

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians***NOTICE OF RULEMAKING ACTION****TITLE 10. CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT****NOTICE IS HEREBY GIVEN [Government Code Section 11346.5, subdivision (a)(1)]**

The Commissioner of Business Oversight (Commissioner) proposes to adopt regulations to implement the Student Loan Servicing Act.¹ Specifically, the Commissioner proposes to adopt Sections 2032-2057 in Subchapter 15, Chapter 3, of Title 10 of the California Code of Regulations.

The Student Loan Servicing Act expands the authority of the Commissioner to include the licensure, regulation, and oversight of student loan servicers. The Student Loan Servicing Act took effect on January 1, 2017, and becomes operational on July 1, 2018. Prior to enactment of the Student Loan Servicing Act, there were no California standards for student loan servicers.

This proposed rulemaking provides necessary detail and specificity, to implement the Act efficiently and effectively, to achieve the stated legislative intent to promote meaningful access to, and reliable information about, student loans, federal alternative repayment and loan forgiveness options, and quality customer service and fair treatment.² The proposed rules provide clarity, certainty and transparency for student loan servicers and the borrowers they serve.

AUTHORITY [Government Code Section 11346.5, subdivision (a)(2)]

Section 28106, Financial Code.

REFERENCE [Government Code Section 11346.5, subdivision (a)(2)]

¹ AB 2251 (Ch. 824, Stats. 2016).

² AB 2251 (Ch. 824, Stats. 2016), § 1, subd. (f).

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Sections 31, 494.5, 17900, 17910, 17913 and 17926, Business and Professions Code; Sections 1633.7, 1798.17, 1798.24, Civil Code; Section 17520, Family Code; Sections 7470, 7473, 7490, and 13140-13144, Government Code; Sections 28104, 28106, 28108, 28110, 28112, 28114, 28116, 28118, 28122, 28124, 28126, 28128, 28130, 28134, 28138, 28142, 28144, 28148, 28150, 28152 and 28174, Financial Code; Section 11077.1, Penal Code; and 5 U.S.C. 552a.

PUBLIC COMMENTS [Government Code Section 11346.5, Subdivision (a)(17)]

No public hearing is scheduled. Any interested person or his or her duly authorized representative may request, in writing, a public hearing pursuant to Section 11346.8, subdivision (a), of the Government Code. The request for hearing must be received by the Department's contact person designated below no later than 15 days prior to the close of the written comment period.

WRITTEN COMMENT PERIOD [Government Code Sections 11346.4, Subdivision (a) and 11346.5, Subdivision (a)(15)]

Where to Submit Comments

Any interested person or his or her authorized representative may submit written comments relevant to the proposed regulatory action to the Department, addressed as follows, by any of these means:

Postal Mail

Department of Business Oversight
Attn: Mark Dyer, Legal Division
1515 K Street, Suite 200
Sacramento, CA 95814

Electronic Mail

Comments may be submitted electronically to regulations@dbo.ca.gov. Please identify the comments as PRO 01/17 in the subject line.

Fax

(916) 322-1559

Time for Comments

Comments may be submitted until 5:00 p.m., November 6, 2017. If the final day for the acceptance of comments is a Saturday, Sunday or state holiday, the comment period will close at 5 p.m. on the next business day.

Comments Relating to the Economic and Cost Impact to Business and Individuals

As required under Government Code section 11346.5, the Department has made an initial assessment of the costs, benefits and cost effectiveness of the proposed regulatory action and reasonable alternatives to regulatory action.

