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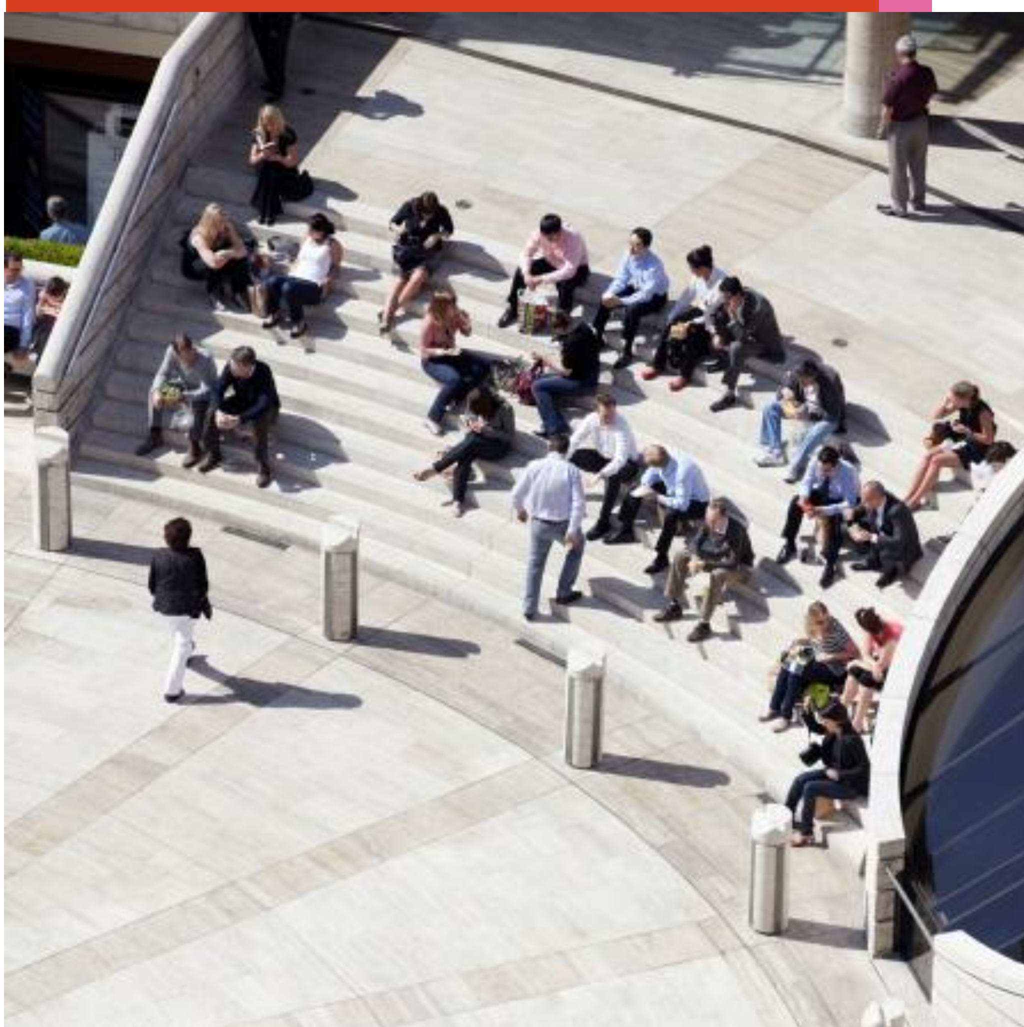
Private Student Lending Complaints

The challenges and opportunities highlighted in the Consumer Financial Protection Bureau's annual report into private student lending complaints

January 2013



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Executive summary

On October 16, 2012 the Consumer Finance Protection Bureau (CFPB) released its first CFPB Student Loan Ombudsman's Annual Report, which summarized and reported on approximately 2,900 complaints received between March 2012 and September 2012. Issues raised by borrowers suggest a number of perceived and actual shortcomings in the practices of the Private Student Lending (PSL) industry.

In particular, the report[1] focuses on six key themes, including:

1. Responsible borrowers are stymied
2. Servicing surprises
3. Frustration faced by struggling borrowers
4. Challenges faced by military families
5. Issues with for-profit college affiliated loans
6. Overall confusion between private and federal student loans

One of the most telling aspects of the report is the similarities to the complaints brought forth by consumers in the mortgage industry, specifically including claims of inappropriate application of payments, timeliness in error resolution and inability to contact appropriate personnel when facing economic hardship.

The Ombudsman's report goes on to make the following three recommendations:

- Identify opportunities to promote the availability of loan modification and refinance options for student loan borrowers;
- Continue initiatives to increase adoption of the Income-Based Repayment program for federal student loans; and
- Assess whether efforts to correct problems in mortgage servicing could be applied to improve the quality of student loan servicing.

While the report stops short of stating that there is a lack of customer centricity in the PSL industry, it does clearly articulate concerns regarding customer choice and a lack of investment in servicing processes that ultimately increase the risk of harm to consumers.

As a result of this report, industry participants and borrowers have an opportunity to improve the overall student lending relationship. The more progressive industry participants will respond proactively to these issues, and seek to remediate problem areas. Where issues result from factors beyond an industry participant's direct control, they should focus on understanding the factors and use the resulting intelligence to minimize the impact on their organizations. Improving borrower communications and developing information resources will be particularly important in achieving this.

