New York Student Loan Servicers Law: A Deeper Dive

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The May 2019 issue of *Insights* included discussion of a growing trend to regulate student loan servicers. Currently, there are a handful of states that impose requirements specifically on such parties. However, the ranks of these jurisdictions will grow by one in the fall of this year when the New York Student Loan Servicers Law (the "Student Loan Servicers Law" or the "Law") comes online. In this issue we will take a closer look at the Law and what it requires.

Generally

New York's Student Loan Servicers Law was enacted as part of the fiscal year 2020 state budget, now codified as Chapter 58 of the 2019 New York Session Laws. Among other things, Chapter 58 adds the Student Loan Servicers Law as a new Article 14-A to the New York Banking Law. The Student Loan Servicers Law, once effective, will impose licensing and substantive conduct-regulating requirements applicable to student loan servicers. These provisions become effective 180 days after the passage of the state budget bill, or roughly in early October of this year. The Law also requires the Department of Financial Services ("DFS") to promulgate regulations to implement the Law.

Student Loan Types Covered

The Student Loan Servicers Law casts a wide net for the types of loans covered. Under the Law, parties that service either (or both) private and/or federal student postsecondary loan programs will be covered. Loans made to finance grammar or high school educations are not covered.

As is often the case, there are several interlocking definitions that should be highlighted. The first is the definition of "student loan" subject to the Law's protection. It is very broad, and means any loan to a "borrower" to finance either postsecondary education or expenses related to postsecondary education. A "borrower" is defined to mean a resident of New York who has received or agreed in writing to pay for a student loan. Given these definitions, the products covered would include both loans made to students as well as parent loans. However, it also includes any person who shares a legal repayment obligation with the resident. As drafted, this would appear to include cosigners regardless of where the cosigner lives.

While there is a subcategory established in the Law for "federal student loans" (defined to include loans under the Direct Loan Program, FFELP loans, and other loans issued under federal programs identified in regulations forthcoming from the DFS), this category will only have implications for the Law's licensing requirements.

Licensing

Generally

Under the Law, any party, unless otherwise exempt, that services student loans owed by New York resident borrowers must be licensed. What constitutes "servicing" a student loan that triggers licensure effectively boils down to two core activities.

First, the receiving and application of borrower payments is a licensable activity. This is unsurprising. However, it is worth noting that, as drafted, the Student Loan Servicers Law does not limit this payment processing and application trigger to parties that do so only as an intermediary for a loan holder or owner. As such, it appears that this licensing trigger could include student loan lenders that self-service loan payments received from their borrowers.

Second, maintaining account records associated with a student loan and communicating with borrowers on behalf of the owner of the loan during those periods when payments are not required is also a licensable activity. Please note that, unlike the payment processing trigger, this trigger appears to be aimed at parties acting as an intermediary between the borrower and the loan owner or holder. However, the drafting is vague enough to remain somewhat unclear.

While there are additional activities noted in the Student Loan Servicers Law that would be considered "servicing" activities (such as providing notices of amounts owed, engaging in pre-default loss-mitigation activities, or otherwise performing administrative services), each of these activities is only relevant when performed in conjunction with one or both of the payment processing and/or account record maintenance activities mentioned above.

Exemptions

The Law includes two broad exemptions to the licensing requirement. The first is for "exempt organizations." This includes banks and credit unions, public postsecondary education institutions, and private nonprofit postsecondary educational institutions. Other parties licensed or supervised by the DFS may be added to the list of exempt organizations under regulations to be issued to implement the Law.

In addition to parties considered to be "exempt organizations," the Student Loan Servicers Law also automatically grants licensed status (as of April 1, 2019) to any party that services federal student loans. However, this automatic license grant does not permit such entity to also service other student loan types without obtaining a license, unless it is also considered an exempt organization.

An exemption from the licensing requirement is not a free pass. The Student Loan Servicers Law requires both exempt organizations and federal student loan servicers to notify the DFS of their servicing activity in the state. The Law also requires these entities to adhere to a number of regulated conduct requirements.

Licensing Standards and Implications of Licensure

The Law establishes a series of requirements for licensure. They will include standard requirements around solvency, as well as the character, fitness, and relevant business experience of the principals of the servicing entity. What, precisely, will be required to obtain the license (or will be required in the event of a change in an officer or director, or a change in control of the servicing entity) is painted only in broad outlines at this point. Presumably, clarity will be forthcoming with

the to-be-drafted DFS regulations.

There are two implications of note associated with licensed status. First, student loan servicers – other than those considered to be “exempt organizations” – are required to provide an annual report to the DFS of their loan servicing activities. The contents of the annual report (or additional reports that may be required) will be subject to further definition by the DFS.

