March 6, 2020

Mr. Thomas G. Wipf
Chair
Alternative Reference Rates Committee
1585 Broadway
New York, NY 10036-8293

Dear Chairman Wipf,

The Student Borrower Protection Center, Americans for Financial Reform Education Fund, the National Community Reinvestment Coalition, and the National Consumer Law Center offer the following comments in response to the Alternative Reference Rate Committee's (ARRC) recent Consultation on Spread Adjustments ("Consultation").[1] The Consultation noted that approximately $80 billion in variable rate private student loans reference LIBOR, and additional research indicates that as many as 3.3 million private student loan borrowers will be impacted by the transition from LIBOR.[2] As the Committee finalizes its methodology on spread adjustments, we urge it to consider the unique risks inherent to the private student loan market and to prioritize the protection of student loan borrowers.

The student loan market is an extremely precarious area of consumer credit where even small consumer-facing rate shocks can cause widespread borrower harm. For example, in the fourth quarter of 2019, the Federal Reserve Bank of New York reported that 11.1 percent of outstanding student loan debt was 90 or more days delinquent. FRBNY further noted that, when limited to student loans in repayment, delinquency rates were "roughly twice as high."[3] Previous research has also estimated that an interest rate increase of as little as 0.5 percent could be associated with private student loan default rates more than doubling in certain borrower segments.[4] Available data show that student loan defaults are disproportionately concentrated

[1] *See* Fed. Res. Bank of NY, *ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR* (Jan. 21, 2020), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation.pdf.
[2] *See* Jason Richardson & Karen Keli, *By 2021, Big Changes For Interest Rates Could Spell Trouble For Borrowers*, Nat'l Comm. Reinvestment Coalition (Apr. 25, 2019), https://ncrc.org/by-2021-big-changes-for-interest-rates-could-spell-trouble-for-borrowers/.
[3] Fed. Res. Bank of N.Y., *Quarterly Report on Household Debt and Credit 2019:Q4*, https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2019q4.pdf ("[D]elinquency rates for student loans are likely to understate effective delinquency rates because about half of these loans are currently in deferment, in grace periods or in forbearance and therefore temporarily not in the repayment cycle. This implies that among loans in the repayment cycle delinquency rates are roughly twice as high.").
[4] *See* Felicia Ionescu & Nicole Simpson, *Default Risk and Private Student Loans: Implications for Higher Education Policies*, Fin. and Econ. Discussion Series (2015), https://bit.ly/2SyxqHj (Table 7).

among borrowers of color, borrowers from low-income backgrounds, and attendees of for-profit institutions.[5]

However, default rates capture only a fraction of those struggling under the weight of student loan debt. Every month, millions of additional borrowers across the country forgo meals,[6] medical expenses,[7] and basic life milestones as they grapple with their student loan bill.[8] We urge the ARRC to protect these vulnerable borrowers from rate increases as it finalizes its methodology on spread adjustments.

Additionally, as it continues its deliberations, the ARRC should consider how limited the avenues are for borrower recourse in the event of harm resulting from the LIBOR transition. This is of particular concern in the context of the Consultation's discussion of spread adjustment methodologies and associated margin adjustments.

In reviewing a sample of a dozen LIBOR-based private student loan contracts, we found that almost every one gave the lender nearly unilateral authority to select a replacement index when LIBOR becomes unavailable, and that many also gave the lender similarly broad authority to readjust the margin that is added to the index. These contracts sometimes require that a chosen replacement index be "comparable" to LIBOR, or that the overall interest rate the borrower eventually faces be "comparable" to their existing rate, but the term "comparable" is generally left undefined.

Industry and consumer advocates alike have observed that the Consumer Financial Protection Bureau (CFPB)—the agency tasked with overseeing consumer financial protection laws—has remained notably silent on the definition of index comparability.[9] The CFPB has also failed to provide appropriate guidance to industry on refinancing disclosures required under the Truth in Lending Act, except to indicate in a public meeting that it did not expect that note holders would need to redisclose if their selected replacement index were "comparable" to LIBOR, a further

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[5] *See, e.g.*, Ben Miller, *Who Are Student Loan Defaulters?*, Ctr. for Am. Progress (Dec. 14, 2017), https://cdn.americanprogress.org/content/uploads/2017/12/11044919/StudentLoanDefault-brief1.pdf.

