STUDENT BORROWER PROTECTION CENTER

NCLC National Consumer Law Center — Fighting Together for Economic Justice

AFR EF Americans for Financial Reform Education Fund

August 4, 2020

Comment Intake—LIBOR
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: Comments in response to the Notice of Proposed Rule Making, Docket No. CFPB-2020-0014, Facilitating LIBOR Transition (Regulation Z)

To Whom It May Concern:

The Student Borrower Protection Center, the National Consumer Law Center, and Americans for Financial Reform Education Fund submit the following comments in response to the LIBOR transition Notice of Proposed Rulemaking (NPRM) published on June 4, 2020.

The undersigned groups commend the Consumer Financial Protection Bureau's (CFPB) efforts to use the rulemaking process to ensure consumers remain protected as the market transitions away from LIBOR. Increased scrutiny of lenders' obligations under the Truth and Lending Act (TILA), as implemented by Regulation Z, is critical given that consumers with LIBOR-based financial products have little if any recourse available should their lender use the LIBOR transition to increase the costs consumers face. Private student loan borrowers in particular are uniquely vulnerable to industry abuse during this transition.

Notably, private student loans lack the consumer protections found with federal student loans.[1] Moreover, as the CFPB itself has repeatedly found, the lenders in this space have a well-documented history of using ambiguous contract terms to exploit vulnerable borrowers,[2] steering private student loan borrowers away from affordable repayment options and into default,[3] and denying student loan borrowers modifications when their loans become unaffordable.[4] The

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[1] *See* Student Borrower Prot. Ctr., *Private Student Lending* (Apr. 2020), https://protectborrowers.org/private-student-lending-report/.

[2] *See, e.g.*, Consumer Fin. Prot. Bureau (CFPB), *CFPB Finds Private Student Loan Borrowers Face "Auto-Default" When Co-Signer Dies or Goes Bankrupt* (Apr. 22, 2014), https://www.consumerfinance.gov/about-us/newsroom/cfpb-finds-private-student-loan-borrowers-face-auto-default-when-co-signer-dies-or-goes-bankrupt/.

[3] *See, e.g.*, CFPB, *CFPB Report Finds Distressed Private Student 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.").

[4] *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.").

transition away from LIBOR presents an immediate risk to private student loan borrowers given the severely lopsided nature of the contractual language underlying most student loan products and industry's dearth of action to prepare for the transition (including, but not limited to, as it pertains to consumer-facing communications and education).[5] In short, it is entirely possible that student loan borrowers will be forced to bear the cost of their creditors' transition from LIBOR and that they will lack any meaningful mechanism to pursue recourse in response.

As we have described elsewhere and as echoed in the Bureau's Notice of Proposed Rulemaking, LIBOR was a benchmark interest rate underlying $800 trillion of financial assets including many variable-rate private student loans.[6] Research indicates that approximately 3.3 million people now owe roughly $80 billion in variable-rate private student loans that reference LIBOR.[7] Since at least 2012, it has been known that LIBOR was being manipulated by some of the largest financial institutions in the world, a scandal that led to criminal liability for some and billions of dollars in fines for others.[8]

As the CFPB continues with the rulemaking process, the undersigned groups offer the following principles to serve as a framework for a final rule governing the transition away from LIBOR.

Principle 1: The CFPB should signal its expectation that industry participants will select SOFR as a replacement index and that failure to do so will invite increased scrutiny of compliance with Regulation Z. The Alternative Reference Rates Committee (ARRC)—a group of private participants, including industry and consumer advocates, convened by the Federal Reserve Board and Federal Reserve Bank of New York—has officially endorsed the Secured Overnight Financing Rate (SOFR), with a pre-determined "spread-adjustment," as the most suitable replacement rate for LIBOR. Many years of research and analysis underpin this

[5] *See* Ben Kaufman, *Are Millions of Student Loan Borrowers About to Pay for Banks' LIBOR Fraud?* (Mar. 6, 2020), https://protectborrowers.org/are-millions-of-student-loan-borrowers-about-to-pay-for-banks-libor-fraud/.

