



**INITIAL STATEMENT OF REASONS
FOR THE ADOPTION OF RULES UNDER THE STUDENT LOAN SERVICING ACT
PRO 06-21**

As required under Government Code section 11346.2(b), the Department of Financial Protection and Innovation (Department) has prepared the following initial statement of reasons for this proposed rulemaking regarding student loan servicing.

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

The Student Loan Servicing Act¹ (Act or SLSA) expanded the authority of the Commissioner to include the licensure, regulation, and oversight of student loan servicers. The Act became effective on January 1, 2017, and operational on July 1, 2018. As of July 1, 2018, persons engaged in the business of student loan servicing, unless expressly excluded from the Act's coverage,² must be licensed and are subject to supervision and regulation by the Department. The Act also provides specified borrower protections.

California augmented borrower protections and servicer oversight with the enactment of the Student Loans: Borrower Rights law,³ which became effective January 1, 2021.

When the Act first became effective, student loans were comprised of traditional student loans, defined in the proposed rules as federal student loans and private student loans offered by traditional lenders such as banks and credit unions. These loans used longstanding terminology and traditional loan forms such as promissory notes and loan agreements.

In the five years which have elapsed since the Act became effective, education financing products (defined in the proposed rules as private loans which are not traditional student loans, including income share agreements and installment contracts) have emerged and their use has increased. These education financing products use terminology and documentation distinct from traditional student loans.

Providers of income share agreements say they do not replace government-subsidized student loans but offer students another option to pay for their education should they need additional resources or a more income-flexible funding alternative.⁴

¹ AB 2251 (Chap. 824, Stats. 2016).

² Fin. Code, § 28102, subd. (b).

³ Civ. Code, § 1788.100 et seq.

⁴ *FAQ About Back a Boiler – ISA Fund*, < <https://www.purdue.edu/backaboiler/FAQ/index.html> > (as of January 26, 2022).

Lenders and servicers of education financing products have asserted that these products are not within the Act's definition of student loans and not subject to the Act. However, these education financing products do the same thing as traditional student loans: help finance the cost of a student's higher education.

The Commissioner has determined that, in addition to traditional student loans, all education financing products used to pay for higher education, including but not limited to income share agreements and installment contracts, are student loans⁵ covered by the Act and that servicers of these education financing products are student loan servicers covered by the Act and must be licensed. Similarly, the Consumer Financial Protection Bureau recently held that income share agreements are within the definitions of "credit" and "private education loan" and subject to the Truth in Lending Act, 12 U.S.C. § 1601, et seq. and implementing Regulation Z, 12 C.F.R. Part 1026.⁶

This proposed rulemaking is necessary in order to clarify the types of products that are subject to the Act. It defines terms and documents specific to education financing products.

The proposed rulemaking also amends certain existing rules, based on the Department's experience licensing student loan servicers and conducting regulatory examinations. This includes removing rules which the Commissioner has determined to be burdensome to servicers and unnecessary.

The proposed rulemaking also includes revisions to rules necessitated by the enactment of the Student Loans: Borrower Rights law.

The Commissioner is expressly authorized to promulgate rules, consistent with the Commissioner's authority to administer the Act⁷ and the Student Loans: Borrower Rights law.⁸

⁵ Consent Order, *In the Matter of the Student Loan Servicing Act license application of: Meratas Inc.*, August 5, 2021, <<https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/08/Meratas-Consent-Order.pdf>> (as of January 20, 2022)

⁶ See 2021-CFPB-0005, *In the Matter of Better Future Forward, Inc., et al.*, pp. 3,8,11-13, <https://files.consumerfinance.gov/f/documents/cfpb_better-future-forward-inc_consent-order_2021-09.pdf> (as of October 15, 2021).

⁷ Fin. Code, § 28106, subd. (a).

⁸ Civ. Code, § 1788.103, subd. (i).

PROPOSED RULES

By this rulemaking, the Commissioner proposes to amend Sections 2032; 2033.5; 2034.5; 2035; 2036.5; 2040; 2040.5; 2041; 2042; 2042.5; and 2043; and to adopt Sections 2033.75; 2042.65; and 2042.75 in Chapter 3 of Title 10 of the California Code of Regulations.

Section 2032. Definitions.

The Department proposes to amend Section 2032 to define certain terms used in the proposed regulations.

Subsection (a)(2): This subsection adds the definition of “annual percentage rate” or “APR.” It is necessary to add this definition because proposed rules 2042.65 and 2042.75 require servicers of education financing products to maintain and make available to the Commissioner the APR of all of their loans on an aggregated basis. This definition specifies that APR is to be calculated using the same methodology in Regulation Z, which implements the Truth in Lending Act, 15 U.S.C. section 1601, et seq. It is necessary to define APR as using the same methodology in Regulation Z because servicers of education financing products are also subject to Regulation Z. Using the same methodology here provides consistency and will facilitate servicer compliance.