In addition to comments relating to the proposed rules, the Department is interested in any perspectives or insights from the public concerning the potential economic and cost consequences to businesses, servicers, and other individuals from the proposed rules, and whether there are other ways to achieve the regulatory objectives in a more cost effective and less burdensome manner. Interested parties are encouraged, but are not required, to submit written comments to any of the following questions:

1. Would the proposed regulations under the Student Loan Servicing Act have an adverse statewide economic impact or the potential for an adverse impact on individuals or businesses, including their ability to compete with businesses in other states? If so, please explain how and to what extent the proposed changes may adversely impact businesses and individuals.
2. What are other alternatives to the proposed changes that would lessen any adverse economic impact to businesses or individuals, and accomplish the regulatory objectives of protecting investors and improving regulatory oversight of the industry?
3. What specific operational or other changes would need to be made by businesses to comply with the proposed changes and what are the potential costs of these changes?
4. What other alternatives would be more effective, or as effective and less burdensome to businesses or individuals, in achieving the regulatory objectives than the proposed changes?
5. What benefits would the proposed changes provide to businesses or individuals?
6. To what extent would the proposed changes create or eliminate jobs or businesses, or expand businesses currently doing business in this state?
7. What performance standards may be used in place of any prescriptive standards in the proposed changes? “Performance standard” means a regulation that describes an objective with the criteria stated for achieving the objective.³ “Prescriptive standard” means a regulation that specifies the sole means of compliance with a performance standard by specific actions, measurements, or other quantifiable means.⁴

³ Gov. Code, § 11342.570.

⁴ Gov. Code, § 11342.590.

INFORMATIVE DIGEST [Government Code Section 11346.5, Subdivision (a)(3)]

Policy Statement and Specific Benefits Anticipated from Regulatory Action [Government Code Section 11346.5, Subdivision (a)(3)(C)]

The objective of the proposed regulations is to implement the provisions of the Student Loan Servicing Act as efficiently and effectively as possible, by:

- Explaining, in easily understandable detail, the process and requirements for applying for a license as a student loan servicer, including the electronic system to use, and supporting documents and information needed;
- Requiring information and documents which will allow the Commissioner to most effectively investigate applicants, to determine if they meet the standards for licensure, and to effectively oversee licensee activities;
- Requiring applicants and licensees to notify the Department of any subsequent change to information in applications;
- Specifying general books and records, as well as individual borrower servicing account records that licensees must maintain, to comply with the Student Loan Servicing Act;
- Requiring servicers to maintain their books and records at a licensed location designated by the servicer, accessible for examination by the Department; and
- Specifying, in clear detail, requirements for compliance with the borrower protection provisions of the Student Loan Servicing Act.

The proposed regulatory action establishes a structure to enable the Department to oversee the activities of student loan servicers, promoting accountability of servicers through Department inspections of books and records, and compliance with borrower protection mandates.

The benefits anticipated from this regulatory action include protective benefits to student loan borrowers, improving the Department's regulatory oversight of the servicer industry, and strengthening enforcement of the Student Loan Servicing Act.

The rules require servicers to inform borrowers about alternative repayment plans and loan forgiveness benefits, and to train servicer representatives to encourage borrowers to enroll in an affordable, income-driven, alternative repayment plan, rather than forbearance, which increases borrowers' debt load. The proposed rulemaking is expected to benefit California's economy by improving the financial conditions of many Californians who will enroll in affordable, income-driven repayment plans.

Borrowers repaying under an income-based, alternative repayment plan will have more discretionary income available to invest in California's economy.

Student loan debt is a weight on the state's economy, preventing borrowers from achieving financial independence, starting businesses, attending graduate school, buying property or cars, or making other large investments. Higher quality student loan servicing will result in decreased defaults, more spendable income, higher credit scores, and greater access to credit. More student loan borrowers will be able to finance life's large purchases. The cumulative effect of these rules will positively affect not just the individual student borrowers, but California's overall economic health.

As of its operational date, this program is to be self-funded, paid through licensing fees and pro-rata annual assessments to licensees. No adverse impact is anticipated to state funds.

This entire regulatory package increases transparency in government by adopting the rules in compliance with California's rulemaking procedures and standards. This helps ensure that the public and those who would be subject to the proposed action are provided with a meaningful opportunity to participate in the adoption of the regulations.

Summary of Existing Laws and Regulations, and Effect of Proposed Action
[Government Code Section 11346.5, Subdivision (a)(3)(A)]

Existing law (the Student Loan Servicing Act) provides for the licensure, regulation, and oversight of student loan servicers by the Commissioner, as head of the Department of Business Oversight. The Student Loan Servicing Act became effective January 1, 2017, and becomes operational July 1, 2018. This rulemaking action seeks to adopt Sections 2032-2057, in eight Articles, as new Subchapter 15 to Chapter 3 of Title 10 of the California Code of Regulations, to implement and effectively administer the Student Loan Servicing Act.

