

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians***INITIAL STATEMENT OF REASONS
FOR REGULATIONS UNDER THE
CALIFORNIA STUDENT LOAN SERVICING ACT
PRO 01/17**

As required by Section 11346.2 of the Government Code, the California Department of Business Oversight Commissioner (Commissioner) sets forth below the reasons for the proposed adoption of Sections 2032-2057, as Subchapter 15, of Chapter 3 of Title 10 of the California Code of Regulations.

**SPECIFIC PURPOSE OF REGULATIONS [Government Code Section 11346.2,
Subdivision (b)(1)]**

This regulatory action proposes to implement, and make specific, Assembly Bill (AB) 2251, the “Student Loan Servicing Act.”¹ 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 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 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.

The Commissioner is expressly authorized to promulgate rules, consistent with the Commissioner’s authority to administer the Student Loan Servicing Act.³

Student Loan Servicing Act Background

¹ AB 2251 (Chap. 824, Stats. 2016).

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

³ Fin. Code, § 28106, subd. (a).

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Student loan debt is second in size only to mortgages, in type of consumer debt.⁴ As of January 2015, there were about 4,156,000 student loan borrowers in California, with approximately \$112 billion in federal student loan debt.⁵ According to *The Institute for College Access & Success*, 54 percent of California's graduating class of 2015 has student loan debt, with an average debt of \$22,191.⁶

Higher education loans are funded by the federal government and private lenders, with the U.S. Department of Education being by far the predominant lender. Federal loans account for 92.5% of outstanding student loan balances, totaling almost \$1.3 trillion in the first quarter of 2017.⁷ The remaining 7.5%, totaling roughly \$102.3 billion, are held by private lenders. Six institutional lenders account for about 65 percent of the private student loan market.⁸

Student loan servicers are commonly different than the original lender or loan holder. Lenders contract with servicing companies to manage student loans. Servicers manage borrowers' accounts, process monthly payments, and communicate directly with borrowers. A borrower typically has no control over which company services his or her loan.

All servicing of federal student loans is contracted out to and performed by just nine entities. Federal student loans offer a number of income-driven repayment plans as affordable alternatives to a borrower's regular monthly payments. Federal student loans also provide loan forgiveness benefits for qualifying borrowers. Borrowers must work with student loan servicers to enroll in alternative repayment plans or process loan forgiveness benefits for which the borrower has qualified. Student loan servicers are a critical link between borrowers and lenders, performing a critical function. Despite the volume of student loan debt and servicing, there are no consistent, market wide federal standards for student loan servicing. Until the Student Loan Servicing Act was enacted, there were no California standards.

In September 2015, the Consumer Financial Protection Bureau (CFPB) released a report on student loan servicing issues and recommendations for improvement.⁹ The CFPB synthesized findings from about 30,000 comments received in response to its Request for Comment and complaints made through the bureau's website.¹⁰ Complaints predominated in five areas: borrower benefits and consumer protections, servicing transfers, customer service and error resolution, payment processing, and practices affecting specific borrower segments. Commenters said that servicers did not make

⁴ Consumer Financial Protection Bureau, *Student Loan Servicing, Analysis of Public Input and Recommendations for Reform* (September 2015), http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf, p.3.

⁵https://obamawhitehouse.archives.gov/sites/default/files/docs/state_by_state_number_of_borrowers_and_outstanding_balance_final.pdf.

⁶ http://ticas.org/sites/default/files/pub_files/classof2015.pdf, Table 3, p.5.

⁷ <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.

⁸<https://www.measureone.com/downloads/MeasureOne%20Private%20Student%20Loan%20Report%20Q32016.pdf>

⁹ http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf

¹⁰ Id., at pp.6-7.

them aware of, or facilitate enrollment in, benefits for which they qualified, including alternative payment plans and loan forgiveness.

It was against this backdrop that the Legislature enacted the Student Loan Servicing Act in 2016, added as a new Division to the Financial Code.¹¹ The Act prohibits a person from acting as a student loan servicer without a license, unless expressly excluded from the Act's coverage, pursuant to Financial Code § 28102(b). The Act requires servicers to adhere to specified borrower protections, when servicing student loans.