[1] The CFPB Student Loan Ombudsman's Annual Report, October 16, 2012

Through proactive measures like these, industry participants will be able to demonstrate that a customer focus is central to their business strategy. More specifically, PSL industry participants should consider including the following "forward-leaning" actions as part of their plan for future success:

- Rethink how complaints are handled to develop a competitive advantage;
- Building the "Voice of the Customer" into future operations;
- Driving quality in servicing operations;
- Using vendor management programs to drive quality and compliance; and
- Assessing the complexity of your product portfolio and associated product development processes.

Borrowers and their families also have a responsibility to be better informed and educate themselves on the mechanics of borrowing, the terms and conditions of each loan and what to expect when the loan enters repayment. In addition, they should consider using the improved information provided by lenders should they be unable to meet their repayment obligations once they have entered repayment.

Industry participants should be prepared for more regulation that could fundamentally change how they operate in the future. Since the publication of the report the CFPB has also released exam procedures[2] for student loans that focus particularly, but not exclusively, on many of the issues highlighted in the report. These procedures are targeted primarily at preventing borrower harm and indicate that the CFPB will be monitoring specifically how industry participants handle enquiries and complaints, provide borrowers with accurate account information, make appropriate disclosures and use accurate/non-discriminatory advertising or marketing. Acting now rather than delaying will mean that proactive organizations are likely to be better positioned to both capitalize on the strategic opportunities of this growing market and be prepared for future CFPB examinations.

While future rules and enforcement actions are unknown at this time, the long term impact of the CFPB is likely to drive the need for business and operating models that are both customer-centric and flexible in the face of continued change.

[2] CFPB Education Loan Examination Procedures – December 2012

Introduction

Since the CFPB published its report on the perceived shortcomings in the practices of PSL industry participants in mid-July 2012, it has continued its research and investigative activities. As a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act[3], an ombudsman for student loans was established as a part of the CFPB to assist borrowers with PSL industry complaints. On October 16, 2012 the CFPB released its first CFPB Student Loan Ombudsman's Annual Report, which summarized and reported on approximately 2,900 complaints received from March 2012 through September 2012, the peak loan processing season. This report has raised many questions and has served as a call-to-action for many student lending industry participants.

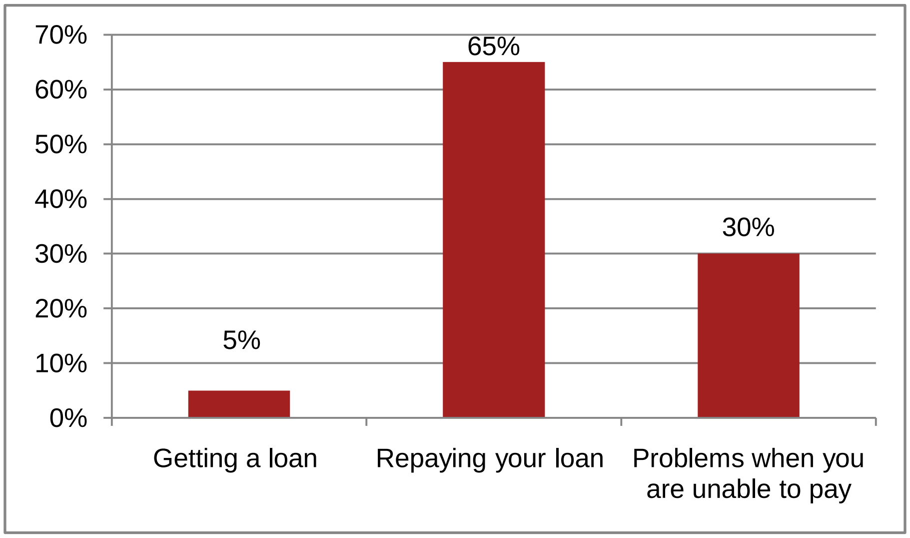
The purpose of this point of view document is to provide an overview of the CFPB report's findings and potential implications for industry participants. In addition, we discuss the potential challenges and opportunities for lenders and other industry participants.

It should be noted that while the report identifies potential consumer protection and procedural shortcomings within the PSL industry, it does not address borrower responsibility in this area. As lenders increase resources and information, it should also be acknowledged that consumers should consider taking advantage of these enhancements when making personal financial decisions.

[3]Dodd-Frank. Wall Street Reform and Consumer Protection Act, July 21, 2010

The report highlights that the majority of borrower complaints relate to getting a loan[4], repaying a loan[5] or problems encountered when borrowers are unable to pay-off their loan[6]. An analysis of complaints by issue type is shown in Figure 1 below. Loan repayment issues accounted for the majority of the complaints.

Figure 1 – Private Student Loan Complaints by Issue Type[7]



The report goes on to suggest a number of perceived shortcomings in the practices of the PSL industry that it sees as underpinning the issues raised by borrowers within their complaints. In particular, it focuses on six key themes summarized in the remainder of this section.

The information in the report helps illustrate where there are areas for improvement available to lenders and other industry participants. It specifically helps identify a number of areas where there is a potential mismatch between borrower expectation and service delivery. PSL industry participants should consider the extent to which there is evidence of these six themes within their own operations.

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[4] Getting a loan issues include confusing terms, rate, denial, confusing advertising or marketing, sales tactics or pressure, financial aid services, recruiting.
[5] Repaying your loan issues include fees, billing, deferment, forbearance, fraud and credit reporting.
[6] Problems when customers are unable to pay include default, debt collection and bankruptcy.
[7] Source: Annual Report of the CFPB Student Loan Ombudsman.