Existing law requires persons servicing student loans in California to apply for, and obtain, a license from the Department, unless exempt.⁵ The proposed rulemaking action specifies the process and requirements for licensure, including the on line system to use, and supporting information and documents required. The proposed rulemaking defines terms, not already defined in existing law, used in the electronic licensing system designated for use by the Commissioner, to clarify the process. The proposed rulemaking defines terms commonly used in student lending and financial aid, not already defined in existing law, to implement and make understandable the borrower protection mandates of the Student Loan Servicing Act.

Existing law requires applicants be fingerprinted.⁶ The proposed rulemaking action specifies the Department of Justice process to provide fingerprinting, providing clarity.

Existing law requires annual independent audit reports, and authorizes the Commissioner to reject audits, or components of the audit.⁷ The proposed rulemaking action implements existing law, by requiring a description of the servicer's internal accounting controls, a list

⁵ Fin. Code, § 28102.

⁶ Fin. Code, § 28114.

⁷ Fin. Code, § 28148.

of any weaknesses, recommendations for improvement, and corrective measures planned or in place.

Existing law requires maintenance of a minimum \$25,000 surety bond, but authorizes the Commissioner to require a higher bond amount, based on the dollar amount of servicing.⁸ The proposed rulemaking action implements this provision by specifying servicing dollar amounts requiring a higher surety bond, and the higher bond amount required.

Existing law requires servicers to adhere to specified borrower protections.⁹ Existing law authorizes the Commissioner to investigate complaints, and prescribe the form of books and records required by a licensee.¹⁰ Existing law authorizes the Commissioner to conduct investigations and examinations of licensees to determine whether a licensee is complying with the Student Loan Servicing Act.¹¹ Existing law requires the Commissioner to examine the affairs of licensees at least once every 36 months for compliance with the Student Loan Servicing Act.¹² This proposed rulemaking action implements these provisions, and provides clarity by specifying records licensees must maintain, and borrower protection actions licensees must take.

Existing law provides the Commissioner's authority to promulgate rules and regulations, consistent with the Commissioner's authority to administer the Student Loan Servicing Act.¹³

Existing Federal Regulation or Statute [Government Code Section 11346.5, Subdivision (a)(3)(B)]

All servicing of federal student loans is contracted out to, and performed by, just nine entities. U.S. Department of Education contracts with the federal loan servicers may contain performance metrics. However, despite the volume of student loan debt, there are no industry wide standards for student loan servicing, in federal law or regulation. The California Legislature enacted the Student Loan Servicing Act to fill this void, and protect California borrowers.

Existing State Regulations [Government Code Section 11346.5, Subdivision (a)(3)(D)]

No current regulations are affected by this proposed rulemaking action. This rulemaking action seeks to adopt Sections 2032-2057, in eight Articles, as new Subchapter 15 to Chapter 3 of Title 10 of the California Code of Regulations. These proposed, new regulations are necessary to implement and effectively administer new legislation in an area previously unlegislated and unregulated in California. This rulemaking provides necessary detail and specificity, to implement the Act as efficiently and effectively as possible, to achieve the stated legislative intent to promote meaningful access to, and reliable information about, student loans, federal alternative repayment

⁸ Fin. Code, § 28142.

⁹ Fin. Code, § 28130.

¹⁰ Fin. Code, § 28106, subd. (b)(5).

¹¹ Fin. Code, § 28108.

¹² Fin. Code, § 28152.

¹³ Fin. Code, § 28106, subd. (a).

and loan forgiveness options, and quality customer service and fair treatment.¹⁴ The proposed rules provide clarity, certainty and transparency for student loan servicers and the borrowers they serve.

FORMS INCORPORATED BY REFERENCE [Title 1, California Code of Regulations, Section 20, Subdivision (c)(3)]

This proposed regulatory action does not incorporate any forms by reference.