PROPOSED RULES

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. No current regulations are affected by this proposed rulemaking action. These proposed, new regulations are necessary to implement and effectively administer new legislation in an area previously unregulated in California. This rulemaking provides the detail and specificity necessary to efficiently, effectively, and robustly implement the Act, and facilitate a smooth roll out of the new program.

Section 2032. Definitions.

This proposed rule defines terms not defined in the Student Loan Servicing Act, but used and required in the proposed rules.

This proposed rule defines private student loans and federal student loans, the different types of federal student loans, and terms commonly used in higher education student lending, financial aid, and student loan servicing.

Licensing and administration of student loan servicers will be processed through the Nationwide Multistate Licensing System & Registry (NMLS),¹² the electronic system of records used by state agencies nationwide to license non-depository financial services providers. This proposed rule defines the NMLS forms applicants will use to apply for and maintain a license.

The definitions in this proposed rule are necessary to make these rules understandable and meaningful, implement the Student Loan Servicing Act, and most efficiently and effectively regulate servicers and protect borrowers. This proposed rule clarifies the Commissioner's authority to license, supervise and regulate student loan servicers.

Section 2033. Electronic Filings.

This proposed rule designates NMLS as the on line system servicers must use to apply for and maintain student loan servicer licenses. This rule clarifies that servicer applicants and licensees must file applications, amendments, surety bonds, notices, related filings, supporting documents, authorizations, and pay assessments and fees through NMLS. This rule specifies NMLS forms to use, information required to be included in the forms, and exhibits and other supporting documents required to be uploaded to NMLS. This

¹¹ Division 12.5, Fin. Code, § 28100, et seq.

¹² <http://mortgage.nationwidelicencingsystem.org/Pages/default.aspx>

proposed rule provides that filings electronically signed constitute irrefutable evidence of legal signature, and that filings are not considered filed with the Commissioner until the Commissioner has received all fees, and the filing has been transmitted from NMLS to the Commissioner.

The Commissioner uses NMLS as the electronic system of records to administer several other programs run by the Department. The Commissioner has determined that using NMLS, and requiring filings to be submitted electronically, instead of by paper, is convenient for applicants, servicers and the Department, and the most efficient and effective way to administer the Student Loan Servicing Act and oversee servicing activities. This proposed rule clarifies the Commissioner's authority to license, supervise and regulate student loan servicers.

Section 2034. Officers, Directors, Partners, and Other Persons: Maintenance of Current List with Commissioner: Information Required.

The proposed rule requires servicers to maintain on file with NMLS, a current list of officers, directors, partners, and other persons named in the license application and related NMLS forms. Servicers must file an amendment with NMLS, within 10 days of any change, and provide the information required for these new persons in related forms. The proposed rule is needed to provide the Department with current information about specified individuals directing servicer operations, and to allow the Department to conduct its statutory mandate to investigate these individuals, to determine that they will conduct servicing activities honestly and fairly. Maintaining current information about these individuals will allow the Department to effectively oversee servicer activities and best protect student loan borrowers.

Section 2035. License Application for Student Loan Servicer.

This proposed rule specifies that applications for a student loan servicer license and amendments thereto, shall be filed on NMLS form MU1; that certain persons directly or indirectly controlling servicers shall file form MU2, a biographical statement and consent form; that servicers must file a form MU3 for each branch office; and that exhibits and supporting documents must also be filed with NMLS. This section itemizes information and supporting documentation required by form MU1; identifies individuals required to file an MU2, and clarifies that these individuals must submit fingerprints, and that individuals residing outside the United States must also submit a background investigative report. The proposed rule clarifies that servicers must file the required surety bond and audited financial statements with NMLS, and that servicers must provide a detailed description of their business activities, policies and procedures demonstrating compliance with borrower protection requirements of the Student Loan Servicing Act, and Secretary of State documents evidencing authorization to conduct business in California. The proposed rule clarifies that the application fee and investigation fee shall be paid through NMLS for transmission to the Commissioner. The proposed rule clarifies that an application is not deemed complete until all required fees, all required submissions, and all background and investigative reports are received by the Commissioner; that filing form MU1 does not constitute automatic approval, but rather that an application is not approved until approved by the Commissioner, and a license is issued to the applicant.