[6] Letter from Student Borrower Protection Center, Americans for Financial Reform Education Fund, National Community Reinvestment Coalition, and the National Consumer Law Center to Thomas G. Wipf, Chair, Alternative Reference Rate Committee (Mar. 6, 2020), *available at* https://protectborrowers.org/wp-content/uploads/2020/03/LIBOR-Spread-Adjustments-Coalition-Letter.pdf; Letter from Student Borrower Protection Center, Americans for Financial Reform Education Fund, and the National Consumer Law Center to Thomas G. Wipf, Chair, Alternative Reference Rate Committee (May 29, 2020), *available at* https://protectborrowers.org/wp-content/uploads/2020/05/Student-loan-fallback-consultation-response-letter.pdf; Facilitating the LIBOR Transition, 85 Fed. Reg. 36936 (proposed June 4, 2020) (to be codified at 12 C.F.R. Part 1026) *available at* https://www.regulations.gov/contentStreamer?documentId=CFPB-2020-0014-0001&contentType=pdf; Kaufman, *supra* note 5.

[7] *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; 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/.

[8] *See, e.g.*, Lucy McNulty, *'I was framed by UBS': Tom Hayes' letters from prison*, Fin. News (June 7, 2018), https://www.fnlondon.com/articles/i-was-framed-by-ubs-tom-hayes-letters-from-prison-20180604; James McBride, *Understanding the Libor Scandal*, Council on Foreign Rel. (Oct. 12, 2016), https://www.cfr.org/backgrounder/understanding-libor-scandal, 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.

endorsement, with the guiding principle of the transition from LIBOR being an effort to minimize value transfer, and thereby minimize costs to consumers. The proposed rule currently states that other replacement indices—including Prime and hypothetical indices with no track record—may also be appropriate. This contemplation of other rates does not appropriately recognize the work of the ARRC to determine that spread-adjusted SOFR as the most suitable and most consumer-friendly replacement rate.

The CFPB should remove all recognition of Prime as an acceptable alternative to LIBOR. Prime tends to run hundreds of basis points higher than LIBOR.[9] Although lenders could attempt to accommodate Prime with a negative adjustment to a loan's margin, we are unaware of examples where this strategy has been used and we fear that making changes to a loan's underlying margin as a method to correct for differences between Prime and LIBOR is too dangerous a path forward for consumer products. Instead, it is likely that the NPRM's repeated mentions of Prime in the context of open-ended credit are an invitation for lenders to increase interest rates on unassuming borrowers in the closed-end credit market, including on student loan borrowers, by adopting Prime and then insufficiently adjusting other aspects of the loan to ensure a minimization of value transfer away from the borrower. As such, illustrative references to Prime should be removed from the NPRM's discussion of open-ended credit.

The CFPB should also limit its recognition of a "newly established" index as an appropriate replacement for LIBOR.[10] Reference rates are a delicate aspect of financial instruments, especially for consumer products, and they should be time-tested before being forced on the public. However, under the NPRM, newly established indices are excluded from the requirement that historical fluctuations match those of LIBOR. Instead, newly established indices need only demonstrate that they are reflective of LIBOR as of a single date: December 31, 2020.[11] Without any historical track record, the appropriateness of a newly established index cannot be determined based only on the fact of it reflecting LIBOR on a single day. Moreover, in the context of a transition stemming from an interest rate manipulation scandal, it is hardly out of line to speculate that such a limited definition of index comparability could invite attempts at

[9] FedPrimeRate, *U.S. Prime Rate v. 1-month LIBOR v. 3-month LIBOR v. The Fed Funds Target Rate* (June 30, 2020), *available at* http://www.fedprimerate.com/usprimerate-vs-libor-vs-fedfundstargetrate-chart.htm.

