

## ASSEMBLY THIRD READING

AB 424 (Stone)

As Amended April 21, 2021

Majority vote

**SUMMARY**

Establishes the Private Student Loan Collections Reform Act to require a private education lender (lender) or a private education loan collector (collector) to possess and make available specified information related to a private education loan (loan) before the lender or collector can initiate certain collection activities. This bill also authorizes a consumer to bring a cause of action against a creditor, lender, or collector that violates any provision of this bill.

**Major Provisions**

- 1) Prohibits a lender or a collector from making any written statement to a debtor in an attempt to collect a loan unless the lender or collector possesses specified information, such as an itemization of interest and fees, the date of the first partial payment or the first day a payment was missed, and specified documentation establishing that the creditor is the owner of the loan at issue. A lender or collector must include in its first written collection communication with the debtor, and at any time the debtor requests, this specified information.
- 2) Requires that all settlement agreements between a debtor and either a lender or collector be documented in open court or otherwise reduced to writing. Further requires that the debtor be provided a copy of the written agreement.
- 3) Mandates that if a lender or collector accepts a payment as a complete settlement of an outstanding loan, then it has to provide the payer with a final statement with specified information, including that a zero balance is owing. This statement may be provided electronically if the parties agree.
- 4) Forbids a lender or collector from bringing suit or initiating an arbitration or other legal proceeding to collect a private education loan if the applicable statute of limitations has expired.
- 5) Requires, in a collection action brought by a lender or collector to collect a loan, that the complaint allege that the collection of the debt is not time barred under applicable law and that the plaintiff has complied with this bill's requirements related to the possession of specified information.
- 6) Prohibits a court from entering a default judgment in an action on a loan unless the plaintiff has complied with the requirements of this bill, and grants the court discretion to dismiss the action if the plaintiff has failed to do so.
- 7) Provides a cause of action against a creditor, lender, or loan collector that violates any provision of this bill.
- 8) Provides that, in a class action, defendants shall be liable for specified statutory damages to each named plaintiff. Additional damages of up to the lesser of \$500,000 or 1% of the net worth of the defendant are available if the court finds that the defendant engaged in a pattern and practice of violating a provision of this bill.

- 9) Exempts private education lenders and private education loan collectors from liability for damages if they show by a preponderance of the evidence that a violation was not intentional and resulted from a bona fide error, and occurred notwithstanding the maintenance of procedures reasonably adopted to avoid error.

## COMMENTS

*Student loan debt in California.* Californians owe more than \$10 billion in private student loan debt, according to statistics provided by the author's office from the Federal Reserve Bank of New York and the United States Department of Education. Relative to federal loans, private student loans typically charge higher interest rates, contain fewer consumer protections, and are targeted at the most vulnerable borrowers, like those attending for-profit schools. Similar to federal loans, private student loans are difficult to discharge in bankruptcy, which reduces the incentive for private lenders to carefully underwrite loans or to offer modified payment plans. Many private student loans are bundled and sold off after origination to investors who pay third-parties modest fees to service the loans and pursue delinquent debts. This market structure – a risky product with creditor-friendly collections terms serviced by austere third parties – creates incentives that lead to outcomes harmful to vulnerable borrowers.

*Loan servicing and debt collection issues.* Originating lenders often sell or outsource the servicing of private student loans to a third party. After funding the loan, the originator bundles and sells the loan, which may pass through multiple entities before landing in a trust that pays a separate entity to service the loan. The servicer receives payments from borrowers and sends money back to the trust. In the case of delinquent loans, the servicer may assign the loan to a different servicer that specializes in overdue accounts. These servicers may engage in debt collection practices directly or may outsource collection activities to debt collectors. In order to eke out a profit, servicers seek to restrict or streamline activities in order to keep their costs low.

Collections practices related to private student debt have come under legal scrutiny in recent years. In 2017, the Consumer Financial Protection Bureau (CFPB) took action against the National Collegiate Student Loan Trusts and their debt collector, Transworld Systems, Inc., for illegal student loan debt collection lawsuits. Consumers were sued for private student loan debt that the companies could not prove was owed or was too old to sue over, and the lawsuits relied on the filing of false or misleading legal documents. The prevalent factor that caused these failures was a business model that relied on mass production of lawsuits by unqualified paralegals and clerks who were forced to make false attestations of their knowledge of individual cases.

In private litigation, students have been sued for debts they no longer owed, by companies they never borrowed from, and by creditors that lacked the legal standing to sue in the first place. Judges across the country have quashed hundreds of lawsuits due to the poor evidentiary merits of cases brought by private student lenders and collectors. The probability of a borrower prevailing in such a case, however, is dependent on whether the borrower is represented by an attorney.

