

Date of Hearing: April 15, 2021

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Timothy Grayson, Chair
AB 424 (Stone) – As Introduced February 4, 2021

SUBJECT: Private Student Loan Collections Reform Act: collection actions

SUMMARY: Establishes minimum evidentiary standards for private education lenders and loan collectors filing lawsuits against borrowers.

Specifically, **this bill:**

- 1) Provides the Private Student Loan Collections Reform Act as a new title in the Civil Code.
- 2) Defines the following terms:
 - a. “Private education loan” means an extension of credit that meets the following conditions:
 - i. Is not made, insured, or guaranteed under Title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 et seq.).
 - ii. Is extended to a consumer expressly, in whole or in part, for postsecondary educational expenses, regardless of whether the loan is provided by the educational institution that the student attends.
 - iii. Does not include open-end credit or any loan that is secured by real property or a dwelling.
 - iv. Does not include an extension of credit in which the covered educational institution is the creditor if either:
 1. The term of the extension of credit is 90 days or less.
 2. An interest rate will not be applied to the credit balance and the term of the extension of credit is one year or less, even if the credit is payable in more than four installments.
 - b. “Private education lender” means either:
 - i. Any person or entity engaged in the business of securing, making, or extending private education loans.
 - ii. Any holder of a private education loan.
 - c. “Private education loan collector” means a person collecting or attempting to collect on a defaulted private education loan.

- d. “Private education loan collection action” means any judicial action in which a claim is asserted to collect a private education loan.
- 3) Prohibits a private education lender or a private education loan collector from initiating a private education loan collection action unless the private education lender or private education loan collector possesses specified documents related to the loan, the servicing of the loan, and the chain of custody of the loan, among other things.
- 4) Prohibits a court from entering a judgment in favor of a private education lender or private education loan collector unless that person introduces evidence the documents described in #3.
- 5) Provides that a failure by a private education loan collector to produce to a borrower, upon request, any documentation described in #3 is a violation of the Unfair Practices Act (Business and Professions Code Section 17000 et seq.).
- 6) Allows a person who suffers damages as a result of the failure by a creditor to comply with this law to bring an action to recover or obtain specified remedies, including but not limited to: actual damages, punitive damages, restitution, and attorney’s fees.

EXISTING LAW:

- 1) Provides the Student Borrower Bill of Rights (Civil Code Section 1788.100 et seq.), which imposes requirements and prohibitions on student loan servicers intended to promote meaningful access to affordable repayment and loan forgiveness benefits and to ensure that California borrowers are protected from predatory student loan industry practices.
- 2) Provides the Student Loan Servicing Act (Financial Code Section 28100 et seq.), which requires student loan servicers to obtain a license, unless the entity meets specified exemptions.
- 3) Provides the Fair Debt Buying Practices Act (Civil Code Section 1788.50 et seq.), which regulates the collection of consumer debt by a debt buyer, including requirements for debt buyers to have specified evidence of the origin, balance, payment history, and ownership history of a charged off consumer debt and to provide this evidence to a debtor upon request

FISCAL EFFECT: Unknown. This bill is keyed fiscal by Legislative Counsel.

COMMENTS:

1) PURPOSE

According to the author:

As of June 2020, more than 650,000 Californians owed \$10.3 billion in private student loan debt. Private student loans often have higher interest rates and offer fewer consumer protections than federally-backed student loans. Low-income and students of color are more likely to take out private loans and are often subjected to predatory practices that increase their debt burden and decrease their likelihood of pay-off.

When borrowers fall behind on loan payments, student loan lenders and debt collectors pursue aggressive litigation, characterized as an “assembly line of lawsuits” against the borrower. Yet, trusts, servicers, and collectors routinely fail to prove that they own the loan, file lawsuits within the statute of limitations, and comply with court requests for additional information. Nevertheless, lenders and collectors automatically win many of these lawsuits because borrowers are unfamiliar with the judicial system, or are unable to afford legal representation. Court rulings in favor of debt collectors result in garnished wages or seizure of federal benefits deposited in bank accounts.

