complete summary. Consult your attorney for specific legal advice.

About Me

- For more than 20 years, I've advised education finance providers about their regulatory compliance obligations as they design, market, service, and collect education finance products. My experience includes:
  - Outside counsel to a consortium of leading student loan providers in assisting the Consumer Financial Protection Bureau in the preparation of its Private Student Loan report to Congress.
  - Lead in-house regulatory counsel to a top-20 bank for multiple lines of business, student lending, personal lending, point-of-sale financing, fair lending, privacy, furnishing of credit information (Metro 2), loan servicing, debt collection, complaint and dispute resolution, texting and telemarketing initiatives, and more.
  - General Counsel of Vemo Education, a leading originator and servicer of income share agreements to post-secondary education providers.
  - Managing Director and Associate General Counsel at Sallie Mae.
  - Author of the student lending chapter in the Practicing Law Institute's Consumer Financial Services Answer Book. https://www.pli.edu/catalog/publications/answer-book/consumer-financial-services-answer-book

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