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BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Chapter X

Bulletin 2023-01: Unfair Billing and Collection Practices After Bankruptcy Discharges of Certain Student Loan Debts

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Compliance bulletin and policy guidance.

SUMMARY: The Consumer Financial Protection Bureau (CFPB) is issuing this Compliance Bulletin and Policy Guidance (Bulletin) to address the treatment of certain private student loans (hereinafter referred to as "student loans") following bankruptcy discharge. In order to secure a discharge of "qualified education loans" in bankruptcy, borrowers must demonstrate that the loans would impose an undue hardship if not discharged. Student loans that are not "qualified education loans" (hereinafter referred to as "non-qualified student loans"), however, are discharged under standard bankruptcy discharge orders. In recent supervisory work, CFPB examiners identified servicers that did not determine whether education loans were qualified or non-qualified. As a result, servicers improperly returned non-qualified education loans to repayment after a bankruptcy concluded and continued to bill and collect payments on the loans, even though the borrowers' bankruptcy discharges released them from these debts. This conduct violated the Consumer Financial Protection Act's (CFPA's) prohibition on unfair, deceptive, or abusive acts or practices. CFPB examiners directed the servicers to cease collection of discharged loans and take remedial action, which includes conducting a multi-year lookback and issuing refunds to affected consumers. In its oversight, the CFPB will pay particular attention to servicers' practices in connection with student loans that are the subject of bankruptcy discharge

orders, including whether discharged debts are being collected contrary to bankruptcy court orders.

DATES: This bulletin is applicable on **[INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].**

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SUPPLEMENTARY INFORMATION:

I. Background

After a debtor files for bankruptcy, a judge issues an order of discharge that releases a debtor from personal liability for all debts unless they are exempted. Some types of student loans are not discharged by general orders of discharge and receive special treatment under section 523(a)(8) of the Bankruptcy Code. Borrowers with these obligations must prove the debt would impose an undue hardship if not discharged. The Bankruptcy Code identifies these debts as:

a. Loans that are made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution;

b. Loans that meet the definition of a "qualified education loan," as defined in section 221(d)(1) of the Internal Revenue Code of 1986;[1] or

c. Obligations to repay funds received as an educational benefit, scholarship, or stipend.[2]

The Internal Revenue Code specifies that qualified education loans are those that are incurred:

[1] 11 U.S.C. 523(a)(8).
[2] 11 U.S.C. 523(a)(8)(A)(ii).

1. Solely to pay for the cost of attendance less scholarships or certain other payments;
2. At institutions eligible to participate in Federal student aid programs under Title IV of the Higher Education Act of 1965; and
3. While attending at least half-time.[3]

In practice, the majority of student loans meet one of the criteria for special treatment under the Bankruptcy Code, and therefore, are not discharged by a general order of discharge.[4] Importantly, however, some loans for educational purposes that borrowers may think of as "private student loans" are not exempt from the general order of discharge,[5] including:

- Loans made to attend non-Title IV schools (that is, schools that are not permitted to process U.S. Federal student aid, such as unaccredited schools and foreign schools);[6]
- Loans made to cover fees and living expenses incurred while studying for the bar exam or other professional exams;[7]
- Loans made to cover fees, living expenses, and moving costs associated with medical or dental residency;
- Loans made in amounts in excess of the cost of attendance;[8]

[3] 26 U.S.C. 221(d)(1).
[4] For example, the majority of student loans are Federal loans made or insured under Title IV of the Higher Education Act. *See* Report of the CFPB Education Loan Ombudsman, https://files.consumerfinance.gov/f/documents/cfpb_education-loan-ombudsman_report_2022-10.pdf (Oct. 2022), pp. 7-8.
[5] *See, e.g., In re McDaniel*, 590 B.R. 537, 545 (Bankr. D. Colo. 2018) (noting that merely labeling a product a "student loan" does not subject it to the undue hardship standard); *Homaidan v. Sallie Mae, Inc.*, 3 F.4th 595, 605 (2d Cir. 2021); *In re McDaniel,* 973 F.3d 1083, 1092 (10th Cir. 2020); *In re Crocker*, 941 F.3d 206 (5th Cir. 2019), as revised (Oct. 22, 2019).
[6] *See Crocker*, 941 F.3d at 217-18 (noting that qualified educational expenses must be used to attend an "eligible educational institution," which section 25A(f)(2) of the Internal Revenue Code defines as eligible to participate in Title IV programs).
[7] *Id.* (bar study loan subject to standard bankruptcy discharge); *see also In re Campbell*, 547 B.R. 49, 61 (Bankr. E.D.N.Y. 2016).
[8] 26 U.S.C. 221(d)(2) (limiting a qualified educational expense to "the cost of attendance"); *see, e.g.*, *Homaidan*, 3 F.4th at 599 (affirming discharge of loans made in excess of the cost of attendance).