Subsection (a)(3): This subsection adds the definition of “borrower.” It is necessary to adopt this rule to clarify that the statutory definition of borrower in the SLSA and the Student Loans: Borrower Rights law includes person(s) responsible for repaying an income share agreement or an installment contract. Because the rules are being amended to clarify that education financing products, which include income share agreements and installment contracts, are student loans, it is necessary to also clarify that recipients of education financing products are likewise borrowers for the purposes of the SLSA and the Student Loans: Borrower Rights law.

Subsection (a)(4): This subsection adds the definition of “education financing products.” It is necessary to define education financing products as all private loans which are not traditional student loans, including but not limited to income share agreements and installment contracts, so that all these products will be subject to the Act. It is necessary to clarify that private loans other than traditional student loans are also subject to the Act because lenders and servicers of income share agreements and installment contracts have argued that these products are not loans or credit and not subject to regulation.

Subsection (a)(12): This subsection adds the definition of “income.” It is necessary to add this definition to clarify that income means gross compensation, not post-tax compensation. It is necessary to use this definition because it aligns with the industry definition, which is used in borrowers’ income share agreements. Using this definition results in borrowers being treated equally, regardless of their tax benefits, such as the home mortgage interest deduction.

Subsection (a)(13): This subsection adds the definition of “income share agreement” or “ISA.” Proposed subsection (a)(25) adds the definition of student loans, defining student loans to include income share agreements; therefore, it is necessary to define “income share agreement.” It is also necessary to add this definition as proposed rules 2042.65 and 2042.75 require servicers of income share agreements to maintain and make available to borrowers and the Commissioner specified information. It is necessary to use this definition because it is based on the definition commonly used by industry.⁹

Subsection (a)(14): This subsection adds the definition of “income share percentage,” “income share,” or “contractual payment percentage.” Proposed rules 2042.65 and 2042.75 require servicers of education financing products to maintain and make available to borrowers and the Commissioner the income share percentage for all loans. It is necessary to define income share percentage as a percentage of income because this is the definition used by industry participants.¹⁰

Subsection (a)(15): This subsection adds the definition of “installment contract.” It is necessary to add this definition because installment contracts are included in the proposed definition of student loan. It is necessary to add this definition because it is based on a definition commonly used and understood by industry and borrowers.¹¹

Subsection (a)(16): This subsection adds the definition of “minimum income threshold,” “minimum threshold,” “payment floor” or “floor.” It is necessary to include this definition because proposed rules 2042.65 and 2042.75 require servicers to maintain and make available to borrowers and the Commissioner this information. The proposed definition is

⁹ <<https://www.purdue.edu/backaboiler/disclosure/contract.html>> (as of January 26, 2022).
Income Share Agreements: A Glossary of Key Terms, Anna, Meratas, Inc., June 24, 2020
<<https://meratas.com/blog/income-share-agreement-key-terms/>> (as of January 19, 2022).
The Ultimate Guide to Income Share Agreements, Anna, Meratas, Inc., October 9, 2020,
<https://meratas.com/blog/guide-income-share-agreement/> (as of January 19, 2022).

¹⁰ See fn. 9, *supra*.

¹¹ <https://www.bankrate.com/glossary/i/installment-contract/> (as of March 1, 2022).

based on the definition used by industry participants in income share agreements.¹² It is necessary to use this definition for consistency.

Subsection (a)(18): This subsection defines “payment cap” or “ceiling” as the maximum amount payable under an income share agreement. It is necessary to adopt this definition because this is the definition used by industry participants in income share agreements.¹³ This will ensure consistency between the way the term is used by industry and the way the information is reported pursuant to proposed rules 2042.65 and 2042.75.

Subsection (a)(19): This subsection adds the definition of “payment term,” “payment window,” “maximum payment term,” or “repayment term.” It is necessary to include this definition because proposed rules 2042.65 and 2042.75 require servicers of income share agreements to maintain and make available to borrowers and the Commissioner this information. The proposed definition is based on the definition used by industry participants in income share agreements.¹⁴ It is necessary to use this definition for consistency between how the term is used by industry and how the information is reported pursuant to proposed rules 2042.65 and 2042.75.

Subsection (a)(21): This section amends the current definition of “private student loan” to mean all student loans which are not federal student loans. It is necessary to amend this definition to make clear that all private loan products used to finance a student’s higher education, including income share agreements and installment contracts, are private student loans. It is necessary to amend this definition to clarify that education financing products are private student loans.

Subsection (a)(22): This subsection adds the definition of “qualifying payment.” It is necessary to include this definition because proposed rules 2042.65 and 2042.75 require servicers of income share agreements to maintain and make available to borrowers and the Commissioner the number of qualifying payments a borrower has made. It is necessary to define “qualifying payment” as a monthly payment that counts toward the payment cap or payment window because this is how the term is used by industry participants.¹⁵

Subsection (a)(23): This section adds the definition of “startup.” This is necessary because the Department revised section 2033.5, subsection (a)(4), to allow startup

¹² See fn. 9, *supra*.