This proposed rule provides a road map for applicants and licensees to follow, to know exactly the information and documentation required to apply for licensure. The required information and documents will allow the Commissioner to most effectively investigate applicants to determine if they meet the standards for licensure, and to effectively oversee licensee activities. The rule provides certainty and transparency for applicants and licensees. The rule clarifies the Commissioner's authority to license, supervise and regulate student loan servicer applicants and licensees.

Section 2036. Appointment of Commissioner of Business Oversight as Agent for Service of Process.

This proposed rule contains the form Appointment of the Commissioner as Agent for Service of Process on servicer applicants, for non-criminal judicial, and administrative proceedings against the applicant. The rule allows applicants to file the required Appointment by uploading a copy to NMLS. The proposed rule requiring execution and upload is necessary to eliminate avoidance of service of process. Including a replica of the Appointment form shows applicants the form that is expected to be signed, providing clarity and transparency for applicants. The proposed rule clarifies the Commissioner's authority to license, regulate and supervise student loan servicer applicants and licensees.

Section 2037. Fingerprints and Background Checks.

This proposed rule specifies the process by which applicants must provide statutorily mandated fingerprinting. California requires fingerprinting be done through the Department of Justice's (DOJ) Live Scan service. Live Scan is a system for electronically submitting fingerprints and receiving an automated background check and response. This system is much quicker and more efficient than the former, fingerprint card system. Individuals are only allowed to use cards if they have filed a Notice of Exemption form and received approval from DOJ to submit fingerprint cards, allowed almost exclusively for non-residents. Because the specific fingerprinting process, logistics and terms can be confusing to the public, this rule details the process, including the individuals required to provide fingerprints, and how fees are paid. This rule is necessary to efficiently and effectively implement the Student Loan Servicing Act, and clarifies the Commissioner's authority to license, regulate and supervise servicer applicants and licensees.

Section 2038. Information Regarding Individuals Who Are Not Residents of the United States.

Under the Student Loan Servicing Act, the Commissioner must investigate applicants and specified control persons, to determine eligibility for licensure. It is difficult and expensive for the Commissioner to thoroughly investigate individuals who live outside the United States, or have previously lived outside the U.S. for at least 10 years. DOJ provides background reports and information, based solely on domestic activity. This proposed rule will provide the necessary tool to satisfy the Commissioner's duty to investigate applicants and specified individuals, when those individuals currently live outside the U.S., or have previously lived outside the U.S. for at least 10 years. For these individuals, the rule requires the submission of a background investigative report, paid by the applicant or individual, containing itemized, comprehensive information. Providing this specificity clearly and transparently informs applicants of application requirements. This rule is

necessary to efficiently and effectively implement the Student Loan Servicing Act, and clarifies the Commissioner's authority to license, regulate and supervise servicer applicants and licensees.

Section 2039. Branch Office Instructions for Student Loan Servicers.

The proposed rule requires servicers to submit a MU3 for each new branch location at least 10 days before engaging in business at this new location. Applicants must list the branch manager, complete a MU2 for the branch manager, and pay fees through NMLS. In accord with the statutory directive,¹³ applicants intending to conduct business at the branch under a fictitious business name not already approved by the Commissioner, must upload to NMLS a copy of the Fictitious Business Name Statement, with the filed stamp from the county clerk's office, and may not use the name until approved by the Commissioner. The proposed rule is needed to provide the Department with current information to allow the Department to determine whether to approve the branch manager, and to satisfy the Department's statutory duty to investigate individuals responsible for the conduct of the applicant's servicing activities in California.¹⁴ This rule will enable the Department to fulfill statutory requirements, effectively oversee servicer activities and best protect student loan borrowers. This rule is necessary to efficiently and effectively implement the Student Loan Servicing Act, and clarifies the Commissioner's authority to license, regulate and supervise servicer applicants and licensees.

Section 2040. Notices Included with Applications.

