STUDENT LOANS: RECENT FEDERAL WARNING SHOTS TO FINANCIAL INSTITUTIONS

You can hardly throw a textbook today without hitting a media story about student loans. From the debt burden that graduates face to the actual loans that students have access to and how they're structured, our country is taking a hard look at college costs and financing. Now the landscape is shifting.

Students, who used to hold little power in the loan process, are gaining a voice. Financial institutions should take note and adjust their loan-making processes or face more regulation and potential losses down the road.

This article shares information about recent federal announcements and their implications to the banking industry.

Recent Federal "Guidance"

There are, essentially, two types of student loans: 1) standard payment plans with established payment amounts and timelines from the moment a student graduates, and 2) graduated repayment plans under which the student's initial payments are lower and then increase approximately every two years. Most graduated repayment plans require monthly payments over ten years.

The problem with graduated payment plans (and, let's face it, many other student loans) is that some students don't end up making as much money as they expected upon graduation and they struggle to pay their debt. A deeper look into some of the loan structures themselves led federal regulators to make a recent announcement to financial institutions that originate private student loans.

On January 29, 2015, federal financial regulatory agencies issued guidance for financial institutions that originate private student loans with graduated repayment terms. Some of the guidance may seem common sense, but clearly the regulators saw practices in the private banking industry that made them take note.

Financial institutions should see these guidelines as a warning shot: you've got to study your private student loan-making process and even your student loan culture or face more federal attention down the road.

The federal agencies issued the following principles for financial institutions that make private student loans with graduated repayment terms to ensure that they “prudently underwrite the loans in a manner consistent with safe and sound lending practices”:

- Ensure orderly repayment by calibrating repayment terms to reasonable standards based on debt;
- Avoid payment shock by including repayment terms that a borrower can meet over the life of the loan;
- Align payment terms with income and do not structure repayment terms to mask delinquencies or defer losses;
- Provide clear disclosures to the borrower as required by applicable laws and regulations, including the Truth in Lending Act;
- Comply with all consumer laws, regulations, and reporting standards; and
- Contact borrowers before reset dates to help establish student debt as a priority and aid borrowers in responding to any challenges.

More Power to the Students Coming

Further proof of a shifting landscape: The White House is studying whether it should be easier to wipe out student loans in the bankruptcy process. Currently, federal law prohibits student loans from being discharged in bankruptcy, except in rare cases. In a nutshell, banks need to work with students to arrive at fair repayment plans, or they may risk losing their assets in that student’s bankruptcy process.

The takeaway from this recent “guidance”? Students are gaining power in the loan process and banks need to be much more careful about how they structure loans and how they communicate with students throughout the life of a loan.

What Should You Do?

Financial institutions need to take a hard look at their private student loan-making process, their relationships with students throughout the life of a loan, and their very culture around student loans. You have received a warning: “Do this right, and do it fairly, or face consequences.”

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