



STATE OF CALIFORNIA

Department of Financial Protection and Innovation

GOVERNOR **Gavin Newsom** · ACTING COMMISSIONER **Clothilde V. Hewlett**

NOTICE OF RULEMAKING ACTION

TITLE 10. CALIFORNIA DEPARTMENT OF FINANCIAL PROTECTION AND INNOVATION

NOTICE IS HEREBY GIVEN [Government Code Section 11346.5, subdivision (a)(1)]

The Commissioner of Financial Protection and Innovation (Commissioner) proposes to adopt new regulations and amend current regulations implementing the Student Loan Servicing Act.¹ The proposed rulemaking also provides additional detail and clarity to the Student Loans: Borrower Rights law,² which became effective January 1, 2021.

Specifically, the Commissioner proposes to make the following changes to Subchapter 15, Chapter 3, of Title 10 of the California Code of Regulations:

- Amend Sections 2032; 2033.5; 2034.5; 2035; 2036.5; 2040; 2040.5; 2041; 2042; 2042.5; and 2043; and
- Adopt Sections 2033.75; 2042.65; and 2042.75.

The Student Loan Servicing Act (Act) 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 exempt from the Act's coverage,³ must be licensed and are subject to supervision and regulation by the Department of Financial Protection and Innovation (Department).

Prior to enactment of the Student Loan Servicing Act, California did not regulate student loan servicers.

When the Act first became effective, student loans were comprised of federal student loans and private student loans, most commonly made by banks and credit unions (traditional loans). These traditional loans used traditional loan forms such as promissory notes and loan agreements.

In the five years which have elapsed since the Act became effective, additional products to finance a student's higher education have emerged, such as income share agreements and installment contracts (collectively, education financing products), which commonly use documentation distinct from traditional loans to evidence the loan and contractual

¹ Fin. Code, § 28100, et seq.

² Civ. Code, § 1788.100, et seq.

³ Fin. Code, § 28102, subd. (b).

agreement to repay. These education financing products also use some terms which are different than terms used for traditional loans.

Lenders and servicers of education financing products have historically asserted that these products were not within the definition of student loan and not subject to the Act. However, these education financing products do the same thing as traditional loans: help pay the cost of a student's higher education. Thus, the Commissioner has determined that education financing products, including but not limited to income share agreements and installment contracts, are student loans⁴ and that servicers of such education financing products are covered by the Act and must be licensed. In providing this clarification, the proposed rules provide certainty for student loan servicers, including servicers of income share agreements, installment contracts and all other education financing products, and protect the borrowers they serve.

This proposed rulemaking defines terms and documents specific to education financing products. The proposed rulemaking also amends some existing rules, based on the Department's years of experience licensing student loan servicers and conducting regulatory examinations. The proposed amendments are to conform to the Department's experience, to streamline implementation of the Act, and to remove rules which the Commissioner has determined to be burdensome to servicers and unnecessary.

The Commissioner is expressly authorized to promulgate rules, consistent with the Commissioner's authority to administer the Student Loan Servicing Act⁵ and the Student Loans: Borrower Rights law.⁶

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

Section 28106, Financial Code, and Section 1788.103, Civil Code.

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

Sections 1788.100, et seq. and 1798.18, Civil Code; Section 684.115, Code of Civil Procedure; Sections 331.5, 28104, 28106, 28110, 28111, 28112, 28114, 28116, 28118, 28122, 28126, 28128, 28130, 28132, 28134, 28138, 28142 and 28152, Financial Code.

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

No public hearing is scheduled. Any interested person or his or her duly authorized representative may request, in writing, a public hearing pursuant to Section 11346.8,

⁴ Similarly, the Consumer Financial Protection Bureau recently held that income share agreements are within the definition 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. See 2021-CFPB-0005, In the Matter of Better Future Forward, Inc., et al., pp. 3,8,11-13, accessible at https://files.consumerfinance.gov/f/documents/cfpb_better-future-forward-inc_consent-order_2021-09.pdf (as of October 15, 2021).

⁵ Fin. Code, § 28106, subd. (a).

⁶ Civ. Code, § 1788.103, subd. (i).

subdivision (a), of the Government Code. The request for hearing must be received by the Department's contact person designated below no later than 15 days prior to the close of the written comment period.

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

Where to Submit Comments

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

Postal Mail

Department of Financial Protection and Innovation
Attn: Sandra Navarro
2101 Arena Blvd.
Sacramento, California 95834

Electronic Mail

Comments may be submitted electronically to regulations@dbo.ca.gov. Please identify the comments as PRO 06-21 in the subject line.

Time for Comments

Comments may be submitted until 5:00 p.m., October 28, 2022. If the final day for the acceptance of comments is a Saturday, Sunday or state holiday, the comment period will close at 5 p.m. on the next business day.

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

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

The objective of the proposed regulations is to implement the provisions of the Student Loan Servicing Act and the Student Loans: Borrower Rights law by:

- Clarifying that all education financing products are student loans within the definition of student loan in the Student Loan Servicing Act and the Student Loans: Borrower Rights law;
- Clarifying that servicers of all education financing products must be licensed as student loan servicers under the Student Loan Servicing Act;

- Clarifying that servicers of all education financing products are subject to and must comply with all laws applicable to student loan servicers;
- Defining terms used in the rules relating to education financing products;
- Specifying that servicers of all education financing products must submit an annual report to the Department regarding the volume and dollar amount of all education financing products serviced during the previous year, on the form specified by the Department; and
- Revising certain existing regulations to remove requirements deemed unnecessary, based on the Department's experience administering the Student Loan Servicing Act, to reduce regulatory burden.

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

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.

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

Existing law (the Student Loan Servicing Act, as amended) provides for the licensure, regulation, and oversight of student loan servicers by the Commissioner, as head of the Department of Financial Protection and Innovation.