- Loans to students attending school less than half-time;[9] and
- Other loans made for non-qualified higher education expenses.[10]

Any private loans in these categories are discharged by standard bankruptcy discharge orders, just like most other unsecured consumer debts.[11] In addition to not fitting the definition of "qualified education loan," these loans are not made, insured, or guaranteed by a governmental unit, and are not educational benefits, scholarships, or stipends. The obligations at issue here are originated as loans requiring repayment; educational benefits, scholarships, and stipends, in contrast, are grants, where repayment is only triggered if the student fails to meet a condition of the grant. Indeed, the Second, Fifth, and Tenth Circuits – the only circuits to analyze the issue fully – have held that the educational benefit exclusion does not apply to student loans.[12]

II. Unfair Acts or Practices in Handling Student Loans Post-Bankruptcy

The CFPB has authority to conduct oversight of student loan servicing, including by citing servicers for unfair, deceptive, or abusive acts or practices.[13] Congress defined an unfair act or practice as one that:

> (A) Causes or is likely to cause substantial injury to consumers which is not reasonably avoidable, and
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> (B) Such substantial injury is not outweighed by countervailing benefits to consumers or to competition.[14]

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[9] *See* 26 U.S.C. 221(d)(1)(C) (defining a "qualified education loan" as a loan made to an "eligible student"); 20 U.S.C. 1091(b)(3) (defining "eligible student" as someone attending at least half-time).
[10] 26 U.S.C. 221(d)(1) (requiring a qualified education loan only be used to pay "qualified higher education expenses").
[11] *See, e.g., Homaidan*, 3 F.4th at 605; *McDaniel,* 973 F.3d at 1092; *Crocker*, 941 F.3d at 206.
[12] *See Homaidan*, 3 F.4th at 604-05; *McDaniel*, 973 F.3d at 1092; Crocker, 941 F.3d at 224.
[13] *See* title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (establishing the CFPB's authority). Under the Dodd-Frank Act, all covered persons or service providers are prohibited from committing unfair, deceptive, or abusive acts or practices in violation of the Act.
[14] 12 U.S.C. 5531(c)(1).

Through its supervisory activities, CFPB examiners found that servicers of various types of student loans failed to maintain policies or procedures for distinguishing between loan types that are discharged in the regular course of a bankruptcy proceeding (generally, non-qualified education loans) and loan types that require consumers to initiate an adversarial proceeding and meet the "undue hardship" standard to receive bankruptcy relief. Some servicers relied entirely on loan holders to distinguish among the loans and did not determine whether holders had in fact done so. Nor did they take any other steps to evaluate whether or not the loans were qualified education loans. Consequently, examiners identified accounts where servicers, following a bankruptcy involving non-qualified education loans, resumed collecting on loans that had been discharged by bankruptcy courts.

CFPB examiners determined that student loan servicers engaged in an unfair act or practice, in violation of the Dodd-Frank Act, when they resumed collection of debts that were discharged by bankruptcy courts.[15] The conduct caused or was likely to cause substantial injury to consumers because the representations made to consumers in billing statements and other collection attempts were likely to result in consumers making payments they did not owe. In fact, CFPB examiners also observed that after exiting bankruptcy and being presented with bills from their student loan servicers, most borrowers made payments toward the debts, sometimes paying thousands of dollars on discharged debts. Since the consumers could not control the servicers' actions, consumers could not reasonably avoid the injury. Lastly, the substantial injury was not outweighed by countervailing benefits to consumers or competition, as there was

[15] Depending on the facts and circumstances, returning consumers to repayment status on debts discharged in bankruptcy may also implicate deceptive or abusive acts or practices, or other unfair acts or practices under the CFPA, sections 1031, 1036; 12 U.S.C. 5531, 5536.

no value to consumers or competition in servicers collecting debts that had already been discharged by operation of bankruptcy court orders.