1. Responsible borrowers stymied

The report suggests that even when borrowers behave in a responsible manner, they face challenges in terms of getting the appropriate solutions. These issues are highlighted in four areas:

- ***Inability to speak with personnel empowered to negotiate a payment plan***: Many borrowers report frustration that they are unable to identify appropriate personnel that can make a determination about their repayment options, particularly during financial hardship.

- ***Inability to refinance:*** Often borrowers are stuck with high interest rates due to the fact that they have very little credit history when applying for a student loan which reflects the potential higher risk they pose to lenders. However, this does not necessarily hold true once borrowers graduate and establish themselves with a career and further credit history. In contrast to the mortgage industry, the report indicates that many borrowers are frustrated by their inability to take advantage of historically low interest rates.

- ***Inability to access repayment plans previously advertised:*** Some borrowers indicate that enrolling in a new re-payment arrangement is a difficult process and one that is hampered by servicing personnel who are not fully aware of all the alternative plans available.

- ***"Good faith" partial payments leading to default:*** Some borrowers express frustration that servicer personnel encourage them to pay what they can afford without informing them that they will still be on a path towards default.

2. Servicing surprises

Some borrowers communicated to the CFPB that after they leave school that they have difficulty determining how much they owe. Borrowers report they often don't receive or remember information about their loans, and may be caught off guard by unexpected terms and costs. As a result, one of the themes highlighted in the report is the prevalence of "servicing surprises". The following issues are highlighted:

- ***Unknown or misunderstood terms and conditions:*** Borrowers complain of not being fully informed of the conditions of their loans. Some say they were never advised of the difference between a federal and private student loan.

- ***Accounts changing hands:*** Some student loan borrowers find that their loans have been sold or their servicer has changed. Borrowers report that sometimes servicers can't even answer who owns their loan.

- ***Unauthorized payments:*** Borrowers report that in some circumstances, where they have other accounts with the same organization, the lender might automatically deduct funds from the borrower's checking account, sometimes also charging an overdraft fee if the account is overdrawn.

- ***Handling of payments:*** Some borrowers were concerned about how payments were applied to their account. Some expressed frustration that they were unable to reach the appropriate staff member to correct a payment that was applied incorrectly.

- ***Payments credited late or unevenly***: According to borrowers, some servicers may take several days to process payments and pay interest on the outstanding principal during that time. Payments may also be applied to an account well after the funds are debited from a borrower's bank account.

- ***Faulty record-keeping:*** Borrowers report that paperwork may get lost and errors aren't always fixed quickly. Some borrowers complain about limited access to their account information, including their payment history and understanding how their payments have been applied to interest and principal.

3. Frustration faced by struggling borrowers

The third theme highlighted within the report relates to issues faced by struggling borrowers. In particular, the report indicates the following areas of concern for struggling borrowers:

- ***Debt collection practices***: Many lenders engage debt collection companies to help once a borrower has gone into default. Borrowers have expressed frustration that debt collection companies take advantage of their confusion with harsh tactics like threatening to garnish wages without a court order, seizing Social Security checks and offsetting tax refunds. Borrowers have also complained that debt collection companies have repeatedly called outside of time periods allowed by laws.

- ***Death of primary borrower:*** Some borrowers describe that the process for handling a loan when the primary borrower dies is not always clear. Co-signers complain that information about discharge or alternative arrangements in the case of death of the primary borrower is not readily available.

- ***Disability issues:*** In contrast to federal student loans, some borrowers who have become totally and permanently disabled after starting repayment may be unable to have their private student loans forgiven.

- ***Accuracy of credit report:*** Borrowers complain that there is a lag or lack of resolution to an inaccurate credit report filed by the servicer or debt collector.

- ***Unexpected forbearance fees:*** Borrowers state that some lenders charge fees for forbearance even though borrowers requesting forbearance typically cannot afford to make their payments.

4. Challenges faced by military families

Many of the complaints reported by service members are related to obstacles and challenges in obtaining access to the benefits they are entitled to as part of the Service Members Civil Relief Act (SCRA). In particular, issues are highlighted in relation to the rate cap afforded to active duty service members as part of this act. Specifically, obstacles related to accessing the rate cap, errors when processing the rate cap, difficulties in determining if the rate cap was retroactively credited and barriers to retaining the rate cap when on active duty for longer periods of time.

Borrowers attribute this to a combination of unclear instructions, paperwork getting lost and receiving conflicting information about their loan.

5. For-profit college affiliated loans

Particular issues related to for-profit college affiliated loans are also highlighted. Some consumers described how school representatives provided information on loan programs in order for the borrower to quickly obtain financing for enrolment. Some borrowers report that they have been subsequently unable to find adequate employment in order to service the debt offered by parties affiliated with the school, despite assurances to the contrary.

6. Overall confusion between private and federal student loans

Some borrowers note directly that they were never advised on the difference between a federal and private student loan. This issue has apparently arisen for borrowers at both origination and repayment stages of their loans. Many PSL borrowers ask for a form of Income-Based Repayment, a program only available for federal student loans.

While lenders do provide the terms of agreement in promissory notes, including associated benefits and protections, many borrowers state they were unaware of these important differences between federal and private protections.