¹³ *Ibid.*

¹⁴ *Ibid.*

¹⁵ *Ibid.*

companies which apply for a student loan servicer license to submit a statement of condition in lieu of audited financial statements. There are many definitions of startup. It is necessary to use this definition because it captures the companies that, due to their short amount of time in existence, cannot be reasonably expected to have audited financial statements.

Subsection (a)(25): This subsection clarifies the definition of “student loan” that is in the Act and the Student Loans: Borrower Rights law. It is necessary to define student loan to expressly include education financing products such as income share agreements and installment contracts to make clear that these products are subject to the Act, the Student Loans: Borrower Rights law, and these regulations. This is necessary to protect the borrowers of these products.

Subsection (a)(26): This subsection clarifies the definition of “student loan servicer” that is in the Act and the Student Loans: Borrower Rights law. It is necessary to expressly define student loan servicer to include servicers of education financing products so it is clear that these servicers must be licensed and are otherwise subject to the Act, the Student Loans: Borrower Rights law, and these regulations. This is necessary to protect borrowers of these products.

Subsection (a)(27): This subsection adds the definition of “Student Loans: Borrower Rights law.” It is necessary to add this definition so that applicants and licensees can refer to the text of the law because the law is referenced in these proposed rules.

Subsection (a)(28): This subsection adds the definition of “traditional student loans.” It is necessary to add this definition because sections 2042 and 2042.5 apply specifically to traditional student loans, whereas proposed rules.2042.65 and 2042.75 apply specifically to education financing products. This rulemaking makes this distinction because traditional student loans use terms and loan documents different from education financing products. It is necessary to define traditional student loans to clarify the rules which apply to each product type so the relevant rules are applied to each product type.

Section 2033.5. License Application for Student Loan Servicer.

Subsection (a)(3)(B): This proposed rule removes the requirement that individuals required to submit an MU2 who live outside the United States submit fingerprints. The current rules require that individuals living outside the United States submit a comprehensive investigative report, which includes a criminal history. The Department has determined that requiring these individuals to locate a place in their home country where they can be fingerprinted is very difficult and unnecessary. The Department has found the investigative

reports submitted in the years of regulating student loan servicers to be sufficiently comprehensive to protect borrowers. It is necessary to remove the fingerprinting requirement to eliminate an unnecessary and burdensome regulatory requirement.

Subsection (a)(4): This proposed subsection (a)(4) authorizes start up applicants for licensure to submit an attested statement of condition in lieu of audited financial statements. This rule is necessary because it is difficult for startups to obtain audited financial statements. Startups commonly do not have audited financial statements because of their brief time in existence. However, startups do have or can readily obtain statements of condition which show the company's financial condition and verify that the applicant has at least the \$250,000 net worth required by the Act. This amendment also makes clear that acceptance of a statement of condition is limited on a one-time basis to startup applicants and that, if granted a license, the startup licensee must submit audited financials each succeeding year of licensure as required by Financial Code section 28148. This amendment is necessary based on the Department's experience in licensing applicants, including startups. Making this change removes a potential barrier to entry into business while simultaneously using a reliable alternative to verify financial soundness.

Subsection (a)(7): The amendment to subsection (a)(7) removes a reference to specific subsections of the Act. It is necessary to remove this reference as two of these subsections were repealed by the Student Loans: Borrower Rights law. Moreover, the new Student Loans: Borrower Rights law includes additional borrower protections. The revised rule provides that the Policies and Procedures which an applicant must upload to NMLS as part of the application requirements must demonstrate compliance with the borrower protection provisions not just of the Act but also the new Student Loans: Borrower Rights law and these rules. It is necessary to require the Policies and Procedures to demonstrate compliance with the Student Loans: Borrower Rights law so that compliance is built into the servicer's daily operations.

Subsection (a)(12): The amendment to subsection (a)(12) clarifies that the individual attesting to the truthfulness of the company's application also attests that the applicant will comply with not just the Act but also the new Student Loans: Borrower Rights law, these rules and all applicable federal laws related to student loan servicing and regulations promulgated thereunder. The current rule only references compliance with the Act, as the Student Loans: Borrower Rights law was enacted in 2020, four years later than the Act. It is necessary to include specific reference to the new state law, these revised rules and applicable federal laws and regulations to make clear to applicants that they must comply with all applicable state and federal laws and regulations.

Subsection (e): This subsection is being added to the application and licensure requirements

to ensure the Department is able to contact the licensee via email. The Department has found that emails listed in an entity's application for licensure frequently go to one or more individuals who handle a specific and limited part of the licensee's operations and that these mailboxes are not always monitored. It is necessary to require student loan servicers to designate an email address that complies with Financial Code section 331.5, which requires that licensees designate an email address that is not the address of an individual employee. Requiring an email address that is regularly monitored and not tied to one individual is necessary so that the Commissioner may communicate electronically with licensees at all times.