This regulatory action proposes to adopt the Department's information practices and privacy notices. The California Information Practices Act of 1977¹⁵ and the Federal Privacy Act of 1974¹⁶ require the Department, when requesting personal information, including social security numbers, to notify the individuals whether disclosure of the social security number is voluntary or mandatory, the statutory authority for requesting social security account numbers, and the purpose for which the social security numbers will be used.

The Department's purpose for collecting social security numbers in this proposed rulemaking is to investigate applicants, obtain prior disciplinary and criminal history, and determine whether entities and individuals are conducting themselves in accordance with applicable law, all to determine whether to grant a student loan servicer license to an applicant.

The notices list the foreseeable disclosures of the information, which include NMLS, law enforcement and regulatory agencies. The rule includes information about the Department's information storage location and access rights.

Adopting the notices in the proposed rulemaking enhances disclosure of the privacy laws and helps ensure that individuals who provide their social security number understand how the Department will maintain and use their social security number.

¹³ Fin.Code, § 28128, subd. (d).

¹⁴ Fin. Code, § 28116, subd. (b).

¹⁵ Civ. Code, § 1798.17

¹⁶ 5 U.S.C. § 552a.

Section 2041. Notice of Changes by Student Loan Servicer.

This proposed rule requires licensees to file an amendment to their applications, every time a change in information occurs, within 10 business days of the change, and to update all NMLS forms affected. The proposed rule is needed to provide the Department with current information, to enable the Department to effectively oversee servicer operations and protect student loan borrowers. This rule is necessary to efficiently and effectively implement the Student Loan Servicing Act, and clarifies the Commissioner's authority to license, regulate and supervise servicer applicants and licensees.

Section 2042. Effectiveness of Student Loan Servicer License.

This proposed rule clarifies that a student loan servicer license does not expire. Rather, the rule confirms that the license remains in effect until revoked, terminated, or suspended by the Commissioner, or surrendered by the student loan servicer, and the surrender has been accepted by the Commissioner. This rule is necessary to emphasize the answer to the fundamental question: "How long does the license last?" This rule provides necessary clarity to applicants and licensees.

Section 2043. Challenge Process for Information Entered into NMLS.

This proposed rule sets forth the process applicants and licensees must follow, if they dispute the accuracy or completeness of information entered into, or maintained by NMLS. This proposed rule provides clarity through its specificity, and will ensure that applicants and licensees are treated fairly and in accordance with due process.

Section 2044. Share Arrangements with Other Governmental Agencies.

This proposed rule specifies that the Commissioner is authorized to share information submitted to NMLS with other regulatory and law enforcement agencies, but that this sharing shall be accomplished without the loss of any applicable privilege or confidentiality protections. The Commissioner is statutorily authorized to share information, in the course of fulfilling the mandate to investigate applicants and licensees; oversee licensee activities to ensure compliance with applicable laws, rules and orders; and to pursue enforcement action, if necessary. This rule is necessary to provide clarity and transparency to applicants and licensees.

Section 2045. Request for Confidential Treatment.

The proposed rule notifies servicers that they may request that certain documents be treated confidentially, and specifies the process to request confidential treatment. This rule is necessary because servicers may not otherwise be aware of their right to request confidential treatment. This rule provides clarity, and treats applicants and licensees fairly, and equally with other Department program licensees.

Section 2046. Surrender of License as a Student Loan Servicer.

The proposed rule identifies the NMLS forms licensees must file to apply to surrender a

license. The rule specifies the additional, statutorily authorized prerequisites to surrender, including a plan for the orderly close out of licensee's business, transfer of the servicing portfolio, the time frame for transfer to the new servicer, and payout of payments received before surrender, to the lender or new servicer. The CFPB report identified problems caused by servicing transfers as a primary area of borrower complaints. Documents and payments were lost or misapplied, leading to incorrect late fees, interest charges, increased loan balances, and negative credit reporting. This rule is necessary to provide the specificity and clarity necessary to protect student loan borrowers, to avoid the negative consequences of mishandled servicing transfers, and disruption to student loan borrowers. This rule is necessary to efficiently and effectively implement the Student Loan Servicing Act and clarifies the Commissioner's authority to regulate and supervise student loan servicer licensees, and protect borrowers.