Parallels to mortgage industry

The report also makes some comparisons with complaints brought forth by consumers in the mortgage industry. This includes similar claims of inappropriate application of payments, timeliness of error resolution and the borrower's inability to contact appropriate personnel when facing economic hardship. Although the report does not make direct mention of it, there are also similarities with the recently published CFPB report on credit card complaints.

The CFPB began accepting credit card complaints in July 2011 and has since issued three major enforcement actions[8] totalling $425M in restitution to consumers and $56.5M in Civil Money Penalties (CMP). In January 2012, the CFPB began collecting complaints within the mortgage industry. Since this time, there have been multiple examinations covering originations, servicing and fair lending. While the exam findings are still in the process of being reported, more rules have been proposed or enacted requiring stricter standards and compliance across the mortgage industry, including but not limited to:

- Servicing standards;
- Consideration and support for military and their families; and
- Loan originator compensation.

The CFPB has also announced that they will set standards in the student lending industry in a similar manner to SCRA in the mortgage industry[9]. Holly Petraeus, the Assistant Director of Service Member Affairs at the CFPB, points out that service members are entering the military with, and sometimes because of, student loan debt and as a result, are facing both financial and paperwork challenges. She also highlights that service members are not always getting the information they need from their loan servicers about programs and policies that could help them reduce that debt significantly while they are on active duty.

In response to this, the CFPB has developed a "Guide for Servicemembers with Student Loans" with information on repayment options, as well as an FAQ section for military student loan borrowers.

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[8] Financial Report of the Consumer Financial Protection Bureau, Fiscal Year 2012

[9] Source: CFPB – The next front? Student loan servicing and the cost to our men and women in uniform, October 18, 2012.

The publication of this guide as well as the recently released exam procedures for student loans are examples of how the CFPB is focused on ensuring that consumers receive the right information and are treated fairly, particularly service members and their families. They are going to continue to look deeper into student lending, as they have done in other asset classes. If they establish through specific examinations that there are indeed deficiencies, they will use this evidence to shape future compliance requirements and enforcement activities.

In the following section, we provide commentary on the three recommendations that conclude the report and put forward some potential areas of future action that industry participants should consider based on the identified shortcomings.

Opportunities for improvement

There are three recommendations made by the Ombudsman within the report. These are:

- Identify opportunities to promote the availability of loan modification and refinance options for student loan borrowers;

- Continue initiatives to increase adoption of the Income-Based Repayment program for federal student loans; and

- Assess whether efforts to correct problems in mortgage servicing could be applied to improve the quality of student loan servicing.

It should be noted that while recommendations are made, it is not possible at this time to predict exactly how these recommendations will translate into enforcement actions, rules, proposals or regulations to change student lending standards. With that said, parallels can be drawn with other lending classes where we have seen significant new rules issued, even more proposed and enforcement actions sanctioned. In fact, since the publication of the report, the CFPB has released exam procedures for student loans that focus particularly, but not exclusively, on many of the issues highlighted in the report. These procedures are targeted primarily at preventing borrower harm and indicate that the CFPB will be monitoring specifically how industry participants handle enquiries and complaints, provide borrowers with accurate account information, make appropriate disclosures and use accurate/non-discriminatory advertising or marketing.

The report suggests that PSL borrowers who are behind on their payments don't have as many loss mitigation options as they would if borrowing from Federal programs. The view expressed is that PSL programs should consider emulating their Federal counterparts that offer flexibility by providing loss mitigation alternatives to distressed borrowers.

While some private lenders allow short-term forbearance periods, the report indicated that they don't generally provide the debt management mitigation options provided by Federal programs. They also don't provide income-contingent repayment options and there is no indication that such options are being considered by private lenders.

While the July 2012 report[10] on the PSL industry noted that some lenders expressed interest in developing "rehabilitation" programs that "would satisfy accounting rules and prudential regulators", new approaches to loss mitigation would have to be consistent with investor goals and approvals.

[10] CFPB Report on Private Student Lending July 19, 2012

To address the first two recommendations, PSL industry participants should monitor discussions between Congress, the CFPB, and the Department of Education to ensure they are in a position to respond positively to new rules and enforcement activities related to relief programs including deferment, Income-Based Repayment options and defaulted loan rehabilitation. At the same time, PSL industry participants should consider what role these types of relief programs could serve in a more progressive loss mitigation and default management strategy.

The third recommendation within the report, assessing whether efforts to correct problems in mortgage servicing could be applied to improve the quality of student loan servicing, is perhaps the most challenging.

While the report stops short of stating that there is a lack of customer centricity in the PSL industry, it implies concern around customer choice and inadequate investment in processes related to servicing practices that have the potential to cause harm to consumers. There are potentially significant areas of opportunity available to PSL industry participants looking to respond positively to the report's underlying message of poor quality servicing and lack of customer centricity.

Based on our experience within the student lending industry and across other asset classes, we suggest PSL industry participants may want to consider actions beyond the formal recommendations made within the report. These actions should address root causes of the issues implied in the report's findings with a clear focus on issues that they can control.

In this section, we will discuss specific actions that forward thinking student lending organizations should consider in response to the report. Regardless of government and regulator action in the future, the following five actions are likely to be beneficial to success:

1. Rethink how complaints are handled to develop a competitive advantage;

2. Build the "Voice of the Customer" into future operations;

3. Drive quality in servicing operations;

4. Use vendor management programs to drive quality and compliance; and

5. Assess the complexity of your product portfolio and associated product development processes.

1. Rethink how complaints are handled to develop a competitive advantage

Since the outset of its involvement in the student lending sector, the CFPB has been clear that one of its top priorities is to monitor the customer complaints handling process. This is reflected in the recently released CFPB procedures for student loan examinations that include specific procedures related to lender and servicer abilities to receive and process customer complaints.