*Modeled after the Fair Debt Buying Practices Act.* This bill is modeled on California's Fair Debt Buying Practices Act, which the Legislature enacted in 2013 to put in place basic requirements for 1) the documentation that a debt buyer must possess to begin debt collection communication with an alleged debtor, 2) pleading standards in debt collection lawsuits, and 3) evidentiary standards to obtain a default judgment. It also created a private right of action for violations. The

Assembly Committee on Judiciary notes in its analysis that the Fair Debt Buying Practices Act has reduced collection lawsuits for unpaid credit card debt by nearly 60% by requiring competent evidence in these cases.

### **According to the Author**

"When borrowers fall behind on [private student] loan payments, lenders and collectors pursue aggressive litigation, characterized as an "assembly line of lawsuits" against borrowers. Yet, trusts, servicers, and collectors routinely fail to prove that they own the loan, file lawsuits within the statute of limitations, and comply with court requests for additional information. Nevertheless, lenders and collectors automatically win many of these lawsuits because borrowers are unfamiliar with the judicial system, or are unable to afford legal representation. Court rulings in favor of debt collectors result in garnished wages or seizure of federal benefits deposited in bank accounts."

### **Arguments in Support**

This bill is co-sponsored by Consumer Reports, NextGen California, Student Borrower Protection Center, Student Debt Crisis, and Young Invincibles, and supported by a number of other organizations, including the California Dental Association, California Association of Realtors, California Federation of Teachers, and SEIU California.

Community Legal Aid SoCal writes in support and argues that "Consumers tell us they want to settle consumer defense matters but they relate that they are met with resistance, lack of cooperation (unreasonable terms) and lack of civility. The odds are stacked in favor of the plaintiff loan servicers leaving the debt lenders and collectors with a lack of motivation to attempt [to] reach a fair, good faith settlement."

The Consumer Federation of California writes that recent federal student loan relief measures only encompassed federally-funded loans, leaving a gap in protections for other borrowers: "Private student loans represent about 8% of total education debt, according to MeasureOne, which tracks data on private student lending. Not only were these borrowers left out of the pandemic related 'payment pause' granted to federal borrowers, they are also rarely included in the ongoing legal and policy conversations about loan forgiveness."

### **Arguments in Opposition**

This bill is opposed by the California Bankers Association and the California Credit Union League. They argue in part that "required documentation that a private education lender or private education loan collector would have to provide appears to be an attempt to invalidate legitimate debts in the event of minor or inadvertent omissions in a log or document."

## **FISCAL COMMENTS**

According to the Assembly Appropriations Committee:

- 1) Annual costs of approximately \$200,000 for the Department of Financial Protection and Innovation (DFPI) to provide specified oversight of the private education lender and loan collector industry. Under the recently enacted California Consumer Financial Protection Law, DFPI has new regulatory powers to oversee currently unlicensed financial industries, including debt collectors.

- 2) Cost pressures (General Fund (GF)/Trial Court Trust Fund) in the mid-hundreds of thousands of dollars annually to the courts in additional workload. This bill authorizes a cause of action for violations of the Act. The estimated workload cost of one hour of court time is \$956. If 20 cases are filed statewide resulting in 20 hours of court time for each case, costs would be approximately \$382,400. Although courts are not funded on the basis of workload, increased pressure on the courts and staff may create a need for increased funding for courts to perform existing duties. This is particularly true given that courts have delayed hundreds of trials and civil motions during the COVID-19 pandemic resulting in a serious backlog that must be resolved. The Governor's 2021-22 budget proposes \$72.2 million in ongoing GF revenue for trial courts to continue addressing the backlog and provide timely access to justice.

**VOTES****ASM BANKING AND FINANCE: 9-3-0**

**YES:** Grayson, Bauer-Kahan, Burke, Cervantes, Gabriel, Cristina Garcia, Petrie-Norris, Stone, Wicks

**NO:** Chen, Choi, Nguyen

**ASM JUDICIARY: 8-2-1**

**YES:** Stone, Chau, Chiu, Lorena Gonzalez, Holden, Kalra, Maienschein, Reyes

**NO:** Davies, Smith

**ABS, ABST OR NV:** Kiley

**ASM APPROPRIATIONS: 12-4-0**

**YES:** Lorena Gonzalez, Calderon, Carrillo, Chau, Gabriel, Eduardo Garcia, Levine, Quirk, Robert Rivas, Akilah Weber, Holden, Luz Rivas

**NO:** Bigelow, Megan Dahle, Davies, Fong

**UPDATED**

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