Section 2033.75. Non-Licensee Filing with the Department.

The newly enacted Student Loans: Borrower Rights law, in Civil Code section 1788.103, authorizes student borrowers to file private rights of action, individually or as a class, after having given notice of the alleged violations underlying the prospective suit to servicers. The required notice is to give servicers the opportunity to cure such alleged violations and eliminate the need for a lawsuit. The law requires borrowers to send notices by certified or registered mail, return receipt requested, to the servicer's address on file with the Department or the servicer's principal place of business in California. The problem is that servicers exempt from licensure under the Student Loan Servicing Act but subject to the Student Loans: Borrower Rights law, such as banks, may not have an address on file with the Department. The proposed rule requires such non-licensees to file with the Department an address where they will receive certified or registered mail. This requirement is necessary so that borrowers have a place to send the notice required by Civil Code section 1788.103.

Non-licensees (such as banks) with branches in California may have designated a central location for service of process, pursuant to Code of Civil Procedure section 684.115, by filing this information with the Department. However, a designation pursuant to Code of Civil Procedure section 684.115 does not necessarily constitute an agreement to accept certified or registered mail at that location. Therefore, the proposed rule provides that if a non-licensee has complied with Code of Civil Procedure section 684.115 but has not filed an address with the Department pursuant to the proposed rule, the non-licensee is deemed to accept certified or registered mail at the location it designated pursuant to section 684.115. This provision is necessary to enable borrowers to comply with the notice requirement in Civil Code section 1788.103 by sending the notice to the designated location for service of process if the non-licensee has not filed another address with the Department.

Additionally, there are non-licensees which do not have branches in California and are not required to designate a central location for service of process under Code of Civil Procedure section 684.115. The proposed rule provides that if a non-licensee does not comply with Code of Civil Procedure section 684.115 and fails to file an address with the Department pursuant to this rule, the non-licensee is deemed to accept certified or registered mail at any branch. This provision is necessary for the protection of borrowers because if a non-licensee fails to comply with the filing requirement in this rule, the borrower should not be penalized with inability to comply with the notice requirement in Civil Code section 1788.103. Instead, the borrower should be permitted to send the notice to any branch.

Section 2034.5. Fingerprints and Background Checks.

The proposed revision to subdivision (d) of the current rule removes the requirement that applicants upload proof of live scan completion. The Department has learned through experience that this requirement is unnecessary. The Department receives live scan results from the California Department of Justice (DOJ) very quickly. Commonly, the Department has received DOJ results days before applicants upload their proof of live scan completion. It is necessary to remove this requirement from applicants to reduce their regulatory burden.

The revision to subdivision (e) of the current rule changes the requirement that applicants using fingerprint cards pay the specific fingerprinting fee of \$49 to the Department of Justice, to generic language requiring applicants to pay "Department of Justice fees." This change is necessary to require applicants to pay whatever fee is required by the Department of Justice for fingerprinting.

Section 2035. Information Regarding Individuals Who Are Not Residents of the United States.

The revision to the current rule removes references to rules which may be read to require fingerprinting for an individual who does not currently reside or has not resided in the United States for at least ten years. This revision aligns with the Department's proposed change to section 2033.5(a)(3)(B), removing the requirement that such individuals submit fingerprints *and* a comprehensive investigative report, which includes a criminal history. The Department has learned from its license applicants that it is very time consuming, difficult and burdensome to find an entity out of country to do fingerprinting acceptable to the FBI. The Department has learned through experience that fingerprinting in this case is unnecessary. The required comprehensive investigative report gives the information the Department needs to determine if the individual merits approval. It is necessary to remove the fingerprinting requirement as unnecessarily duplicative and to reduce regulatory burden.

on these individuals and the applicant entities by which they are employed.

Section 2036.5. Notice of Changes by Student Loan Servicer.

This proposed revision removes a reference to Financial Code section 28130 and adds a reference to section 2033.5(a)(7) of these proposed rules. The deletion is necessary because the Student Loans: Borrower Rights law repealed subdivisions (g) and (h) of Financial Code section 28130. The addition is necessary because 2033.5(a)(7) is the provision requiring the applicant to upload its Policies and Procedures to demonstrate it will comply with borrower protections. This change is necessary in order for the rule to clearly describe the types of changes that do *not* require an amendment to the application.

Section 2040. Borrower Information and Statements of Account, Payment Processing, Co-signer Payments.

Subsection (b): Section 2040 requires servicers to maintain consolidated reports of account for each borrower and references the rule which specifies the information required in the consolidated report. It is necessary to amend the current rule to reference a second rule which governs the information servicers must maintain for education financing products, including income share agreements and installment contracts. Different information is required depending on the type of student loan serviced. It is necessary to add the second reference to clarify how this rule would apply to servicers of education financing products.