[6] *See Lessons Learned*, SWNS Media Group (Nov. 1, 2019), https://bit.ly/2HVVBdI.

[7] *See, e.g.,* Mathieu Despard et al., *The Burden of Student Debt: Findings from a Survey of Low- and Moderate-Income Households,* CSD Res. Briefs (2016), https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1611&context=csd_research (finding that student loan borrowers were six percentage-points (16 percent) more likely than nonborrowers to report having "[s]kipped medical care.").

[8] *See, e.g.*, *Student Debt Across Three Generations: Infographic*, AARP and the Assoc. of Young Am. (Sep. 13, 2018), https://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2018/three-generations-student-debt-infographic.doi.10.26419-2Fres.00249.002.pdf.

[9] Allison Bisbey, *Will CFPB weigh in on an appropriate Libor replacement?*, Asset Securitization Rep. (Feb. 26, 2018), https://asreport.americanbanker.com/news/will-cfpb-weigh-in-on-an-appropriate-libor-replacement ("So far, efforts to find a suitable replacement for the London interbank offered rate have largely considered the impact on investors, lenders and other financial market counterparties. But one voice has been conspicuously missing: consumers. . . . 'We're not hearing from consumer groups, we're not hearing from the CFPB,' said [an industry participant]. . . . [Industry is] wary of making any decisions about replacing the benchmark on outstanding loans until the Consumer Financial Protection Bureau weighs in.").

reference to this undefined term.[10] These facts combine with the language of existing private student loan contracts to give note holders extremely broad discretion in determining the rates that borrowers will pay after transitioning.

For example, a recent private student loan contract from Discover states:

> *If the 3-month LIBOR Index is no longer available, we will substitute an index that is comparable, in our sole opinion, and we may adjust the Margin so that the resulting variable interest rate is consistent with the variable interest rate described in this paragraph. If at any time the fixed or variable interest rate as provided in this paragraph is not permitted by applicable law, interest will accrue at the highest rate allowed by applicable law.*[11]

Similar language is present in several other LIBOR-based contracts we reviewed. Such provisions effectively eliminate any chance for input consumers might hope to have in determinations of their future interest rate.

However, the potential for consumer harm stemming from the LIBOR transition extends beyond fallback language. In 2015, the CFPB found that as many as 86 percent of private student loan contracts contained mandatory arbitration clauses.[12] These clauses require that borrowers' disputes with note holders be "resolved by privately appointed individuals (arbitrators)" instead of by judges, allowing companies to "sidestep the court system, avoid big refunds, and continue harmful practices."[13] Many private student loan contracts also contain class-action waivers, which prevent borrowers from joining with their peers to seek justice through the courts, blocking their access to a pathway that could lead to "millions of dollars in redress" for consumer harm.[14]

Further, borrowers are unlikely to succeed in securing a modification to their repayment plan if they find that their loans become unaffordable after the transition. Regulators and law enforcement officials alike have documented inconsistencies in how lenders and servicers offer alternative repayment plans to private student loan borrowers.[15]

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[10] *See* 12 C.F.R. Part 1026.20; ARRC Consumer Products Working Group Meeting, Fed. Res., 2001 Constitution Ave NW, Washington, DC 20551 (December 5, 2019).
[11] Promissory Note, Discover Bank, https://www.discover.com/content/dam/dfs/student-loans/pdf/PCL_Prom_Note.pdf.
[12] *See* CFPB, *Arbitration Study* (Mar. 2015), https://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.
[13] CFPB, *CFPB Issues Rule to Ban Companies From Using Arbitration Clauses to Deny Groups of People Their Day in Court* (Jul. 10, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-rule-ban-companies-using-arbitration-clauses-deny-groups-people-their-day-court/.
[14] *Arbitration Study, supra* n. 12.
[15] *See, e.g.,* CFPB, *CFPB Concerned About Widespread Servicing Failures Reported by Student Loan Borrowers* (Sep. 29, 2015), https://www.consumerfinance.gov/about-us/newsroom/cfpb-concerned-about-widespread-servicing-failures-reported-by-student-loan-borrowers/ ("Many federal and private loan borrowers report experiencing serious problems accessing affordable repayment options or other repayment alternatives to avoid default."); CFPB, *CFPB Report Finds Distressed Private Student*

Finally, borrowers with private student loans are denied access to bankruptcy discharge through the normal bankruptcy process,[16] making the burden of student loan debt frequently inescapable even for those who have already been declared insolvent.[17]

Should the ARRC's recommended spread adjustment methodology result in rate shock or long-run rate increases for borrowers, these underlying loan terms and limited protections will cause or exacerbate financial harm for millions of consumers. The fact that LIBOR's publication will eventually cease will make any long-term rate increases hard to detect, and borrowers are inherently less equipped than note holders to determine in advance whether the ARRC's recommended spread adjustment will increase their future loan costs. But any value transfer related to the spread adjustment could lead to thousands of dollars in additional costs for borrowers, widespread increases in delinquencies and defaults, and long-term damage to borrowers' financial lives.