Section 2047. Preparation of Independent Audit Report.

The proposed rule requires that statutorily mandated audit reports contain a description of the servicer's internal accounting controls, and list any weaknesses, recommendations for improvement, and corrective measures planned or in place. Maintenance of correct individual and aggregate servicing accounts and accounting is the crux to protecting student loan borrowers. This rule is necessary to ensure that licensees' accounting controls and operations achieve excellence and reliability, to best protect borrowers.

Section 2048. Surety Bond.

The proposed rule clarifies that applicants and licensees must use NMLS' electronic surety bond function to submit surety bonds and amendments. The rule specifies varying bond amounts required, based on volume of student loans serviced, or a determination by the Commissioner that a licensee is not in compliance with any law, rule or order. The rule requires at least 30 days notice to the Commissioner before a bond may be cancelled, in whole or in part. The rule requires notification to the Commissioner within 10 days of any claim being filed against the bond, or any amount being paid out under the bond. This rule is necessary to ensure that appropriate amounts of money are available to satisfy borrower claims and expenses, fines and fees levied by the Commissioner, which may reasonably be presumed to increase as the dollar amount of servicing increases. The rule clarifies the Commissioner's authority over servicers, with respect to surety bonds, and provides certainty and transparency to servicers and borrowers.

Section 2049. Borrower Information and Statements of Account, Payment Processing, Co-signer Payments.

The proposed rule requires servicers to maintain detailed account information for each student loan borrower, on the servicer's website, accessible to the borrower only, through a secure login system. The rule requires an account history for each loan serviced, and a consolidated report of all loans for each borrower serviced by the servicer. The rule requires same-day crediting of electronic payments, if made before the posted cut off time for same-day crediting, and crediting of paper check payments on the date received by servicer. The rule requires servicers to apply payments made by co-signers only to the loan for which the payor has co-signed, unless specifically directed otherwise by the co-signer/ payor. The proposed rule clarifies the Commissioner's authority to specify required

records, payment crediting and allocation, to allow the Department to examine servicer books and records, to investigate complaints, and to ascertain compliance with, and enforce borrower protection provisions of the Student Loan Servicing Act. The proposed rule clarifies the Commissioner's authority to enforce the borrower protection provisions of the Student Loan Servicing Act, and provides certainty and transparency to servicers and borrowers.

Section 2050. Customer Service, Alternative Repayment Plans, Loan Forgiveness Benefits.

The proposed rule addresses a primary area of borrower complaint and difficulty, as indicated in the September 2015 CFPB report, *Student Loan Servicing, Analysis of Public Input and Recommendations for Reform*,¹⁷ the 2016 *Annual Report of the CFPB Student Loan Ombudsman, Transitioning from Default to an Income-Driven Repayment Plan*,¹⁸ and the May 16, 2017 supplemental *Update from the CFPB Student Loan Ombudsman, Transitioning from Default to an Income-Driven Repayment Plan*¹⁹ (collectively, "the CFPB reports"). Servicers fail to provide complete information about affordable, alternative repayment options and loan forgiveness benefits; servicers fail to adequately inform borrowers of the differences between, and ramifications of, forbearance and income-driven repayment; and servicers fail to properly and timely process alternative repayment applications.

To address this problem, and enable the Commissioner to most effectively and efficiently enforce the borrower protection provisions of the Student Loan Servicing Act, the proposed rule: requires servicers to post a toll-free number on the homepage of the servicer's website, which borrowers may call to discuss their student loans with a live person; requires servicers to train representatives answering calls to this toll-free number to be capable of discussing alternative repayment plans, loan forgiveness benefits, and the differences between alternative repayment and forbearance, and encourage borrowers to opt for an income-driven repayment plan, instead of forbearance; requires servicers to post on their website homepages information and specified links to alternative repayment plan and loan forgiveness benefits, and to send borrowers an annual written notice, containing this information, links and toll-free number. The rule specifies that servicers may satisfy the annual notification requirement by sending a "Payback Playbook" notice, jointly developed by the CFPB, the U.S. Department of Education, and the U.S. Treasury, if the prototype becomes finalized. The rule requires private loan servicers to establish policies and procedures to consistently inform, and make available to similarly situated borrowers, information about alternative repayment options, and to satisfy the annual written notification requirement through a one-page notice, written in plain language.