Subsection (c): Section 2040 requires servicers to maintain loan histories for each student loan serviced and references the rule which specifies the information required in the loan history. It is necessary to amend the current rule to add a reference to a second proposed rule which specifies the information which servicers must maintain for education financing products, including income share agreements and installment contracts. Different information is required depending on the type of student loan serviced. It is necessary to add the second reference to clarify how this rule would apply to servicers of education financing products.

Subsection (d): It is necessary to amend the current rule to clarify Civil Code section 1788.102(a)(1), a provision of Student Loans: Borrower Rights law. This statutory provision specifies that payments made by student borrowers on the date due count as a timely payment if made by 11:59 p.m. but does not specify the operative time zone. The proposed rule clarifies that 11:59 p.m. means the time in the time zone in which the payment is made. It is reasonable that a borrower would assume that the applicable time zone is the one in which the borrower makes the payment. It is necessary to add this clarification to protect consumers from incurring late fees or other penalties for any payments made on the due

date.

Section 2040.5. Qualified Written Requests.

The proposed revision to the rule adds the requirement that all acknowledgments of receipt and responses to Qualified Written Requests (QWRs) be in writing. A QWR is a borrower communication to a servicer claiming an error in his/her account and asking for a response or requesting specific information such as a loan history or a copy of a promissory note. The Student Loans: Borrower Rights law requires an acknowledgement of receipt if not resolved within ten business days and a response in 30 business days, which may be extended an additional 15 days if the servicer notifies the borrower and provides the reason for the delay. The servicer's response must provide the requested information or the action the servicer will take to correct the account or an explanation for the servicer's position that the borrower's account is correct.

When asked by the Department during regulatory examinations to provide the acknowledgments and responses to QWRs sent by the servicer, some servicers told examiners that the servicer acknowledged and responded to QWRs verbally and believed this satisfied the requirement.

It is necessary to require written acknowledgments of receipt and responses to be able to verify whether the servicer has complied with the law and to provide a written record of the exchange between the borrower and servicer and the servicer's reasons for taking or not taking the requested action. It is necessary for the Department and borrowers to have a written record of the QWR and the servicer's response and reasoning that can be referred to in any additional follow up on this QWR, and as needed.

Section 2041. Customer Service, Alternative Repayment Plans, Loan Forgiveness Benefits.

The current rule requires private loan servicers to inform and be able to discuss with borrowers alternative repayment options available in the promissory note or from the promissory note holder. The proposed amendment requires servicers to make available repayment options offered by the contractual obligee or payee or under the contractual agreement evidencing the student loan. Education financing products such as income share agreements and installment contracts do not use promissory notes. Rather, these products use a contractual agreement between the borrower and the payee or obligee. It is necessary to add additional contractual verbiage, including "contractual obligee" or "payee" and "contractual agreement," so the rule includes terminology that applies to education financing products. Without these added terms, servicers of education financing products could claim

that they are not obligated to offer alternative repayment options to borrowers as these products don't use a promissory note and there is no promissory note holder. While income share agreements and installment contracts are based on contracts, rather than promissory notes, they are student loans. They fall within the Act and the Student Loans: Borrower Rights law's definition of student loan as "made solely for use to finance a postsecondary education and costs of attendance at a postsecondary institution, including, but not limited to, tuition, fees, books and supplies, room and board, transportation, and miscellaneous personal expenses."¹⁶

Section 2042. Aggregate Student Loan Servicing Report--Traditional Student Loans.

The proposed revision to the current rule clarifies that the rule applies to traditional student loans. The revised rule references the new rule and section number applicable to education financing products. It is necessary to specify the rule which applies to each type of education financing product so servicers and borrowers know which rule applies to the products they service. This is necessary in order to require the appropriate data regarding each type of loan.

Section 2042.5. Student Loan Servicing Records--Traditional Student Loans.

The revision to the current rule removes the student loan application from the list of records which servicers must maintain for traditional loans. These rules implement the Act and the Student Loans: Borrower Rights law, under which the Department regulates student loan servicing. It is unnecessary for the Department to review the application, which relate to lending practices, not servicing practices. This change is necessary to eliminate a books and records requirement that is not relevant to the Department's regulation.

The revision also deletes language that would exempt servicers from maintaining certain loan documents if the servicer has not received or does not have access to the document. Before commencing its regulatory examinations about four years ago, the Department did not know if lenders provided servicers the documents listed in the rule or access to these documents. The Department has learned through its four years of servicer examinations that the remaining records are commonly maintained by servicers. The promissory note or loan agreements provide proof that a servicer may begin servicing and the terms it must follow. The remaining documents demonstrate compliance or noncompliance with the note or loan agreement, the Act, the Student Loans: Borrower Rights law and these rules. It is necessary to require servicers to maintain these records

¹⁶ Fin. Code, § 28104, subd. (l)(1) and Civ. Code, § 1788.100, subd. (q)(1), respectively.

without exception so that the Department can ascertain and enforce compliance with the Act, the Student Loans: Borrower Rights law and these rules and to investigate borrower complaints against servicers.