One of the main parts of the CFPB Supervision and Examination Manual focuses on common elements of an effective consumer compliance management system. Consumer complaint response is one of those elements and private student lending industry participants need to ensure that their policies and procedures are in line with the objectives stated in the manual[11]:

- Record and categorize consumer complaints and inquiries, regardless of where submitted;
- Promptly address and resolve complaints and inquiries, whether regarding the entity or its third-party service providers;
- Appropriately escalate complaints that raise legal issues involving potential consumer harm from unfair treatment or discrimination, or other regulatory compliance issues;
- Make adjustments to business practices, as appropriate, based on complaint data and individual cases;
- Perform retrospective corrective action as a result of consumer complaints to correct the effects of the supervised entity's actions, when appropriate; and
- Identify where weaknesses in the compliance management system exist, based on the nature or number of substantive complaints from consumers.

Additionally, the CFPB Supervision and Examination Manual highlights the role of complaints in identifying unfair, deceptive, or abusive acts or practices (UDAAPs)[12]. In fact, the CFPB indicates that even a single substantive complaint may raise serious concerns that would warrant further review.

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[11] Consumer Financial Protection Bureau Supervision and Examination Manual, CMR 10, October 2011.
[12] http://www.consumerfinance.gov/guidance/supervision/manual/udaap-narrative.

Complaints have historically been viewed as bad news, costly, and inconvenient. However, if used in the right way, complaint handling can provide an avenue for competitive differentiation. Customers who speak up when they have a complaint provide companies the opportunity to apologize, turn possible vigilantes into advocates and transform a complaint into a customer success story.

Organizations that are looking to achieve a differentiated customer experience through effective complaint handling should consider incorporating some of the leading practices into their approach to complaints handling as described in Figure 2.

Figure 2 – Complaints handling leading practices

Leading practices	***Build a solid foundation of resources for student lending complaint resolution***	***Develop a new complaint-handling culture in the organization***	***Seize opportunities presented by customer complaints***	***Transform customer vigilantes into company advocates***	***Be empathetic to unhappy customers***	***Anticipate and prepare for new regulatory pressures***
	Educate employees on complaint handling procedures and escalation procedures	Make known the company's willingness to hear grievances	Document all customer complaints	Identify dissatisfied customers through a variety of monitoring methods	Identify the most likely or common complaint issues	Adopt a single team approach to increase transparency and accountability
	Establish a policy to satisfy unhappy customers quickly	Promote the favorable acceptance of complaints companywide	Leverage feedback from multiple points of contact to identify dissatisfaction issues	Contact disgruntled customers and resolve their complaints	Familiarize employees with factors that lead customers to complain	Develop a common workflow tool for all complaints across the organization
			Action steps			
	Create a feedback loop for complaint follow-up	Remove obstacles that prevent customers from complaining	Transform customer complaints into process improvements	Prioritize the resolution of public complaints from extremely distressed customers	Prevent customer defection with action-backed apologies	Create a single companywide resource for complaint policies and procedures
	Anticipate complaints	Thank customers for complaining	Turn information gleaned from complaints into product development insight	Examine the reasons customers become vigilantes	Know when "sorry" is not enough	Periodically determine that policies and procedures reflect current operations

It is likely that the CFPB will focus on investigating the themes identified within the complaints gathered to date as part of their future examinations, so PSL industry participants should consider carefully the extent to which they are applicable to their organization and put in place clear plans for their mitigation in the future accordingly.

Participants should focus specifically on areas of “controllable complaints” i.e., areas where the root cause of complaints are caused by actions undertaken by the organization and can be directly fixed. It is in these areas that impacts can be biggest and most rapid as there is an opportunity to stop these complaints from happening in the first place.

“Uncontrollable complaints” are also important, but need to be handled differently. These are caused by external environmental factors that are currently prevalent in the student lending market e.g., high rates of unemployment, increased tuition costs and lower perceived levels of return on investment from secondary education. Industry participants should closely monitor the trends in key external factors likely to lead to rising levels of uncontrollable complaints and use the intelligence gathered to shape their complaint response processes. Mitigating actions can also be designed where at risk customers or customer groups are indentified. Close monitoring of social media can play an important role in early identification of risk areas in this respect. In addition, proactively communicating with borrowers and providing information resources will also go a long way to closing the understanding gap.

By putting in place these leading practices now, lenders can establish the approach necessary to rectify the root causes of complaints before they become issues. Not only will this provide clear business benefit it will also minimize the scrutiny they might otherwise come under as part of future CFPB examinations.

2. Build the “Voice of the Customer” into future operations

Companies that deliver a better customer experience during this time of scrutiny and change may position themselves to capitalize on strategic opportunities within the market. This report highlights the disconnect between borrower expectations and what lenders are delivering.