Accordingly, as it finalizes its spread adjustment methodology and in response to Question 12 of its Consultation, we urge the ARRC to:

- **Ensure that borrowers will not face higher rates due to the transition from LIBOR.** The events and behaviors that necessitated the cessation of LIBOR were the work of financial institutions. Borrowers should not be penalized for industry efforts to manipulate benchmark interest rates, nor for large scale changes to patterns of interbank lending. However, if the nature of ongoing resistance to SOFR adoption (discussed further below) is any indication, there is ample reason to doubt that note holders have borrowers' best interests in mind as they prepare for this transition. Accordingly, the ARRC should:

    - Insist, per the guiding principles of the Consumer Products Working Group, that note holders involved in LIBOR transition execute the adoption of new index rates and make associated technical changes in a way that seeks "to minimize expected value transfer based on observable, objective rules determined in advance."[18]

Loan Borrowers Driven Into Default (Oct. 16, 2014), https://www.consumerfinance.gov/about-us/newsroom/cfpb-report-finds-distressed-private-student-loan-borrowers-driven-into-default/ ("Distressed borrowers report that they receive very little information or help when they get in trouble, that there are no affordable loan modification options available, and that the alternatives to default are temporary at best."); State of Illinois v. Navient, 17-CH-761 (Cir. Ct. Cook Cnty Ill. Ch. Div., filed Jan 18, 2017).

[16] *See* 11 U.S.C. § 523.

[17] *See, e.g.*, *Quicksand: Borrowers of Color & the Student Debt Crisis*, UNIDOS US, et al. (Sep. 2019), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-quicksand-student-debt-crisis-jul2019.pdf.

[18] *Guiding Principles and Scope of Work for the ARRC Consumer Products Working Group*, Alternative Reference Rates Comm. (2019), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC_Consumer_Products_Guiding_Principles.pdf.

- Recommend that a transition period of at least one year be applied to the introduction of a spread adjustment to SOFR (in response to Question 9 of the Consultation, and for the reasons discussed above). We applaud the ARRC's acknowledgment in its Consultation that a transition period will be necessary for consumer products in the move to spread-adjusted SOFR.[19]

- **Insist on more transparency from industry.** Basic questions about the transition from LIBOR remain unanswered, including whether note holders will adopt the ARRC's recommended replacement rate and spread adjustment, when they will make a determination about replacement rates, how their transition will be executed, and how borrowers will be made aware of changes to their rate. To gain clarity on each of these critical points, the ARRC should:

    - Insist that note holders provide details to the ARRC and borrowers regarding when they will indicate whether they will accept the ARRC's recommendations and when they will transition to a new benchmark rate.

    - Insist that lenders provide clarity regarding when and how they will communicate with borrowers regarding any changes to the rates borrowers face, including offering specificity around any potential changes in borrowers' monthly payment obligations.

    - Insist that lenders provide an explanation for how they intend to determine whether a given replacement index is "comparable" to LIBOR if legacy contracts require that a replacement rate be "comparable," detail on how they will choose their desired method for determining compatibility, and transparency surrounding calculations eventually made in execution of that methodology.

- **Stand by its commitment to the adoption of a fair, transparent replacement index rate.** The ARRC was formed to find a replacement rate to LIBOR that is "firmly based on transactions from a robust underlying market."[20] However, industry continues to push against this goal, and to recommend the adoption of replacement rates not based on deep

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[19] *ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR, supra* n. 1, ("Respondents to ISDA's recent consultation generally did not support a transition period with some citing the costs of the additional complexity outweighing the benefits. ISDA respondents, however, may be better positioned to absorb interest rate shocks than retail borrowers.").