The proposed rule clarifies the Commissioner's authority to specify customer service to be provided to borrowers and information and annual notices to be sent borrowers to enforce the borrower protection provisions of the Student Loan Servicing Act. The proposed rule is necessary to clarify the Commissioner's authority over servicers with

¹⁷ http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf

¹⁸ https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/102016_cfpb_Transmittal_DFA_1035_Student_Loan_Ombudsman_Report.pdf.

¹⁹ http://files.consumerfinance.gov/f/documents/201705_cfpb_Update-from-Student-Loan-Ombudsman-on-Redefaults.pdf.

respect to the borrower protection provisions of the law, to enforce compliance with the law, and to investigate complaints against servicers. The proposed rule will protect and assist California student loan borrowers, and provide clarity, certainty and transparency for servicers and borrowers.

Section 2051. General Books and Records.

The proposed rule requires servicers to maintain general ledgers containing specified financial information, and a cash receipt and disbursement journal, and to reconcile bank accounts at least monthly. The rule will allow the Commissioner to stay informed of the financial soundness of servicers and their ability to remain in business. The rule is necessary to specify books and records required for purposes of examining the servicer to ascertain financial health and ability to continue to serve California borrowers, and to demonstrate compliance with the law, including statutory net worth requirements. The rule will protect borrowers by facilitating avoidance of sudden disruption to the servicing of borrower accounts, and clarifies the Commissioner's authority over servicers with respect to the examination provision.

Section 2052. Aggregate Student Loan Servicing Report.

The proposed rule requires servicers to maintain an aggregate student loan servicing report, to be produced upon request by the Commissioner. The report must include specified information about all borrowers serviced, including number and type of loans serviced, original and remaining loan balances, loan terms, and whether the borrower has applied for, or is paying under an alternative repayment plan or loan forgiveness benefit. The proposed rule is necessary to specify books and records servicers must maintain to ensure compliance with the law; to provide the Department information, which will allow the Department to examine the servicer; to ascertain compliance with the law, including borrower protection provisions; to investigate complaints against the servicer; and to clarify the Commissioner's authority over servicers with respect to the investigation, examination, and borrower protection provisions.

Section 2053. Individual Student Loan Servicing Records.

The proposed rule requires servicers to maintain books and records at the location designated by the servicer, and requires servicers to maintain, for each student loan serviced, the student loan application; disclosure statements sent to the borrower; the promissory note or loan agreement; the complete loan history; qualified written requests; borrower instructions how to apply overpayments; statements of account sent to the borrower; and such records as the Commissioner may designate.

Additional primary areas of student borrower complaints discussed in the CFPB reports, concern misapplication of payments and servicers' failure to provide borrowers basic loan documentation, which should be maintained in the normal course of servicer business. The Student Loan Servicing Act requires servicers to promptly respond to qualified written requests.²⁰ The Student Loan Servicing Act also requires servicers to ask borrowers how to apply overpayments, and to follow borrower instructions.²¹ This

²⁰ Fin. Code, § 28130, subd. (g).

²¹ Fin. Code, § 28130, subd. (h).

rule is necessary to enforce and ascertain compliance with these provisions of the law, and investigate borrower complaints against servicers. The rule clarifies the Commissioner's authority over servicers with respect to investigation, examination, records maintenance, and borrower protection provisions.

Section 2054. Records of Servicing Sold, Assigned, or Transferred.

The proposed rule requires servicers to maintain contract and delivery schedules for loans transferred to another servicer, in addition to other records required to be maintained under these rules. Problems resulting from servicing transfers was a primary area of borrower complaints in CFPB reports. This rule is necessary to help eliminate these problems, by requiring servicers to maintain records detailing loans transferred and dates of transfer. This rule clarifies the Commissioner's authority over servicers, with respect to servicing transfers, and provides certainty and transparency to servicers and borrowers.

Section 2055. Records Retention Requirements.