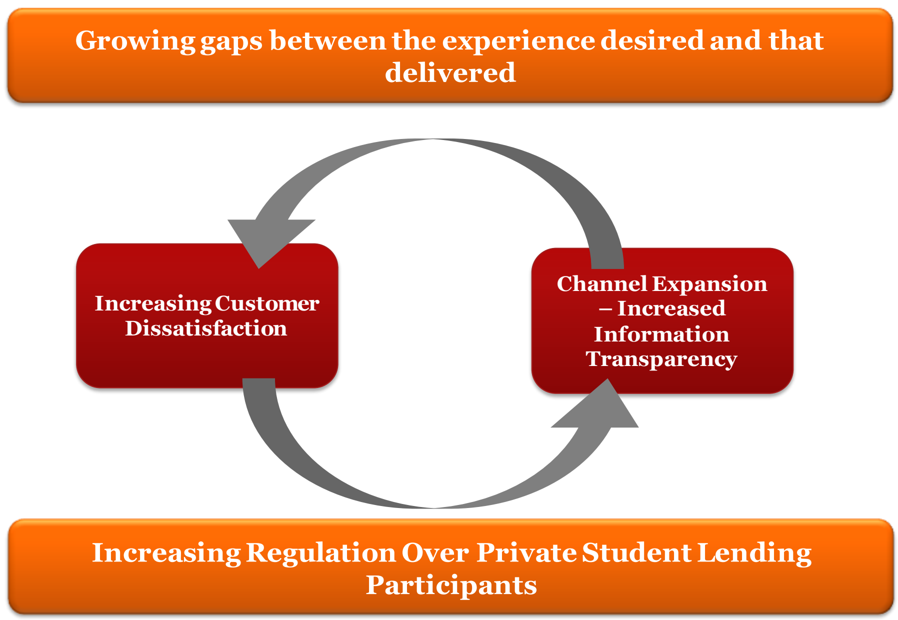
Overall sentiment towards financial institutions is extremely low, with approximately 80% of consumers having negative sentiment towards their financial institution, with this sentiment not expected to change[13]. In addition to this, social media channels continue to emerge providing a louder collective customer voice and decreasing the dissemination time of feedback to mere seconds.

[13] PwC Viewpoint. “Love Them or Lose Them: Why Becoming a “Top Provider” is an All or Nothing Game With Your Top Clients”

Developing a proactive approach to customer complaints is an important first step in responding positively to these challenges but this in itself does not go far enough. Lenders should consider differentiating themselves through the development of a "Voice of the Customer" (VOC) program, focused on identifying potential gaps between their performance and customer expectations, as quickly as possible.

Key to this will be to understand the reinforcing loop emerging between customer dissatisfaction and the expansion of channels available for feedback in the student lending space illustrated in Figure 3.

Figure 3 – The challenge of channel expansion and increased customer dissatisfaction[14]



In practice, PSL industry participants should consider how to design, implement and execute a VOC program. In Figure 4, we have highlighted the key elements for consideration, as well as questions for consideration in relation to each element.

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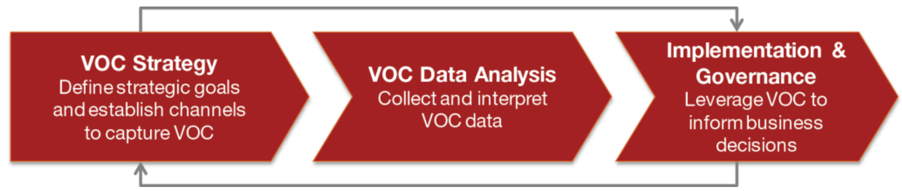
[14] PwC – Listening to the Voice of the Customer in Retail Banking, August 2012

Figure 4 – A framework for "Voice of the Customer"[14]



- What are the channels that your customers prefer to use? Are all of these channels available and monitored closely?
- How to monitor VOC across multiple sources to gain actionable insights?
- What best-in-class methodologies can be applied?

- How to organize the data in a format that will help derive best insights?
- What is the appropriate analysis method to interpret feedback?
- What are the customer pain points uncovered?

- How to incorporate VOC into strategic decisions, such as product development, retention and targeting?
- How to align the organization behind success metrics?

PSL industry participants already have access to much of the information that can be used to build a 360^{o} view of the customer from contact centers, surveys, complaints, third party industry reports, user forums and publicly available databases.

By creating this type of program, focused on listening to outputs and using simple analytical techniques, PSL industry participants can drive value by:

- Increasing customer satisfaction, increasing repeat borrowing, reducing churn and acquisition costs; and

- Managing regulatory issues by monitoring leading indicators of risk and compliance issues.

Leading companies in other industries have already demonstrated how it is possible to build profitable business models by significantly exceeding customers' expectations. It is time for the student lending industry to embrace a similar approach.

3. Drive quality in servicing operations

The report indicates that 65% of borrowers that submitted complaints had issues when it came to repaying their loans and 30% had problems finding solutions when they were unable to pay. As such, the majority of complaints are related to default and loan servicing.

This, combined with what is likely to be an environment of continued regulatory/compliance scrutiny and ever increasing customer expectations, makes it essential that lenders put a significant focus on driving loan servicing quality in the future. The elimination of processing issues and the minimization of product complexity will be particularly important.

In the future, lenders may find that the existence of a Quality Assurance (QA) function alone will not be sufficient. Regulators may want to see evidence of quality assurance processes in which identified servicing defects are not only reported, but are also used as the basis of process improvement in the future.

The role of the QA function may be under greater scrutiny than in the past. From what we've experienced across asset classes, there are a number of common challenges that lenders should consider addressing to improve overall servicing quality and QA performance. These include:

- ***Challenge 1*** – Underlying policies and procedures are not focused on "doing it right first time" and are designed with basic controls to speed up servicing processing rather than controls required to prioritize accuracy.