[20] ARRC, *Frequently Asked Questions* (Jan. 31, 2019), https://www.sec.gov/spotlight/fixed-income-advisory-committee/arrc-faqs-041519.pdf ("The ARRC was charged with finding a rate that was more firmly based on transactions from a robust underlying market and that would comply with certain standards, including the IOSCO Principles for Financial Benchmarks.").

markets[21] or actual transaction data.[22] In defense of the need for replacement rates that do not suffer from the same structural flaws as LIBOR, the ARRC should:

- ○ Reiterate that a dynamic credit spread is inappropriate for use as an adjustment to SOFR, as any dynamic spread would "need to be based on the same wholesale unsecured funding markets that underpin LIBOR and that have now grown to be so thin."[23]

- ○ Reiterate that index rates that are not based on actual transaction data are inappropriate as benchmark interest rates to replace LIBOR.[24]

- **Debunk flawed arguments against SOFR adoption.** Discussion of spread adjustment methodology is meaningful only as a step on the path toward SOFR adoption. However, reports indicate that industry has recently pushed for regulators to rubber-stamp the use of additional alternative reference rates.[25] In particular, these reports indicate that note holders and lenders are searching for a rate they hope to be "more closely tied to their funding costs," especially as it relates to SOFR's performance in a stress scenario.[26] In those reports and elsewhere, some regulators have expressed receptiveness to such concerns, undermining the likelihood of SOFR's widespread use.[27] However, these

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[21] *See, e.g.,* Scott Shay, *The Fed's Libor Replacement Would Shackle Small Banks*, Wall St. J. (Dec. 18, 2019), https://www.wsj.com/articles/the-feds-libor-replacement-would-shackle-small-banks-11576715153?ns=prod/accounts-wsj ("Ameribor more accurately reflects the actual borrowing costs of thousands of banks and financial institutions across America."). Note that Ameribor reflects a market with only $2 billion in daily trading volume. *See* Andrew Deichler, *Beyond Libor: It's Time to Think About Alternative Rates,* AFP Online (Feb. 18, 2020), https://www.afponline.org/ideas-inspiration/topics/articles/Details/beyond-libor-it-is-time-to-think-about-alternative-rates ("Ameribor is a daily rate. It's IOSCO compliant, like SOFR. It's not really a competitor; it's more complimentary. . . . And it's about $2 billion a day of volume and growing."). Meanwhile, SOFR reflects a market "[a]veraging over $1 trillion of daily trading." *ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR, supra* n. 1.

[22] *See, e.g.*, Letter from Regional Banks to Regulators (Sep. 23, 2019), https://www.politico.com/f/?id=0000016d-d15d-d0d8-af6d-f77d6c5f0001 ("We also note that in addition to those rates, multiple other rates (e.g., CMT (constant maturity treasury rate) . . . are used in lending markets . . . ."). Note that CMT is based on "indicative" rate quotations and not on actual transaction data. *See* U.S. Dep't of the Treasury, *Daily Treasury Yield Curve Rates* (last accessed Feb. 26, 2020), https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.).

[23] *See ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR, supra* n. 1.

[24] *See Frequently Asked Questions, supra* n. 20 ("The ARRC was charged with finding a rate that was more firmly based on *transactions* from a robust underlying market and that would comply with certain standards, including the IOSCO Principles for Financial Benchmarks. . . . The ARRC believes that SOFR is the most appropriate reference rate for wide-spread and long-term adoption as market participants seek to transition from LIBOR because, among other reasons, it: . . . *is fully transaction-based* . . . ." (emphasis added)).

[25] *See* Victoria Guida, *Otting: Agencies will launch dialogue on Libor alternative for loans,* Politico (Jan 22, 2020), https://subscriber.politicopro.com/financial-services/whiteboard/2020/01/otting-agencies-will-launch-dialogue-on-libor-alternative-for-loans-3975896 ("Some banks have warned that tying their loans to the Secured Overnight Financing Rate, the official alternative to dollar-based Libor, could squeeze their bottom line when the U.S. economy inevitably enters a downturn. They've expressed a desire for another option for products like business loans, commercial real estate loans and adjustable-rate mortgages that is more closely tied to their funding costs.").