Second, placement of the Student Loan Servicers Law within the New York Banking Law triggers application of the state’s relatively onerous cybersecurity regulation. The requirements of this regulation apply to “covered entities,” which includes any party operating under a license required under the New York Banking Law. Thus, in addition to ramping up efforts to comply with the requirements of the Student Loan Servicers Law, servicers must also face the challenge of building out a compliance program for the Empire State’s cybersecurity requirements.

Regulated Conduct

Generally

The Student Loan Servicers Law regulates servicer conduct essentially as a two-sided coin. On one side, it prohibits servicers from engaging in certain types of activities. On the other, it imposes certain affirmative obligations on servicers. We generally discuss each below.

Prohibited Conduct

Like many licensing regimes, the Law prohibits servicers from engaging in any conduct that would be considered fraudulent, unfair, deceptive, or predatory. Such activities could include misrepresenting or omitting material information (such as the amount, nature, or terms of a fee or required payment) from a borrower. Servicers are prohibited from misapplying payments, reporting inaccurate information to consumer reporting agencies, or filing false statements or reports with governmental agencies or in connection with a governmental investigation.

In addition to these relatively run-of-the-mill requirements, the Student Loan Servicers Law prohibits two different activities that will require an operational/procedural build for servicers. The first is that the Law prohibits a servicer from refusing to communicate with an “authorized representative” of the borrower, as identified in writing by the borrower. Servicers must therefore ensure that they have appropriate procedures in place to accommodate this requirement. It is unclear at this point whether the borrower may provide a limited authorization. For example: can an authorized party’s access to information be limited by the borrower to only certain aspects of a student loan and its servicing, or must the authorization provide for full access? Additional clarity on this point in the regulations would be helpful.

Second, the Law imposes two 15-day windows during which a servicer must respond to certain communications. Servicers are prohibited from failing to respond within 15 days to a communication from the DFS. This response period is a maximum and may be shortened by the DFS in its communication to the servicer. Additionally, the Law prohibits servicers from failing to respond within 15 days to a consumer complaint that is submitted to the servicer by the DFS. The Law permits an extension of this time frame to 45 days, if requested by the servicer along with an explanation of why the additional time is necessary. As drafted, this complaint response timeline appears to apply only to those complaints received from the DFS and not those that might be directly received from borrowers.

Required Conduct

In addition to prohibiting certain types of conduct, the Student Loan Servicers Law also imposes certain affirmative servicing obligations. Several of them are mirror images (or near mirror images) of conduct that is prohibited. For example, the Law requires servicers who regularly report to a consumer reporting agency to provide accurate payment performance information to at least one credit bureau that operates on a nationwide basis. Additionally, the Law requires that servicers respond within 30 days to a written inquiry from a borrower or his/her "representative." Please note that this requirement is more expansive than the customer complaint requirements discussed above as the inquiry may come directly from the borrower. Ideally, it would be helpful if the servicer could require such inquiries to be sent to a specific address so that they may be appropriately captured and tracked. The Law as currently drafted technically does not specify whether the "representative" must also be an "authorized representative" as discussed above. Uniformity of interpretation on this front would be helpful, but is not currently found in the Law.

The other affirmative requirements applicable to servicers under the Law address two issues that have long been a thorn in the side of borrowers and a cause for concern among regulators. First, unless it is otherwise required by either federal law or the terms of the student loan agreement, servicers must ask a borrower how s/he would like a nonconforming payment to be applied. As defined, a "nonconforming payment" is any payment that is not precisely in the amount called for in the loan agreement. If a borrower provides direction as to how s/he would like such payments to be applied on a going-forward basis, this directive must be followed until the borrower provides a different payment directive.

Second, a party transferring servicing to a new servicer has a 45-day window in which to provide the new servicer with all information specific to the borrower and his/her loan account. This transfer must also be completed at least 7 days before the borrower's next payment is due. How this might be accommodated for servicers with multiple billing cycles is unclear. The information provided to the new servicer must include, among other things, the borrower's repayment status and any borrower benefits (such as rate reductions, principal rebates, cosigner release, etc.) associated with the student loan account. In an effort to curb disappearing borrower benefits, the Law requires that the terms of any sale or transfer of servicing require the party obtaining servicing responsibilities to honor all borrower benefits that were represented to the borrower as available, even if s/he has not yet qualified for them.

More to Come

We have detailed, above, some of the substantive requirements of the new Law. However, many of them remain in outline form to be completed by the upcoming DFS regulations. It is also possible that the DFS regulations may impose additional requirements inspired by, but not necessarily found in, the Law. While servicers remain in a wait-and-see mode for the regulations, prudence dictates that efforts to comply should already be underway. We will conclude our three-part survey of these laws in the next issue of *Insights* with a brief summary of pending legislation.