Section 2042.65. Aggregate Student Loan Servicing Report--Education Financing Products.

Subsection (a) requires servicers to maintain an aggregate student loan servicing report for all education financing products, to be produced within ten days of Commissioner request.¹⁷

It is necessary for licensees to maintain an aggregate student loan servicing report showing the total amount of student loans serviced, to allow for the Commissioner's effective examination, oversight and supervision of servicers and to enable the Commissioner to calculate the servicer's pro rata assessment based on total loan volume.¹⁸ It is necessary to require servicers to produce the report within ten days because the Commissioner may need this information for an examination or investigation, and this amount of time is reasonable because the rule requires information that servicers should be maintaining in the ordinary course of business.

Subsection (b) itemizes information which servicers of all education financing products must include in the aggregate report. Section 2042.75(d) requires servicers to make the same information available to borrowers in a consolidated report.

Subsection (b)(1) requires servicers to include the borrower's name in the aggregate report. It is necessary to require the borrower's name so the Department can determine whether servicer records match the borrower's loan documents when conducting transaction testing during regulatory exams. This will allow the Department to assess servicer performance and mandate resolution of deficiencies.

Subsection (b)(2) requires servicers of education financing products to include the account number in the aggregate report. It is necessary to include the account number so Department examiners can confirm that the servicer is maintaining correct information for borrowers, and to investigate complaints.

¹⁷ Section 2042 requires the same type of basic information be maintained for traditional student loans and provided in the aggregate to the Commissioner, upon request.

¹⁸ Fin. Code, §28144.

Subsection (b)(3) requires servicers of education financing products to include the number of education financing products serviced for each borrower in the aggregate report. It is necessary to include the number of education financing products serviced to effectively examine servicers. The Department may conduct transaction testing, comparing the report provided by the servicer with loan documents, to determine accuracy and mandate the resolution of servicing deficiencies.

Subsection (b)(4) requires servicers of education financing products to include in the aggregate report the type(s) of education financing products serviced for the borrower. It is necessary to include the type of products serviced to confirm the information maintained by servicers matches loan documents and, if not, to mandate resolution.

Subsection (b)(5) requires servicers of education financing products to include in the aggregate report the date of execution of the agreement evidencing the education financing product. It is necessary to require this information to see if this date matches the source document evidencing the loan and to facilitate effective Department supervision of servicers. This information will also allow borrowers to check whether servicer records match the borrower's records and pursue resolution of discrepancies.

Subsection (b)(6) requires servicers of education financing products to include the payoff amount in the aggregate report. It is necessary to require this information so that it will appear in the consolidated report servicers must provide borrowers pursuant to Section 2045.75(d). The payoff amount will allow borrowers to quickly check their financial condition and decide whether to keep the loans or pay them off. This protects borrowers.

Subsection (c) specifies information which servicers of income share agreements must include in the aggregate report, in addition to the information required under subsection (b). It is necessary to require certain information that is unique to income share agreements because each type of education financing product uses terminology that is unique.

Subsection (c)(1) requires servicers of income share agreements to include the funded date in the aggregate report. It is necessary to include the funded date so the Department may conduct transaction testing during examinations to determine the accuracy of servicing and require resolution of errors.

Subsection (c)(2) requires servicers to include the funded amount in the aggregate report. It is necessary to include the funded amount so the Department may conduct transaction testing during examinations to determine the accuracy of servicing and require resolution of errors.

Subsection (c)(3) requires servicers of income share agreements to include the borrower's income in the aggregate report. It is necessary to include the borrower's income so the Department may use it, along with income share percentage, to determine the accuracy of the payment amounts.

Subsection (c)(4) requires servicers of income share agreements to include the income share percentage in the aggregate report. It is necessary to include the income share percentage so the Department may use it, along with the borrower's income, to determine the accuracy of the payment amounts.

Subsection (c)(5) requires servicers of income share agreements to include the annual percentage rate, calculated at the minimum annual income above which payments are required and at \$10,000 income increments thereafter up to the annual income where the maximum number of monthly payments results in the maximum amount payable. It is necessary to require this information so borrowers will know the ISA's interest rate and decide whether it is best to pay off the ISA with a student loan that carries a lower interest rate. It is necessary to require this information so the Department can determine whether, based on the interest rates charged, the servicer may be servicing an income share agreement that is illegal and unenforceable.

Subsection (c)(6) requires servicers of income share agreements to include the minimum threshold or payment floor in the aggregate report. It is necessary to include the minimum threshold or payment floor so the Department may compare the payment amounts and determine whether the servicer is collecting payments in accordance with the contract.

Subsection (c)(7) requires servicers of income share agreements to include the payment cap or payment ceiling in the aggregate report. It is necessary to include the payment cap or payment ceiling so the Department may conduct transaction testing and assess whether the servicer is complying with the income share agreement.