[26] *See id.*

[27] *See id* ("SOFR 'would not appear to be a logical solution' for loans because the rate might drop in a crisis, even as banks' cost of funds increases, Otting said."); *see also* Hannah Lang, *Fed's Powell open to more than one Libor alternative*, Am. Banker (Feb. 12, 2020), https://www.americanbanker.com/news/feds-powell-open-to-more-than-one-libor-alternative ("Powell

arguments from industry ignore realities of contemporary funding markets and are beside the point with regard to the need for borrower protection. To defend the possibility of SOFR's broad adoption, the ARRC should:

- Underscore that fears related to SOFR's behavior in a stress scenario are unfounded. LIBOR cessation became necessary in part because institutions were no longer funding themselves in the wholesale unsecured market. This implies that, regardless of the relative performance of SOFR and LIBOR during the Financial Crisis, SOFR adoption could not meaningfully expose note holders to additional interest rate risk, as such risk cannot be present if an institution is not borrowing in LIBOR in the first place.

- Note that, even if SOFR adoption were to expose note holders to interest rate risk in a stress scenario, the alternative would be to pass that interest rate risk to borrowers through rate shock in moments of economic and financial crisis. There is no reason to think that an individual consumer would be better equipped than a financial institution to hedge against interest rate risk, nor is there a reason why consumers should be expected to become so.

Finally, in response to Questions 8 and 11 of the Consultation, we offer the following:[28]

- Question 8: We consider using the ISDA methodology of a five-year median of the historical difference between LIBOR and the selected SOFR fallback rate to be an acceptable choice for consumer products.

- Question 11: We would prefer to use the spread adjustment associated with the difference between LIBOR and a compound average of SOFR in arrears if there is less than five years of available data when calculating a spread adjustment for a forward-looking term rate.

In closing, we reiterate that the transition from LIBOR to SOFR is one that borrowers of consumer financial products neither caused nor requested. These borrowers do not engage in wholesale unsecured interbank term lending in London.[29] They do not currently have teams analyzing whether SOFR may expose them to basis risk.[30] And most importantly, they did not

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acknowledged that a number of banks have publicly said that they would prefer using a different rate than SOFR, and that the Fed is supportive of the possibility of creating a different rate. 'A number of banks have come forward and said that they want to work on a separate rate, which would not replace SOFR, but would be credit sensitive, and so they're doing that now and ... we're working with them to support that process,' he said.").

[28] Note that we have chosen not to respond to Question 10, which concerns adjustable-rate mortgages.

[29] *But see* David House and David Skeie, *LIBOR: Origins, Economics, Crisis, Scandal, and Reform*, Fed. Res. Bank of N.Y. Staff Rep. (2014), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr667.pdf.

[30] *But see* Victoria Guida, *Otting: Agencies will launch dialogue on Libor alternative for loans, supra* n. 25.

manipulate LIBOR to boost profits on derivatives trades.[31] Yet, it is exactly these borrowers who may be punished because some of the largest financial institutions in the world did.

Thank you for your consideration of these comments, and for your continued work in the ongoing transition away from LIBOR.

Sincerely,

Student Borrower Protection Center
Americans for Financial Reform Education Fund
National Community Reinvestment Coalition
National Consumer Law Center

CC:
Honorable Joseph Otting, Comptroller of the Currency, U.S. Department of the Treasury
Honorable Kathleen Kraninger, Director, Consumer Financial Protection Bureau
Honorable Jelena McWilliams, Chairwoman, Federal Deposit Insurance Corporation
Honorable Jerome Powell, Chairman, Board of Governors of the Federal Reserve System
Honorable Randal Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System
Honorable John Williams, President and Chief Executive Officer, Federal Reserve Bank of New York
Representative Maxine Waters, Chairwoman, House Financial Services Committee
Representative Patrick McHenry, Ranking Member, House Financial Services Committee
Senator Michael Crapo, Chairman, Senate Committee on Banking, Housing, and Urban Affairs
Senator Sherrod Brown, Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs

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[31] *But see* Republican Staff of the Joint Econ. Comm., *The LIBOR Scandal: What We Know, What We Don't, and What to Expect* (Aug. 2, 2010), https://www.jec.senate.gov/public/_cache/files/5906a359-6ecd-4aba-ba23-ae71706575a6/libor-scandal-final.pdf ("From mid-2005 through 2007, and from time-to-time thereafter through 2009, several of Barclays' swaps traders requested that certain Barclays LIBOR submitters intentionally submit misleading information to Thomson Reuters in order to manipulate the published LIBOR rate for the benefit of specific derivatives trades." (citations omitted)).