The proposed rule requires servicers to maintain all records required under these rules for a minimum of three years after the loan serviced has been paid in full, or assigned to collection; or the servicing rights have been sold, assigned, or transferred. The rule is necessary to ensure that critical records are maintained by servicers for the statutorily mandated time, and to protect borrowers, who may be severely harmed if unable to access these records. The rule clarifies the Commissioner's authority over servicers, with respect to the records retention, examination and borrower protection provisions of the Student Loan Servicing Act, and provides certainty and transparency to servicers and borrowers.

Section 2056. Electronic Records: Maintenance, Storage and Reproduction Requirements.

The proposed rule specifies that electronic records must be maintained in a commonly used format; be readily accessible, readable, and printable by the Commissioner and Department staff; and be maintained in accordance with generally acceptable accounting principles. The proposed rule specifies that optical image reproductions must meet specified requirements, to be accepted as an exact copy of a document. The rule clarifies the Commissioner's authority over servicers, with respect to electronic records, investigation and examination, and will enable the Commissioner to efficiently enforce compliance with the Student Loan Servicing Act. The proposed rule provides certainty and transparency for servicers.

Section 2057. Annual Assessments.

The rule clarifies that annual assessments are calculated from information provided in annual reports, will be distributed to licensees on or before September 30 of each year, and that the Commissioner may distribute assessments through NMLS, and require assessments to be paid through NMLS. The rule is necessary to clarify the Commissioner's authority over servicers, with respect to annual assessments, and provides certainty and transparency for servicer licensees.

NON-DUPLICATION STANDARD [Title 1, California Code of Regulations, Section 12, Subdivision (b)(1)]

The proposed regulations duplicate state statutes which are cited as authority or reference for the proposed regulations. The duplication is necessary to satisfy the clarity standard of Government Code section 11349.1, subdivision (a)(3). Specifically, the rules in Sections 2034, 2035, 2037, 2039, 2041, 2042, 2046, 2047, 2048, 2050, 2055, and 2057 include language which repeats or rephrases in whole or in part state statutes to assist student loan servicers in understanding the law, to provide the Commissioner's authority for requiring servicers to file certain information with the Department, through specific means and systems of records, and demonstrate compliance with borrower protection provisions of the Student Loan Servicing Act.

BENEFITS ANTICIPATED FROM REGULATORY ACTION [Government Code Section 11346.2, Subdivision (b)(1)]

The proposed regulatory action will ensure that those engaged in business as student loan servicers are regulated, by identifying persons who are operating as student loan servicers, establishing a regulatory structure to enable the Department to oversee their activities, and promoting accountability of servicers through Department inspections of books and records.

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.

Student borrowers will benefit from rules which 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, 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. A greater percentage of borrowers will avoid default, have higher credit scores, obtain other credit, and finance large purchases, such as cars and homes. The cumulative effect of these rules will positively affect not just the individual student borrowers, but California's overall economic health.

Student loan debt is a weight on the state's economy, preventing borrowers from achieving financial independence, starting businesses, attending graduate school, or buying property or cars. Higher quality student loan servicing will result in decreased defaults, more spendable income and greater access to credit, all of which will benefit borrowers and the California economy.

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.

POTENTIAL FOR ADVERSE ECONOMIC IMPACT ON BUSINESS AND INDIVIDUALS
[Government Code Section 11346.3, Subdivision (a)]

The Commissioner has determined that it is unlikely that the proposed regulatory action will have an adverse economic impact or potential for an adverse economic impact on business, including the ability of California businesses to compete with businesses in other states, or individuals. While there are costs associated with licensure, 93% of all student loans are made by the federal government. All nine servicers servicing federal student loans are headquartered outside of California.²² The Department anticipates that prospective licensees currently maintain records and information, and take actions required by this proposed rulemaking under 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. Conversely, the protections and benefits of these rules are expected to improve the financial condition and long term economic health and wealth of Californians. Borrowers paying under an affordable, income-driven repayment plan, will have more disposable income, default less, and have access to other credit. Borrowers may use the increased income to open businesses, potentially creating jobs, and improving California's economic picture.