DISCLOSURES REGARDING THE PROPOSED ACTION [Government Code Section 11346.5, Subdivisions (a)(5), (6), and (12)(A)]

- Mandate on local agencies or school districts: None.
- Cost to any local agency or school district which must be reimbursed in accordance with Government Code sections 17500 through 17630: None.
- Cost or savings to any state agency: The Department of Business Oversight submitted a Budget Change Proposal (BCP) to the Legislature, requesting \$1.2 million and three permanent positions in Fiscal Year 2017-18, to stand up the Student Loan Servicing Program. The BCP was approved. The BCP request will be funded by Department funds. The actual amount expended under the BCP may be less than the \$1.2 million authorized, depending on new hire start dates and actual costs incurred. The Department may seek retroactive reimbursement from prospective student loan servicer licensees for funds advanced to cover these startup costs.
- Other nondiscretionary cost or savings imposed on local agencies: None.
- Cost or savings in federal funding to the state: None.

ECONOMIC IMPACT ON BUSINESS [Government Code Section 11346.5, Subdivision (a)(8)]

The Commissioner has made an initial determination that the proposed regulatory action will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The nine federal loan servicers, servicing about 93% of student loans, are all headquartered outside of California. Conversely, the protections and benefits of these rules should improve the financial condition and long term economic health and wealth of Californians. Individuals with more disposable income may use the increased income to open businesses, potentially creating jobs, and improving California's economic picture.

The Department relied upon the legislative findings and declarations in AB 2251 and reports referenced therein; the Consumer Financial Protection Bureau's report, *Student*

¹⁴ Id, § 1, subd. (f).
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Loan Servicing, Analysis of Public Input and Recommendations for Reform (September 2015)¹⁵, and the Senate and Assembly committee analyses¹⁶, in proposing this regulatory action.

EFFECT ON SMALL BUSINESS [Title 1, California Code of Regulations, Section 4]

Based on information and belief, the Department has determined that no small business, within the meaning of Government Code Section 11342.610, subdivision (b), conducts student loan servicing. Therefore, this rulemaking action does not impact small businesses.

COST IMPACTS ON REPRESENTATIVE PRIVATE PERSON OR BUSINESS [Government Code Section 11346.5, Subdivision (a)(9)]

Applicants for a student loan servicer license must pay all costs associated with licensure, including a \$300 application fee, a \$100 fee to cover the Department's cost to investigate the applicant to determine eligibility for licensure, and expenses related to statutorily required fingerprinting. Applicants must submit audited financial statements.¹⁷

Once licensed, the law and this proposed action requires licensed servicers to adhere to specified borrower protections;¹⁸ maintain a surety bond in the minimum amount of \$25,000;¹⁹ pay for regulatory examinations conducted at least once every 36 months;²⁰ submit annual, audited financial statements;²¹ and pay a pro rata share of the Department's cost to administer the Student Loan Servicing Act program.²²

The Department anticipates that licensees currently maintain records and post information on their websites, employ compliance and customer service representatives, and regularly maintain audited financial statements to meet performance metrics and other requirements of their contracts with the U.S. Department of Education and other lenders and noteholders of the loans they service. Therefore, some or many of the requirements of these proposed rules may not add additional expense, or add absorbable expense. It is unknown at this time whether servicers will have to hire additional staff to comply with the borrower protection, record keeping, examination, annual report, and other requirements of the Student Loan Servicing Act and these proposed, implementing rules.

It is important to again note that 93% of the \$1.3 trillion total student debt is made up of federal student loans. Federal loans are serviced by just nine entities, all headquartered

¹⁵ http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf.

¹⁶ Legislative analyses are available at www.leginfo.ca.gov.

¹⁷ Fin. Code, § 28112.

¹⁸ Fin. Code, § 28130.

¹⁹ Fin. Code, § 28142.

²⁰ Fin. Code, § 28152.

²¹ Fin. Code, § 28148.