AB 424 will protect private student loan borrowers from unsubstantiated lawsuits and collection on illegitimate debts. The bill requires private student loan lenders and debt collectors to comply with common sense evidentiary standards when bringing debt collection lawsuits against borrowers.

2) BACKGROUND

Californians owe more than \$10 billion in private student loan debt, according to statistics provided by the author’s office from the Federal Reserve Bank of New York and the US Department of Education. Using the same data sources, the author’s office estimates that more than 650,000 Californians owe this debt. The California Department of Financial Protection and Innovation stated in a recent press release that more than 1.1 million Californians owe private student loan debt.¹ While there is no authoritative, publicly available data source to provide a more precise estimate, the available evidence suggests that the problem is sufficiently large to warrant closer scrutiny from the Legislature.

Relative to federal loans, private student loans typically charge higher interest rates, contain fewer consumer protections, and are targeted at the most vulnerable borrowers, like those attending for-profit schools.² Similar to federal loans, private student loans are difficult to discharge in bankruptcy, which reduces the incentive for private lenders to carefully underwrite loans or to offer modified payment plans. Many private student loans are bundled and sold off after origination to investors who pay third-parties modest fees to service the loans and pursue delinquent debts. This market structure – a risky product with creditor-friendly collections terms serviced by austere third parties – creates incentives that lead to outcomes harmful to vulnerable borrowers.

3) LOAN SERVICING AND DEBT COLLECTION ISSUES

Originating lenders often sell or outsource the servicing of private student loans to a third party. After funding the loan, the originator bundles and sells the loan, which may pass through multiple entities before landing in a trust that pays a separate entity to service the loan. The servicer receives payments from borrowers and sends money back to the trust. In the case of delinquent loans, the servicer may assign the loan to a different servicer that specializes in overdue accounts. These servicers may engage in debt collection practices

¹ <https://dfpi.ca.gov/2020/04/23/california-provides-expansion-of-student-loan-relief-most-private-loan-servicers-agree-to-help/>

² <https://www.nytimes.com/2017/07/17/business/dealbook/student-loan-debt-collection.html>

directly or may outsource collection activities to debt collectors. In order to eke out a profit, servicers seek to restrict or streamline activities in order to keep their costs low.

Collections practices related to private student debt have come under legal scrutiny in recent years. In 2017 the Consumer Financial Protection Bureau (CFPB) took action against the National Collegiate Student Loan Trusts and their debt collector, Transworld Systems, Inc., for illegal student loan debt collection lawsuits. Consumers were sued for private student loan debt that the companies couldn't prove was owed or was too old to sue over, and the lawsuits relied on the filing of false or misleading legal documents.³ The prevalent factor that caused these failures was a business model that relied on mass production of lawsuits by unqualified paralegals and clerks who were forced to make false attestations of their knowledge of individual cases.⁴

In private litigation, students have been sued for debts they no longer owed, by companies they never borrowed from, and by creditors that lacked the legal standing to sue in the first place.⁵ Judges across the country have quashed hundreds of lawsuits due to the poor evidentiary merits of cases brought by private student lenders and collectors. The probability of a borrower prevailing in such a case, however, is dependent on whether the borrower is represented by an attorney.

4) DEFAULT JUDGMENTS

Borrowers who ignore a summons related to their private student loans will likely be hit with a default judgment. While some borrowers may intentionally avoid court, others may not be aware of their rights or be able to afford legal representation. Regardless of the reason, a default judgment authorizes the private student lender or collector to garnish wages and seize certain assets – legal tools with serious consequences and the ability to significantly disrupt a family's life. With default judgments for private student loan debt often exceeding \$10,000, this debt can weigh significantly on a low- to moderate-income family's budget for years.

Cases that have resulted in default judgments may have concluded differently had the defendants retained legal representation. According to an in-depth report from the National Consumer Law Center in 2014, a review of more than 200 cases in California and Ohio showed that approximately half of cases resulted in a default judgment; however, *every single one* of those cases relied on robo-signed affidavits that did not meet basic evidentiary standards.⁶ Defendants in these cases had valid defenses, but their lack of awareness or ability to seek legal counsel left them with substantial debt.