[10] *See, e.g.*, Facilitating the LIBOR Transition, *supra* note 6 at 36938 ("The Bureau is proposing to determine that the prime rate published in the Wall Street Journal (Prime) has historical fluctuations substantially similar to those of certain U.S. Dollar (USD) LIBOR indices."), 36948 ("Proposed § 1026.40(f)(3)(ii)(A) provides that if the replacement index is newly established and therefore does not have any rate history, it may be used if it and the replacement margin will produce an APR substantially similar to the rate in effect when the original index became unavailable. The Bureau solicits comment on whether the Bureau should provide any additional guidance on, or regulatory changes addressing, when an index is newly established with respect to replacing the LIBOR indices for purposes of proposed § 1026.40(f)(3)(ii)(A).").

[11] *Id.* at 36948 ("Proposed § 1026.40(f)(3)(ii)(B) also provides that if the replacement index is newly established and therefore does not have any rate history, it may be used if the replacement index value in effect on December 31, 2020, and replacement margin will produce an APR substantially similar to the rate calculated using the LIBOR index value in effect on December 31, 2020, and the margin that applied to the variable rate immediately prior to the replacement of the LIBOR index used under the plan."), 36988 ("For purposes of replacing a LIBOR index used under a plan, a replacement index that is not newly established must have historical fluctuations that are substantially similar to those of the LIBOR index used under the plan. . . .").

gamesmanship by industry. We strongly disagree that a newly established index could be an appropriate substitute for LIBOR for legacy student loans.

The ARRC and its organizing members, including the Federal Reserve Board and the Federal Reserve Bank of New York, have demonstrated time and time again that spread-adjusted SOFR is the most appropriate replacement rate for LIBOR.[12] The NPRM should remove references to Prime and to newly established indices in favor of references to spread-adjusted SOFR.

Principle 2: Consumers should be informed at each critical stage of the transition. Federal student loans authorized under the HEA are excluded from TILA's disclosure requirements.[13] However, billions of dollars in private student loans are subject to TILA. These loans are regulated under Regulation Z's sections on closed-end credit (§§ 1026.17 - 1026.24) as well as additional subsections for higher education loans.[14] The NPRM specifically recommends modifications to § 1026.20, which discusses when disclosures are required because of changes to a loan after it has been issued. The NPRM suggests changes that would not require disclosure if a lender made a transition from LIBOR to SOFR.

We agree that as long as there is *no reasonable expectation of value transfer based on predetermined, objective criteria* when choosing an alternative reference rate, including by transitioning to spread-adjusted SOFR, such a change should not trigger a refinancing disclosure required by TILA. However, we continue to believe consumers should be entitled to information about the transition, including early notification of their lender's chosen replacement rate. We believe disclosure is critical to a fair and equitable transition away from LIBOR, and as such, the final rule should not provide carve-outs that limit opportunities for disclosure. Instead, the CFPB should require that lenders and servicers make information about the transition, including the new replacement rate, readily available to existing and prospective customers, even when their debts transition to spread-adjusted SOFR.

Similarly, while all market participants should have long ago ceased lending in LIBOR, it should be expected that institutions that continue lending in LIBOR ahead of the rate's cessation will add unambiguous language to their loan contracts clearly articulating the index that any LIBOR-based loan will fall back to upon LIBOR's cessation and any associated changes that will be made to the loan's margin at that time. In particular, lenders that do not adopt the ARRC's recommendations for fallback language,[15] which include a pre-specified "waterfall" for

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[12] Fed. Res. Bank of N.Y., *Interim Report and Consultation of the Alternative Reference Rates Committee* (May 2016), *available at* https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2016/arrc-interim-report-and-consultation.pdf; *see also* Joshua Frost, *Introducing the Secured Overnight Financing Rate (SOFR)*, Fed. Reserve Bank of N.Y. (Nov. 2, 2017), *available at* https://www.newyorkfed.org/medialibrary/media/newsevents/speeches/2017/Frostpresentation.pdf; David Bowman, Chiara Scotti & Cindy M. Vojtech, *How Correlated is LIBOR with Bank Funding Costs* (June 29, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/how-correlated-is-libor-with-bank-funding-costs-20200629.htm.