- ***Challenge 2*** – QA metrics often contain a significant time lag that prevents timely remediation and perpetuates a reactive rather than a preventative cycle.

- ***Challenge 3*** – Metrics and reporting from interrelated quality functions are not linked or aligned to specific processes making underlying control issues and the identification of systemic processing issues difficult.

- ***Challenge 4*** – Where good reporting on quality exists, there is often no clear accountability and response procedures to address the defect trends displayed.

- ***Challenge 5*** – An embedded culture of "getting it mostly right" within the business results in the QA function being seen as a built-in "safety net" to catch defects. Because the "safety net" doesn't always work, it becomes practically impossible to be sure that quality is consistently delivered.

The combined impact of these weaknesses can result in a reactive culture in which defects are addressed on an ad hoc basis with little consideration to the underlying weaknesses in processes, controls, systems or staffing. To move away from this reactive culture with limited ability to manage end-to-end servicing quality, lenders should consider aligning their approach to servicing quality around the following characteristics.

- **Thorough documentation of processes and controls,** including related inputs and outputs, systems, and performance measures. This provides a reference for employees to address day-to-day queries, a basis for developing training and accountability where defects are discovered and the "correct" documented procedures have not been followed.

- **Clearly defined roles, responsibilities, and escalation procedures** within the governance framework. This provides clear visibility around who is responsible for identifying, reporting and remediating defects, as well as who is responsible for preventing/rectifying negative customer impacts if particular defects are discovered.

- **An active governance process** that oversees activities and requires cross-functional communication. This is particularly important where organizational structures mean that departments responsible for servicing quality don't report through to one executive.

- **Training programs** to keep employees informed about changing regulatory requirements and customer expectations.

- **Standardized quality control processes** regardless of department or student lending products – this should include testing programs that are embedded within servicing operations and are focused on specific areas of risk.

- **Reporting and tracking of key metrics** such as overall defect and defective rates, criticality of defects, department responsible, individual responsible and other regulator-specific metrics. Although there is often an unavoidable delay in the production of such metrics, particularly where external providers are used, the timeliness of the metrics will support servicing's ability to drive the rectification of root causes.

By focusing on the development of these characteristics, a culture that focuses on getting things right the first time can be developed. It will also help focus on "closing the loop" on recurring defects by tracing them to their root cause and identifying the relevant control(s) that needs to be improved, the system(s) that needs to be fixed or the individual(s) responsible. In some cases, organizations are taking this a step further by linking employee compensation to both individual and overall defect rates, which acts as an incentive for a culture of quality in servicing practices.

4. Use your vendor management program to drive quality and compliance

Many lenders outsource some portion of servicing functions to third party vendors. As a result, they are exposed to the risks created by the actions of their vendors. The CFPB report included discussion on consumer complaints stemming from interactions between borrowers and third party debt collectors. As made very clear in other asset classes, the CFPB views these vendors as an extension of the servicers and will hold lenders accountable for their vendors' actions.

Going forward, student loan servicers must demonstrate rigorous risk management of their vendors to limit the potential for statutory or regulatory violations and consumer harm caused by vendors. While many organizations have established vendor management programs, an assessment should be performed to evaluate the effectiveness of the program in certain areas including, but not limited to, the following:

- Product/services risk assessment;
- Vendor due diligence;
- Contracting; and
- Ongoing oversight of vendor performance.

Special focus should be placed on monitoring and testing of vendor compliance with applicable laws and regulations and reviewing customer complaints regarding vendor services for patterns of service issues. A review of compensation and incentive structures within the vendor should also be performed to ensure vendors are not incented solely on processing volume.

Quality of service and compliance with laws and regulations should be appropriately factored into the compensation structure. Furthermore, a robust governance process should be in place to oversee the performance of the vendor risk management program to ensure appropriate actions are taken to address vendor issues. Ultimately, an effective program will not only mitigate vendor risks, but also align incentives for the vendors to innovate and create long-term values for the student loan servicers.

5. Assess the complexity of your product portfolio and associated product development processes.

The CFPB report included discussion on consumer complaints stemming from customers not fully understanding the products they had purchased and not being able to access valuable product features.

Given the recent enforcement actions by the CFPB on credit cards[15], it is vital that lenders focus on how they manage student loan products and communicate the features of these products to student borrowers and guarantors. Specifically, lenders need to be confident that:

- Products and their features are well understood by customer facing colleagues;
- Product features advertised at the point of purchase are made available to customers when requested;
- Criteria for accessing specific product features are clearly stated and that no additional or unreasonable organizational barriers are put in place which deter qualifying customers from accessing product features; and
- Product literature is comprehensive, clear and consistent.

Organizations should conduct a comprehensive review of their existing product portfolio to identify products where there is complexity. This review should focus specifically on:

- The structure of features;
- How features are implemented operationally;
- How the customer qualifies for particular features; and
- Barriers that could deter qualifying customers from requesting/accessing particular features.

[15] CFPB orders American Express to pay $85 million refund to consumers harmed by illegal credit card practices – www.consumerfinance.gov/pressreleases

Once identified, specific action plans need to be put in place to ensure that:

- “Product promises” can be successfully implemented when customers qualify;
- Customer facing colleagues understand the product features and can explain any associated qualifying criteria;
- Customer facing colleagues can support the customer through any associated process steps;
- Onerous and unreasonable barriers to accessing product features are removed; and
- Product literature is reviewed to ensure that product features and any associated qualifying criteria are clearly explained.