5) THIS BILL ESTABLISHES REASONABLE MINIMUM EVIDENTIARY STANDARDS

Although state law provides consumer protections related to student loan servicing and debt collection, the law fails to establish commonsense evidentiary standards for debt collection cases involving private student loans. As discussed above, the private student loan market requires heightened scrutiny due to several factors:

³ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-national-collegiate-student-loan-trusts-transworld-systems-illegal-student-loan-debt-collection-lawsuits/>

⁴ <https://www.nytimes.com/2017/11/13/business/dealbook/student-debt-lawsuits.html>

⁵ Ibid.

⁶ <https://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/robo-signing-2014.pdf>

- Private student loans carry higher costs, contain fewer consumer protections, and are targeted to a riskier population of borrowers, compared to federal loans.
- Private student loans are rarely held by the originator, often transferring to multiple parties with potentially different servicers that ultimately work on behalf of investors.
- Many defendants who have low awareness of legal procedure and/or lack the financial resources to retain legal counsel are burdened by default judgments that would not have held if plaintiffs were required to show proof of ownership and proof of amount owed.

Rather than impose additional regulations on the industry or restrictions on the product, this bill provides clarity to California judges on how to review cases related to private student loans. The bill requires a plaintiff suing a private student loan borrower to provide documentation related to the servicing of the loan, the chain of ownership of the loan, and a log of debt collection activities in the prior year. Given the potentially devastating effects of a default judgment, this bill provides protection that would prevent unlucky consumers from being saddled with a debt they no longer owed, by companies they never borrowed from, and by creditors that lacked the legal standing to sue in the first place.

6) DOUBLE-REFERRAL

This bill is double-referred to the Assembly Judiciary Committee. Issues related to the judiciary system, including the appropriate level of evidentiary standards, will be considered in the second committee.

7) ARGUMENTS IN SUPPORT

NextGen California, one of this bill's sponsors, writes in support:

Student loan servicers and debt collectors routinely fail to provide the critical documentation needed to prove they have the legal right to pursue repayment through wage garnishment or other court orders. Frequently, borrowers are being dragged into court under false pretenses with loan servicers and debt collectors merely claiming they have the right to collect on the borrower's private student loan debt without any proof. The National Collegiate Student Loan Trust (NCT) is one of the nation's largest holders of private student loans -- holding 800,000 private student loans. A sample audit of 400 NCT loans found that NCT could not establish the chain of ownership for any of these loans.

Loan servicers and debt collectors generally win most of these fraudulent lawsuits because borrowers are unfamiliar with their rights and/or are unable to afford legal representation. These unfavorable court rulings result in devastating impacts on the student borrower -- many of whom are already economically disadvantaged -- such as wage garnishments or seizure of other monetary assets.

8) ARGUMENTS IN OPPOSITION

The California Credit Union League, writing in opposition, argues:

While we appreciate the intent of the bill to protect student loan borrowers, the required documentation that a private education lender or private education loan collector would have to provide appears to be an attempt to invalidate legitimate debts in the event of minor or inadvertent omissions in a log or document. Financial communities are a reflection of the communities they serve: we succeed when our customers succeed. Therefore, it is in the best interest of financial institutions who serve student loans to help their borrowers achieve financial stability.

REGISTERED SUPPORT / OPPOSITION:

Support

Nextgen California (Sponsor)
Student Borrower Protection Center (Sponsor)
Student Debt Crisis (Sponsor)
California Association for Micro Enterprise Opportunity (CAMEO)
California Association of Nonprofits
California Association of Realtors
California Dental Association
California Low-income Consumer Coalition
California Optometric Association
Consumer Federation of California
Consumer Reports
Friends Committee on Legislation of California
Housing and Economic Rights Advocates
Legal Aid Association of California
Legal Aid Foundation of Los Angeles
Neighborhood Legal Services of Los Angeles County
Public Counsel
Public Law Center
The Century Foundation
The Institute for College Access & Success
University of California, Irvine School of Law Consumer Law Clinic
Western Center on Law & Poverty
Young Invincibles

Oppose

California Bankers Association
California Credit Union League

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