[13] 15 U.S.C. § 1603(7).

[14] Subpart F - Special Rules for Private Education Loans (§§ 1026.46 - 1026.48).

[15] *See* Fallback Contract Language, Alt. Ref. Rates Comm., Fed. Res. Bank of N.Y., *available at* https://www.newyorkfed.org/arrc/fallbacks-contract-language (last accessed Aug. 4, 2020).

replacement rates with spread-adjusted SOFR as its first step, should be subjected to heightened scrutiny from the Bureau.

Borrowers already have very little say in the outcome of the transition away from LIBOR. Particularly given that the transition is slated to occur during an economic recession with unprecedented unemployment, most borrowers will have few if any options for refinancing or early pay-off. Informing borrowers of the transition and the steps that have been taken to ensure the minimization of value transfer is a basic dignity that should be afforded to American consumers. We believe requiring lenders to inform borrowers of the change in the reference index rate on their loan, regardless of whether such change triggers a refinancing, fits squarely within the scope of this rulemaking exercise.

Principle 3: The CFPB should use all available authorities to ensure the timely transition away from LIBOR. As the CFPB proceeds through the rulemaking process, it is imperative to recognize that the transition away from LIBOR can no longer be ignored or denied. LIBOR is slated to sunset at the end of December 2021, a schedule that has been repeatedly reaffirmed even in the face of the disruptions stemming from COVID-19.[16] State regulators have asked for transition plans from consumer lenders.[17] Fannie Mae and Freddie Mac have already signaled plans to stop buying LIBOR-based mortgages.[18] And yet, private student lenders responsible for billions of dollars in loans still have not taken the necessary steps to make a timely and orderly transition away from LIBOR.[19]

The CFPB's proposed rule notes that several stakeholders have called on the Bureau to eventually make a determination as to when LIBOR is no longer representative and is therefore unavailable. However, the Bureau has declined to make this determination, citing several reasons, including the risk of "put[ting] pressure on those creditors to replace the LIBOR index used for those products before those creditors are ready for the change." In effect, the Bureau has acknowledged that industry has failed to take the necessary steps to ensure and a timely and orderly transition.

As the chief federal regulator for the consumer financial market, the CFPB has a responsibility to ensure industry is taking the necessary steps to transition without risk to consumers. Beyond rulemaking, the CFPB should use all of its authorities, including supervision and market monitoring, to engage with industry and ensure each market participant is taking the necessary steps to complete an on-time transition, without harm to consumers.

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[16] *See* John C. Williams, *537 Days: Time is Still Ticking*, Speech, Fed. Res. Bank of N.Y. (July 13, 2020), *available at* https://www.newyorkfed.org/newsevents/speeches/2020/wil200713.

[17] *See Financial Services Superintendent Linda A. Lacewell Announces Action to Ensure Regulated Financial Institutions Are Prepared for LIBOR Transition*, Press Release, N.Y. Dep't of Fin. Serv. (Dec. 23, 2019), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1912231.

[18] *See Fannie, Freddie to eventually end buying of LIBOR mortgages: FHFA's Calabria*, Reuters (July 17, 2019), https://www.reuters.com/article/us-fannie-freddie-reform-libor/fannie-freddie-to-eventually-end-buying-of-libor-mortgages-fhfas-calabria-idUSKCN1UC2PO.

[19] *See* Alt. Ref. Rates Comm., *Webinar: Approaching the Transition* (Aug. 3, 2020).

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In sum, we ask the Bureau to consider the impacts of this NPRM on borrowers and particularly student loan borrowers. The Bureau should better recognize the work that has already gone into addressing this thorny problem as part of the ARRC's deliberations and strive to create a uniform and clear transition program away from LIBOR that works as well for student loan borrowers as it does for credit card holders and mortgage holders.

We thank you for your time and consideration of this response.

Sincerely,

Student Borrower Protection Center

National Consumer Law Center

Americans for Financial Reform Education Fund