Subsection (c)(8) requires servicers of income share agreements to include the payment window or maximum payment term in the aggregate report. It is necessary to include the payment window or maximum payment term so the Department can examine servicers to determine whether they are complying with the income share agreement.

Subsection (c)(9) requires servicers of income share agreements to include the number of required payments in the aggregate report. It is necessary to include the number of required payments so the Department and borrowers can determine if the information

provided by the servicer matches the borrower's records and resolve any discrepancies and so borrowers can have an accurate financial picture and the status of their loans.

Subsection (c)(10) requires servicers of income share agreements to include the monthly payment amount in the aggregate report. It is necessary to include the monthly payment amount so the Department can determine whether the servicer is collecting payments in accordance with the income share agreement.

Subsection (c)(11) requires servicers of income share agreements to include the number of qualifying payments made. It is necessary to include the number of qualifying payments made so the Department and borrowers can determine if the information provided by the servicer matches the borrower's records resolve any discrepancies and so borrowers can have an accurate financial picture and the status of their loans.

Subsection (d) requires servicers of installment contracts to include additional information beyond that required for other education financing products. It is necessary to require certain information that is unique to installment contracts because each type of education financing product uses unique terminology.

Subsection (d)(1) requires servicers to include the amount advanced in the aggregate report. This is necessary so the Department can conduct transaction testing to determine whether the servicer is complying with the contract.

Subsection (d)(2) requires servicers to include the date the amount was advanced in the aggregate report. It is necessary to include the date the amount was advanced so the Department may determine whether the servicer is collecting payments in accordance with the installment contract.

Subsection (d)(3) requires servicers to include the annual percentage rate in the aggregate report. It is necessary to require this information so borrowers will know the interest rate and decide whether to pay off the installment contract with a student loan that carries a lower interest rate. It is necessary to require this information so the Department can determine whether, based on the interest rates charged, the servicer may be servicing an installment contract that is illegal and unenforceable.

Subsection (d)(4) requires servicers to include the installment contract term, including date of commencement and date of termination. It is necessary to require this information so the Department may determine whether the servicer is collecting payments in accordance with the written agreement.

Subsection (d)(5) requires servicers to include the date the first installment payment is due. It is necessary to require this information so Department examiners may compare this date with the written agreement to determine and resolve inconsistencies.

Subsection (d)(6) requires servicers to include the installment payment amount in the aggregate report. It is necessary to include the installment payment amount to catch discrepancies between the report and the written agreement, which may have resulted in an incorrect loan history. It is necessary to provide borrowers an accurate status of their loan, including payment amount, so the borrower can decide whether to keep the existing loan at the same repayment schedule, change to another repayment schedule, refinance or prepay.

Subsection (d)(7) requires servicers to include the maximum number of required payments due, payments made, and payments remaining due until the installment contract is paid or satisfied. It is necessary to require this information so the Department and borrowers can determine if the information provided by the servicer matches the borrower's records and resolve any discrepancies and to provide borrowers an accurate status of their loans.

Subsection (e) requires servicers of education financing products which are not income share agreements or installment contracts to include specified information. It is necessary to include this provision to collect information analogous to the information required regarding income share agreements and installment contracts for all other types of education financing products.

Subsection (e)(1) requires servicers to include the funded date or the date the amount was advanced. It is necessary to include this information so the Department may audit the servicer's loan files and identify any errors in its servicing of the loan.

Subsection (e)(2) requires servicers to include the funded amount or the amount advanced. It is necessary to include this data point so the Department examiners may compare the amount listed with the loan documents to assess the accuracy of servicer performance.

Subsection (e)(3) requires servicers to include the annual percentage rate in the aggregate report. It is necessary to include the annual percentage rate to check accuracy and so the borrower can decide if it would be best to pay off the loan with a student loan with a lower interest rate. It is necessary for the Commissioner to have this information to determine if, based on the interest rates, the servicer may be servicing an education financing product that is illegal and unenforceable. Subsection (e)(4) requires servicers

to include the amount of each payment due in the aggregate report. It is necessary to include this information so Department examiners may compare the amount listed with the loan documents to assess the accuracy of servicer performance and resolve errors.

Subsection (e)(5) requires servicers to include the maximum number of required payments. It is necessary to include this data point so Department examiners may compare the amount listed with the loan documents to assess the accuracy of servicer performance and mandate the resolution of errors.

Subsection (e)(6) requires servicers to include the maximum payment term in the aggregate report. It is necessary to include this data point so Department examiners may compare the amount listed with the loan documents to assess accuracy, resolve errors and ensure that borrowers have an accurate loan history. An accurate loan history and status will allow borrowers to make informed decisions about whether to keep their existing loans or make changes.

Section 2042.75. Student Loan Servicing Records--Education Financing Products.

