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CFPB Finds 90 Percent of Private Student Loan Borrowers Who Applied for Co-Signer Release Were Rejected

Industry Inquiry Reveals Problems for Consumers Seeking to Prevent Auto-Defaults

WASHINGTON, D.C. — Today the Consumer Financial Protection Bureau (CFPB) Student Loan Ombudsman released a report finding high rates of consumers are being rejected for co-signer release on their private student loans, based on its review of industry practices. The Bureau uncovered problematic industry practices that may be disqualifying some consumers from securing a co-signer's release from their loans. When student borrowers and co-signers seek a co-signer release but are unable to obtain it, the co-signer can suffer from damage to their credit or be subject to higher rates on other forms of credit. This can also result in serious financial distress for the borrower if a company triggers an auto-default when a co-signer dies or goes bankrupt.

"Parents and grandparents put their financial futures on the line by co-signing private student loans to help family members achieve the dream of higher education," said CFPB Director Richard Cordray. "Responsible borrowers and their co-signers should have clear information and standards for releasing the co-signer if the time is right. We're concerned that the broken co-signer release process is leaving responsible consumers at risk of damaged credit or auto-default distress."

The CFPB Student Loan Ombudsman's Mid-Year Update is available at:http://files.consumerfinance.gov/f/201506_cfpb_mid-year-update-on-student-loan-complaints.pdf

"Private student loan companies should own up to borrowers when they qualify for valuable benefits, clean up contracts with surprises buried in the fine print, and step up to provide borrowers and their co-signers the service they deserve," said CFPB Student Loan Ombudsman Rohit Chopra.

Student loans make up the nation's second largest consumer debt market. The market has grown rapidly in the last decade. Today there are more than 40 million federal and private student loan borrowers and collectively these consumers owe more than $1.2 trillion. While private student loans are a small portion of the overall market, they are generally used by borrowers with high levels of debt who also have federal loans. In general, private student loans carry higher interest rates and lack flexible repayment options, compared to federal student loans. Unlike other markets, independent data on the size and performance of the private student loan market is not available to investors and the public.

Most private student loans require a co-signer. In fact, according to a 2012 report on private student loans published by the CFPB and the Department of Education, while co-signers were less often required during the years prior to the financial crisis, by 2011 more than 90 percent of new private student loans were co-signed, often by a parent or grandparent.

A co-signer may help a borrower access credit or obtain a lower rate because they may be more creditworthy and can step in if a borrower is unable to repay. However, borrowers have also been hit with a default because of activities related to the co-signer, even if the borrower is paying on time. However, the loan will appear on the co-signer's credit record which will count towards the co-signer's total debt level and can affect the co-signer's credit score if the loan is not repaid. Consumers also can be at a disadvantage if they are unable to obtain a co-signer release. For example, a co-signer may also have a more difficult time obtaining an affordable rate on other credit, making it more expensive to refinance a home or to buy a car.

Last year, the CFPB released a report highlighting complaints related to auto-defaults. Consumers reported that private student lenders and servicers placed borrowers in default when a co-signer died or filed for bankruptcy, even if the loan was in good standing.

Following the report, the Bureau's Student Loan Ombudsman issued an information request to companies comprising much of the activity in the market in order to better understand and address current practices and policies affecting consumers.

Today's report includes findings of the information request from industry participants as well as analysis of more than 3,100 private student loan complaints and approximately 1,100 debt collection complaints related to student loan debt received between October 1, 2014, and March 31, 2015. Overall, private student loan complaints increased by 34 percent compared to the same time period last year.

Among the issues that consumers face:

- **Companies rejected 90 percent of consumers who applied for co-signer release:** Many private student lenders advertise options to release a co-signer from a private student loan. However, an analysis of industry responses to the CFPB's information request found that the lenders and servicers surveyed granted very few releases—of those borrowers that applied for co-signer release, 90 percent were rejected.

- **Consumers left in the dark on co-signer release criteria:** The CFPB found that consumers have little information on the specific borrower criteria needed to obtain a co-signer release. Consumers reported being confused about their eligibility for obtaining a co-signer release as well as not understanding why they had been denied.

- **Most private student loan contracts continue to contain auto-default clauses:** Last year, the CFPB reported that private student loan servicers were putting borrowers in default when a co-signer died or filed for bankruptcy, even when their loans were otherwise in good standing. Following that report, some financial institutions stated that they would no longer hit borrowers with auto-defaults. The CFPB's analysis of private student loan contracts, however, found that most private student loan contracts continue to include auto-default clauses.

- **Borrowers are at risk when loans are sold and packaged by Wall Street:** Even if individual companies state that they will not trigger auto-defaults in certain cases, loans are often sold to other banks and securitized on Wall Street. This exposes borrowers to risk that the new owner of the loan will trigger an auto-default.

- **Company policies can permanently disqualify borrowers from co-signer release:** Student loan borrowers reported that some companies' policies penalize or disqualify borrowers who prepay their loans and are in good standing. Some companies also disqualify borrowers from releasing a co-signer if the consumer accepts the servicer's offer of postponing payment through forbearance. These company policies can permanently ban a consumer from seeking co-signer release for the life of the loan and penalize consumers that may have graduated during tough economic times.

- **Potentially harmful clauses found in the fine print:** In addition to auto-default clauses, the CFPB found other potentially harmful clauses hidden in fine print of some loans including "universal default" clauses. Financial institutions use these clauses to trigger a default if the borrower or co-signer is not in good standing on another loan with the institution, such as a mortgage or auto loan, that is unrelated to the consumer's payment behavior on the student loan. These clauses can increase the risk of default for both the borrower and co-signer.

Today's report describes opportunities to improve the private student loan industry's co-signer practices. The report identifies practices that could benefit consumers and industry, including:

- **Improving transparency around co-signer release criteria:** Consumers and industry would benefit from increased transparency around the availability of co-signer release, including what specific requirements exist that a borrower needs to meet to obtain a release.

- **Improving consumer notifications for co-signer release eligibility:**Private student loan servicers could notify consumers before placing them in a repayment status, such as forbearance, that it would disqualify them from co-signer release. In addition, private student loan servicers could improve their customer service by proactively notifying borrowers when they meet prerequisites for releasing a co-signer, such as making a certain number of on-time payments.

- **Examining potentially harmful clauses in the fine print:** The CFPB report notes that policymakers should consider whether auto-default, universal default, and other potentially harmful terms in the fine print of private student loan contracts are appropriate.

To help borrowers overcome obstacles to co-signer release, the CFPB published a set of sample letters for private student loan borrowers and their co-signers that they can send to the private student loan servicer. These letters instruct servicers to provide clear information about co-signer release policies.

Last month, the CFPB launched a public inquiry into student loan servicing practices that can make paying back loans a stressful or harmful process for borrowers. The issues that the Bureau is seeking information on include: industry practices that create repayment challenges, hurdles for distressed borrowers, and the economic incentives that may affect the quality of service. The comment period is open until July 13, 2015.The CFPB also launched a new version of the Repay Student Debt tool, which helps borrowers get unbiased tips on how to navigate student loan repayment, along with other sample letters they can send to their student loan servicers.

The CFPB began accepting consumer complaints about private student loans in March 2012. More information is at: consumerfinance.gov/students.

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