²² Fin. Code, § 28144.

outside California.²³

RESULTS OF THE ECONOMIC IMPACT ANALYSIS [Government Code Section 11346.5, Subdivision (a)(10)]

The Department has determined that:

- The proposed action will not create or eliminate jobs within California;
- The proposed action will not create new businesses or eliminate existing businesses within California;
- The proposed action will not expand businesses currently doing business within California;
- As discussed above under the Informative Digest, the proposed action is expected to benefit the health and welfare of California residents by improving transparency in government and the student loan servicing market; and increasing protections for student loan borrowers, resulting in improved financial conditions for many Californians, who enroll in affordable, income-driven repayment plans, default less, have more discretionary income, and greater access to credit, to invest in themselves and the California economy;
- No benefits or adverse impacts to worker safety or to the state's environment are anticipated from this regulatory action.

BUSINESS REPORTING REQUIREMENT [Government Code Section 11346.5, Subdivision (a)(11)]

The Department finds that it is necessary for the health, safety or welfare of the people of this state that the reports required in this regulatory action apply to businesses. Student loan servicers are businesses. Aggregate servicing reports called for in this regulatory action will contain fundamental information about the loans serviced by these entities. Department examinations and supervision of servicers will be efficient and effective, with access to comprehensive information in aggregate reports.

CONSIDERATION OF ALTERNATIVES [Government Code Section 11346.5, Subdivision (a)(13)]

The Department has determined that no reasonable alternative considered by the Department or that has otherwise been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of the law.

²³ <https://studentaid.ed.gov/sa/repay-loans/understand/servicers>
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AVAILABILITY OF THE NOTICE, STATEMENT OF REASONS, TEXT OF PROPOSED REGULATIONS AND RULEMAKING FILE [Government Code Section 11346.5, Subdivisions (a)(16), and (20), and (b)]

As of the date this notice is published, the rulemaking file consists of this notice; the initial statement of reasons, which contains all the information upon which the proposal is based; and the proposed text of the regulation. The notice, initial statement of reasons, and proposed text are available by contacting the person designated below.

Mark Dyer
Legal Analyst and Regulations Coordinator
California Department of Business Oversight
1515 K Street, Suite 200
Sacramento, California 95814
Telephone: (916) 322-1977
e-mail: Mark.Dyer@dbo.ca.gov

The notice, initial statement of reasons and proposed text are also available on the Department's website at www.dbo.ca.gov. To access the documents from the Department's website, hover over the "Laws/ Regulations" tab at the top of the home page; click on the "Rulemaking" link below; and then click on the "Student Loan Servicing Act" link, below "Proposed and Approved Regulations (By subject)".

As required by the Administrative Procedure Act, the Legal Division maintains the rulemaking file. The rulemaking file is available for public inspection and copying throughout the rulemaking process at the Department of Business Oversight, Legal Division, 1515 K Street, Suite 200, Sacramento, California 95814.

AVAILABILITY OF CHANGED OR MODIFIED TEXT [Government Code Section 11346.5, Subdivision (a)(18)]

If the Department makes changes which are sufficiently related to the originally proposed text, it will make the modified text (with changes clearly indicated) available to the public for at least 15 days before the Department adopts, amends or repeals the regulations as revised. A request for a copy of any modified regulation(s) should be addressed to the contact person designated below. The Department will accept written comments on the modified regulations for at least 15 days after the date on which they are made available.

AVAILABILITY OF FINAL STATEMENT OF REASONS [Government Code Section 11346.5, Subdivision (a)(19)]

Upon its completion, the Final Statement of Reasons will be available and copies may be requested from the contact person named below or may be accessed on the Department's website listed above.

CONTACT PERSON [Government Code Section 11346.5, Subdivision (a)(14)]

Inquiries regarding the substance of the regulations described in this notice may be

directed to:

Mary Dean Audick
Senior Counsel, Legal Division
Department of Business Oversight
320 West 4th Street, Suite 750
Los Angeles, California 90013-2344
Telephone: (213) 576-7589
e-mail: Mary.Audick@dbo.ca.gov

All other inquiries concerning this regulatory action, such as requests for copies of the proposed regulation or questions regarding the timelines or rulemaking status, may be directed to the designated backup contact person:

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Dated: August 18, 2017
Sacramento, California