ECONOMIC IMPACT ASSESSMENT [Government Code Section 11346.3, Subdivision (b)]

A. The Creation or Elimination of Jobs Within the State

The Commissioner has determined that this regulatory proposal will not have a significant impact on the creation or elimination of jobs in the State of California. Nine servicers service all federal student loans; about 93% of all student loans. These nine servicers are all headquartered outside California.

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 has a Budget Change Proposal pending, which would add three positions to the Department. Approval is anticipated. These new employees would implement this new Departmental program, and then license, examine, supervise and regulate student loan servicers. The program is to be self-funded, paid through licensing fees and pro-rata annual assessments to licensees. Thus, no adverse impact is anticipated to the state's general fund or other state funds.

B. The Creation of New Businesses or the Elimination of Existing Businesses Within the State

The Commissioner has determined that this regulatory proposal will not have a significant impact on the creation of new businesses or the elimination of existing businesses in the

²² <https://studentaid.ed.gov/sa/repay-loans/understand/servicers>
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State of California because the proposed regulations apply only to student loan servicer applicants and licensees under the Student Loan Servicing Act.

C. The Expansion of Businesses Currently Doing Business Within the State

The Commissioner has determined that this regulatory proposal will not result in the expansion of businesses - student loan servicers - currently doing business in California. The regulatory proposal will require regulation of the existing student loan servicer industry, which has been operating unregulated. Student lending has a defined and limited target market – post-secondary students. These rules will not add to, or decrease the marketplace or lending limits. Rather, the rules will increase the quality of student loan servicing.

D. The Benefits of the Regulations to the Health and Welfare of California Residents, Worker Safety and the State's Environment

The Commissioner has determined that this regulatory proposal may benefit the health and welfare of California residents by increasing protections for student loan borrowers, through the licensure, regulation, and oversight of student loan servicers, and enforcement of the law's protections.

These rules are expected to improve the financial condition of many Californians, who will enroll in affordable, income-driven repayment plans. These rules should result in a lower percentage of defaulting borrowers.

The Act and 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. This will leave borrowers with more discretionary income, and decrease borrower defaults. Decreased defaults will increase the number of borrowers with higher credit scores, making a greater number of borrowers eligible to obtain other credit.

Borrowers with improved financial conditions will have more discretionary income and greater access to credit, positively impacting the state's economy. A higher percentage of student borrowers should be able to finance large purchases, such as cars and homes. This will positively affect not just the individual student borrowers, but California's overall economic health. The regulatory proposal does not benefit worker safety or the state's environment.

TECHNICAL, THEORETICAL AND/OR EMPIRICAL STUDIES, REPORTS OR DOCUMENTS [Government Code Section 11346.2, Subdivision (b)(3)]

The Department relied upon the legislative findings and declarations in AB 2251 and reports referenced therein, the CFPB report, and the Senate and Assembly committee analyses,²³ in proposing this regulatory action.

REASONABLE ALTERNATIVES AND REASONS FOR REJECTING THOSE

²³ Legislative analyses are available at www.leginfo.ca.gov.
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ALTERNATIVES [Government Code Section 11346.2, Subdivision (b)(4)(A)]

No reasonable alternative to these regulations has been identified or brought to its attention that would be more effective in carrying out the purpose for which the action is proposed, or would be as effective and less burdensome to affected private persons, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposal described in this Initial Statement of Reasons.

REASONABLE ALTERNATIVES THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESSES AND REASONS FOR REJECTING THOSE ALTERNATIVES [Government Code Section 11346.2, Subdivision (b)(4)(B)]

No reasonable alternative considered by the Department or that has otherwise been identified and brought to the attention of the Department would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small business. Based on information and belief, the Commissioner 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.

FACTS, EVIDENCE, DOCUMENTS, TESTIMONY OR OTHER EVIDENCE RELIED ON BY AGENCY [Government Code Section 11346.2, Subdivision (b)(5)(A)]

The Department relied upon the legislative findings and declarations in AB 2251 and reports referenced therein, the CFPB report, and the legislative committee analyses, in proposing this regulatory action. The proposed regulations are necessary to implement and make specific the Student Loan Servicing Act, fulfill the Department's duty to effectively implement and administer the Act, and to protect more than four million California student loan borrowers.