A similar rule, Section 2042.5, applies to traditional student loans. It is necessary to have a separate rule for education financing products because these products use terminology and documentation different from that used for traditional student loans. If incorrect terminology or documentation names are used, the servicer may not maintain critical information and documentation about this type of student loan and borrowers could be harmed. Subsections are discussed below.

Subsection (a): It is necessary to require servicers to maintain their books, records and accounts at one or more licensed locations, designate the locations at which the books, records and accounts are maintained, and make the location and books, records and accounts accessible to the Department, to facilitate the statutorily mandated examination of licensees.¹⁹

Subsection (b): It is necessary to require servicers to maintain all education financing contracts; disclosure statements sent to the borrower; a complete loan history; qualified written requests (QWRs); borrower instructions how to apply overpayments; and statements of account sent to the borrower, so the Department may examine these documents to determine compliance with the Student Loan Servicing Act, the Student Loans: Borrower Rights law and these regulations, including whether payments and

¹⁹ Fin. Code, § 28152.

overpayments have been correctly applied and QWRs have been timely and appropriately addressed.

Subsection (c): It is necessary to require servicers to maintain loan histories for borrowers and to specify the minimum information which must be included. This is necessary so the Department can perform examinations that determine if the borrower's record is accurate, including the correct application and posting of all loan disbursements, payments and fees.

Subsection (d): requires servicers of education financing products to maintain a consolidated report for all borrowers, individually, which contains information itemized in section 2042.65. It is standard industry practice for lenders and servicers of consumer financial products, including, for example, checking accounts, mortgage loans and credit card accounts, to maintain and make readily available to consumers account information containing all pertinent information. It is necessary for student borrowers to be able to readily access their loan information, know where they are in the repayment process, and have a clear picture of their financial condition in order to make informed decisions about whether to keep their current student loans at the current repayment schedule or to change to a different repayment schedule, refinance, or attempt to prepay the loans. Requiring servicers to maintain this information for education financing products improves accountability and is necessary to protect borrowers.

Section 2043. Records of Servicing Sold, Assigned, or Transferred.

The proposed revision to the current rule references a new rule proposed in this rulemaking which mandates records which servicers of education financing products must maintain. It is necessary to add this reference so that records of all products serviced—not just records for traditional student loans—are transferred to the new servicer, if servicing is transferred. If the reference is not added, education financing records may not be transferred to the new servicer, causing harm to borrowers who need these records to assess their student loans.

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

The proposed regulatory action will ensure that all those engaged in business as student loan servicers are regulated—not just those servicers servicing the “traditional” federal student loans and private student loans made by banks and credit unions. Regulating all servicers will promote accountability and best serve and protect all California student loan borrowers.

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 and the Student Loans: Borrower Rights Law.

Student borrowers will benefit from rules requiring servicer compliance with consumer protection laws and regulations. This will allow borrowers to make more informed financial decisions. Improving the financial conditions of California's student borrowers will benefit California's overall economy. Borrowers will have more discretionary income available to invest in California's economy. 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. Bringing servicers of all education financing products within California's regulatory scheme will best protect all California student loan borrowers. Comprehensive 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 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. The Department anticipates that prospective licensees currently maintain records and information, and take actions required by this proposed rulemaking under their contracts with the lenders and noteholders of the education financing products 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. An improved financial condition of student borrowers may lead to borrowers opening 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. The proposed regulations only define terms specific to education financing products, which is a small percentage of the student loan market. The proposed regulations also remove or revise certain existing rules, based on the Department's experience in regulating servicers since the Act became operational. These changes streamline and make the rules more efficient and effective and less burdensome on servicers.

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 State of California because the proposed regulations apply only to student loan servicer applicants and licensees under the Student Loan Servicing Act and certain student loan servicers that are exempt from 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 a relatively small segment of the existing student loan servicer industry, which has been operating unregulated. Student lending has a defined and limited target market – post-secondary students. The market for education financing products is a small percentage of this market. These rules will not add to or decrease the marketplace or lending limits. Rather, the rules will increase the scope and quality of student loan servicing and protect all California student loan borrowers.

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 all student loan servicers, and enforcement of the law's protections and consumer protection statutes overall. These rules should result in a lower percentage of defaulting borrowers. Borrowers with improved financial conditions will have more discretionary income and greater access to credit, positively impacting the state's economy. 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 because it has no direct impact on worker safety or the environment.

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

The Department did not rely on any technical, theoretical or empirical studies, reports or documents in proposing this regulatory action.

REASONABLE ALTERNATIVES AND REASONS FOR REJECTING THOSE 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)]

Based on its examinations and other interactions with servicers, the Department believes prospective licensees currently maintain records and information, and take actions required by this proposed rulemaking under their contracts with the lenders and noteholders of the education financing products they service. Therefore, some or many of the requirements of these proposed rules may not add additional expense, or add absorbable expense. Based on its experience, the Department determined that the proposed regulatory action will not have a significant adverse economic impact on business.