More broadly, organizations should use this opportunity to review their student loan product portfolio to assess whether there are any opportunities for product simplification. Additionally, they should review their product design processes to ensure that features are assessed for operational impact and complexity. Finally, new product concepts should be assessed from a customer risk perspective prior to entering the product development process.

The strategic response

The report makes it clear that there are a number of avenues that all PSL industry participants need to explore to drive quality and customer satisfaction across their loan operations. The question becomes how should opportunities for improvement be prioritized and implemented by different companies.

From the student lender's perspective, change should not only be about one-time fixes but considered across the entire lending operation. The CFPB is firmly focused on addressing consumer protection issues and on the fair treatment of customers. In addition, it has a wide ranging remit and will likely change consumer dynamics in this market.

The depth and breadth of the CFPB agenda, covering oversight, rule making and enforcement, creates long term strategic challenges to industry business models as well as immediate demands on business resources and the attention of management.

While we have not yet seen enforcement actions or specific new rules within the student lending industry, we can learn from the experience of other areas of the consumer lending industry. Other sectors have seen the publication of complaints reports and subsequent investigations into the validity of complaints, examinations of the loan lifecycle/fair lending practices and the implementation of significant new rules and enforcement actions.

Recognizing the approach the CFPB is using and the guidance they have provided, student lenders can probably assume that more is to come and it could include regulations that fundamentally change how industry participants will need to operate in the future.

In considering their response to these recommendations, lenders should look first at their overall strategy and consider the extent to which it strikes the right balance between customer and business value. If the strategy lacks a clear customer focus, then it probably needs a fundamental rethink.

While future rules and enforcement actions are unknown at this time, the long term impact of the CFPB is likely to drive the need for a business and operating model that is both customer-centric and flexible in the face of continued change. Responding strategically to the CFPB agenda by building a customer focused and agile target operating model could provide the necessary sustainability, competitive advantage and reduction of cost and operational risk that companies are looking for in this rapidly changing asset class.

How PwC can help

The challenges and associated opportunities highlighted in this report are considerable. PwC has significant experience of working with student lenders and organizations in other asset classes to responds to these types of challenges. The action items listed below present opportunities to rethink long term business practices that may position PSL industry participants to have a more customer centric view as well as take steps to capitalize on the changing market.

Opportunity/issue	Examples of how PwC can help you to respond
Rethink how complaints are handled to develop a competitive advantage	Assessing the extent to which there is evidence of the specific issues highlighted in the report within your student lending operation. Supporting the development of understanding of both “controllable” and “uncontrollable” complaints to ensure focus on what can be fixed now as well as on developing an early response to likely future areas of complaint. Reviewing your alignment with the common elements of an effective complaints response system as outlined in the CFPB’s Supervision and Examination Manual. Performing a gap analysis of your complaints management around the six leading principles to support the development of a complaints handling culture and differentiated customer experience.
Building the “Voice of the Customer” into future operations	Helping to define the channels through which your customers prefer to communicate and put in place a strategy for capturing their feedback. Supporting the development of your ability to organize the data available from multiple channels and the methodologies required to support analysis. Performing a gap analysis between delivered and required customer experiences. Supporting you to build the “Voice of the Customer” into day-to-day decision making including product development, retention and targeting decisions. Helping you to develop customer focused metrics and targets at all levels in your organization.

Opportunity/issue	Examples of how PwC can help you to respond
Driving quality in servicing operations	Supporting you to assess the extent to which the common challenges that underpin poor student loan servicing quality are prevalent in your operation. Helping you to develop a plan to re-align your operation with the characteristics of a continuous improvement focused servicing operation. Working with you to embed a culture of "right the first time" by incorporating it into incentives at all levels and to understand the customer behind the loan.
Using vendor management programs to drive quality and compliance	Helping you to assess the performance of your vendor management operation in four critical areas – services risk assessment, vendor due diligence, contracting and ongoing oversight of vendor performance. Supporting you to review the compensation and incentive structures within your vendors to ensure that they are not focused solely on processing volume. Performing a gap analysis against lending industry practice to assess the governance and oversight processes for vendor risk management.
Assessing the complexity of your product portfolio and associated product development processes	Supporting the review of the products in your student lending portfolio to identify where operational issues are likely to arise due to product complexity. Working with you to assess whether product design features or "promises" can be successfully implemented when borrowers qualify. Supporting training for staff in areas where complexity is likely to cause issues to arise. Reviewing your product literature to ensure that product features are clearly explained. Helping to identify opportunities to simplify products. Helping you to develop customer risk assessment as a key component of the new product development process.

For more information

For more information, please contact:

Andy Hawley
Principal
andy.hawley@us.pwc.com
(617) 803 5993

Martin Touhey
Principal
martin.touhey@us.pwc.com
(206) 790 8751

Richard Altham
Principal
richard.d.altham@us.pwc.com
(207) 502 2347

Nick Tilston
Senior Manager
nicholas.p.tilston@us.pwc.com
(857) 383 9057

Nathan Parry
Senior Manager
nathan.e.parry@us.pwc.com
(617) 415 3148

Jason Chan
Senior Manager
jason.chan@us.pwc.com
(214) 435 1161

Samantha Buhr
Manager
samantha.buhr@us.pwc.com
(646) 471 5117

Alexander Baren
Senior Associate
alexander.baren@us.pwc.com
(571) 249 0965

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