In addition to directing the servicers to revise their policies and procedures to prevent the collection of discharged loans, CFPB examiners directed them to do a multi-year lookback resulting in refunds to affected borrowers.[16]

III. Supervision and Enforcement

The CFPB's supervisory observations and consumer complaints show that servicers continued to make collection attempts on student loans that were discharged through bankruptcy in many instances. This conduct violates Federal consumer financial law.[17] The CFPB expects servicers to proactively identify student loans that are discharged without an undue hardship showing and permanently cease collections following a standard bankruptcy discharge order. The CFPB is prioritizing student loan servicing oversight work in deploying its supervision and enforcement resources in the coming year, including a focus on evaluating whether lenders and servicers cease collection of student loans once they have been discharged.[18]

In its student loan servicing oversight work, the CFPB plans to pay particular attention to:

a. Whether student loan servicers continue to collect on loans that are discharged by a bankruptcy discharge order;

[16] In addition, CFPB examiners have separately cited student loan servicers for deceptive conduct that violates the CFPA when the servicers misrepresented to consumers that student loans are never dischargeable in bankruptcy or conveyed to consumers that their loans are not dischargeable because those consumers have completed bankruptcy. *Supervisory Highlights, Fall 2014,* section 2.5.5, https://files.consumerfinance.gov/f/201410_cfpb_supervisory-highlights_fall-2014.pdf and *Supervisory Highlights, Fall 2015*, section 2.5.3, https://files.consumerfinance.gov/f/201510_cfpb_supervisory-highlights.pdf.

[17] Practices of this kind might also violate State laws, including State prohibitions on unfair or deceptive practices and State student loan servicing statutes.

[18] To the extent that continued attempts to collect result in improper accrual and collection of interest on discharged education loans, such practices may result in the provision of any report of examination or related information identifying possible tax law noncompliance to the Commissioner of Internal Revenue, per 12 U.S.C. 5514(b)(6).

b. Whether servicers and loan holders have adequate policies and procedures to identify loans that are discharged by a bankruptcy discharge order and loans that require the borrower to go through an adversarial proceeding to demonstrate that they meet the undue hardship standard; and

c. Whether servicers provide accurate information to borrowers about the status of their loans and the protections that bankruptcy offers.[19]

In exercising its supervisory and enforcement discretion, the CFPB will consider the extent to which entities engage in proactive review and remediation. For example, where servicers or loan holders identify errors, they can expand their analysis to include a review of all accounts exiting bankruptcy going back to their earliest available data and provide full remediation where they wrongfully collected from any borrower. In addition, servicers can proactively categorize loans based on whether they can be discharged, so their policies and procedures do not require individual determinations at the time of bankruptcy. In future supervisory and enforcement work, the CFPB will assess servicers' processes and determine whether necessary remediation was adequate to compensate borrowers for the errors.

IV. Conclusion

The CFPB will continue to review closely the practices of student loan servicers for potential unfair, deceptive, or abusive acts or practices. Examiners will determine whether servicers of private student loans return loans to repayment status after a standard bankruptcy discharge has released the borrowers from these debts. The CFPB will use all appropriate tools, including its supervisory authority, enforcement authority, and referrals to State and other

[19] This list is not exhaustive. The CFPB may also scrutinize additional practices related to discharged student loans.

Federal authorities where appropriate to hold entities accountable if they engage in unfair, deceptive, or abusive acts or practices in connection with these bankruptcy-related practices.

V. Regulatory Requirements

This is a general statement of policy under the Administrative Procedure Act (APA). It is intended to provide information regarding the CFPB's general plans to exercise its supervisory and enforcement discretion for institutions under its jurisdiction and does not impose any legal requirements on external parties, nor does it create or confer any substantive rights on external parties that could be enforceable in any administrative or civil proceeding. Because no notice of proposed rulemaking is required in issuing the Bulletin, the Regulatory Flexibility Act also does not require an initial or final regulatory flexibility analysis. The CFPB has also determined that the issuance of the Bulletin does not impose any new or revise any existing recordkeeping, reporting, or disclosure requirements on covered entities or members of the public that would be collections of information requiring approval by the Office of Management and Budget under the Paperwork Reduction Act.

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