Existing law requires persons servicing student loans in California to apply for, and obtain, a license from the Department, unless exempt.⁷ Existing law specifies the requirements for licensure.

Existing regulations implement the Student Loan Servicing Act by further detailing the specific requirements and related processes to obtain a student loan servicer license.

The subsequently enacted Student Loans: Borrower Rights law, which became effective on January 1, 2021, provides additional protections to student borrowers and extends applicability of these borrower protections to student servicers currently licensed by the Department, as well as some servicers exempt from licensure. The definitions of student loan in the Student Loan Servicing Act and the Student Loans: Borrower Rights law are identical.

This rulemaking action seeks 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 Subchapter 15 to Chapter 3 of Title 10 of the California Code of Regulations, to clarify that the definition of student loan includes all education financing products. This rulemaking provides necessary clarity and certainty.

Existing law provides the Commissioner's authority to promulgate rules and regulations implementing the Student Loan Servicing Act⁸ and the Student Loans: Borrower Rights law.⁹

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

U.S. Department of Education contracts with the federal loan servicers may contain performance metrics. However, despite the volume of student loan debt, there are no industry-wide standards for student loan servicing, in federal law or regulation.

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

Existing regulations implement the Student Loan Servicing Act by providing the specific requirements and related processes to obtain a student loan servicer license. Existing regulations do not cover the subjects addressed in the proposed regulations. Thus, the proposed regulations are not inconsistent or incompatible with existing regulations.

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

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

⁷ Fin. Code, § 28102.

⁸ Fin. Code, § 28106, subd. (a).

⁹ Civ. Code, § 1788.103, subd. (i).

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

- Mandate on local agencies or school districts: None.
- Cost to any local agency or school district which must be reimbursed in accordance with Government Code sections 17500 through 17630: None.
- Cost or savings to any state agency: None.
- Other nondiscretionary cost or savings imposed on local agencies: None.
- Cost or savings in federal funding to the state: None.

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

The Commissioner has made an initial determination that the proposed regulatory action will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

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

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

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

Applicants for a student loan servicer license must pay all costs associated with licensure, including a \$300 application fee, a \$100 fee to cover the Department's cost to investigate the applicant to determine eligibility for licensure, and expenses related to statutorily required fingerprinting. Applicants must submit audited financial statements.¹⁰

Once licensed, the law and this proposed action requires licensed servicers to adhere to specified servicing standards;¹¹ maintain a surety bond in the minimum amount of \$25,000;¹² pay for regulatory examinations conducted at least once every 36 months;¹³ submit annual, audited financial statements;¹⁴ and pay a pro rata share of the

¹⁰ Fin. Code, § 28112.

¹¹ Fin. Code, § 28130.

¹² Fin. Code, § 28142.

¹³ Fin. Code, § 28152.

¹⁴ Fin. Code, § 28148.

Department's cost to administer the Student Loan Servicing Act program.¹⁵

The Department anticipates that servicers of all education financing products currently maintain records and post information on their websites, employ customer service representatives, and regularly maintain audited financial statements to meet performance metrics and other requirements of their contracts with lenders and noteholders of the products they service. Therefore, it is anticipated that some or many of the requirements of these proposed rules will not add additional expense or add absorbable expense.

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

The Department has determined that:

- The proposed action will not create or eliminate jobs within California;
- The proposed action will not create new businesses or eliminate existing businesses within California;
- The proposed action will not expand businesses currently doing business within California;
- The proposed action is expected to benefit the health and welfare of California residents by improving transparency in government and the student loan servicing market; and increasing protections for student loan borrowers, resulting in improved financial conditions for many Californians; and
- No benefits or adverse impacts to worker safety or to the state's environment are anticipated from this regulatory action.

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

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

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

¹⁵ Fin. Code, § 28144.

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

AVAILABILITY OF THE NOTICE, STATEMENT OF REASONS, TEXT OF PROPOSED REGULATIONS AND RULEMAKING FILE [Government Code Section 11346.5, Subdivisions (a)(16), and (20), and (b)]

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

Department of Financial Protection and Innovation
Attn: Sandra Navarro
2101 Arena Blvd.
Sacramento, California 95834
Telephone: (213) 897-3432
E-mail: regulations@dfpi.ca.gov

The notice, initial statement of reasons and proposed text are also available on the Department's website at www.dfpi.ca.gov.

As required by the Administrative Procedure Act, the Legal Division maintains the rulemaking file. The rulemaking file is available for public inspection and copying throughout the rulemaking process at the Department of Financial Protection and Innovation, Legal Division, 300 S. Spring Street, Suite 15513, Los Angeles, California 90013.

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

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

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

Upon its completion, the Final Statement of Reasons will be available and copies may be

requested from the contact person named below or may be accessed on the Department's website listed above.

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

Department of Financial Protection and Innovation
Attn: Senior Counsel Mary D. Tomé
300 South Spring Street, Suite 15513
Los Angeles, CA 90013-1259
Telephone: (213) 897-2160
E-mail: mary.tome@dfpi.ca.gov

Non-substantive inquiries concerning this action, such as requests for copies of the proposed regulation or questions regarding the timelines or rulemaking status, may be directed to:

Department of Financial Protection and Innovation
Attn: Sandra Navarro
2101 Arena Blvd.
Sacramento, California 95834
Telephone: (213) 897-3432
E-mail: regulations@dfpi.ca.gov

The backup contact person for non-substantive inquiries is:

Department of Financial Protection and Innovation
Attn: Araceli Dyson
2101 Arena Boulevard
Sacramento, California 95834
Telephone: (916) 576-3637
E-mail: regulations@dfpi.ca.gov

Dated: August 30, 2022
Sacramento, California