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DEPARTMENT OF EDUCATION

34 CFR Chapter VI

Federal Preemption and State Regulation of the Department of Education's Federal Student Loan Programs and Federal Student Loan Servicers

AGENCY: Office of the Secretary, Department of Education.

ACTION: Interpretation.

SUMMARY: Recently, several States have enacted regulatory regimes that impose new regulatory requirements on servicers of loans under the William D. Ford Federal Direct Loan Program (Direct Loan Program). States also impose disclosure requirements on loan servicers with respect to loans made under title IV of the Higher Education Act of 1965, as amended (HEA). Finally, State regulations impact Federal Family Education Loan (FFEL) Program servicing. The Department believes such regulation is preempted by Federal law. The Department issues this notice to clarify further the Federal interests in this area.

DATES: [insert date of publication in the FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

Congress created and expanded the Direct Loan Program with the goal of simplifying the delivery of student loans to borrowers, eliminating borrower confusion, avoiding unnecessary costs to taxpayers, and creating a more streamlined student loan program that could be managed more effectively at the Federal level.

Recently, several States have enacted regulatory regimes or applied existing State consumer protection statutes that undermine these goals by imposing new regulatory requirements on the Department's Direct Loan servicers, including State licensure to service Federal student loans. State servicing laws are purportedly aimed only at student loan servicers, but such regulation affects the "[o]bligations and rights of the United States under its contracts" with servicers and with student loan borrowers, the "relationship between a Federal agency and the entity it regulates," and the rights of the Federal government related to federally held debt. (*Boyle v.*

United Technologies Corp., 487 U.S. 500, 504-05 (1988); *Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 347 (2001); *United States v. Victory Highway Vill., Inc.*, 662 F.2d 488, 497 (8th Cir. 1981).) Accordingly, the servicing of Direct Loans is an area "involving uniquely Federal interests" that must be "governed exclusively by Federal law." (*Boyle*, 487 U.S. at 504.)

A. Interest of the United States

Recently, the United States filed a Statement of Interest in a lawsuit brought by the Commonwealth of Massachusetts against a Department loan servicer alleging violations of Massachusetts State law for allegedly unfair or deceptive acts related to the servicing of Federal student loans and administration of programs under the HEA. (Statement of Interest by the United States, *Massachusetts v. Pennsylvania Higher Education Assistance Agency, d/b/a FedLoan Servicing*, No. 1784-CV-02682 (Mass. Super. Ct., filed Jan. 8, 2018).) The United States explained that Massachusetts is improperly seeking to impose requirements on the Department's servicers that conflict with the HEA, Federal regulations, and Federal contracts that govern the Federal loan programs. Accordingly, Massachusetts' claims are preempted because the State has sought to proscribe conduct Federal law requires and to require conduct Federal

law prohibits. We believe that attempts by other States to impose similar requirements will create additional conflicts with Federal law.

This is not a new position. The United States has previously responded when State law has been utilized in a way that conflicts with the operation and purposes of loan programs the Department administers pursuant to the HEA. On October 1, 1990, the Department issued a notice of its interpretation of regulations governing the FFEL Program (then known as the Guaranteed Student Loan program) (55 FR 40120) that prescribe the actions lenders and guaranty agencies must take to collect loans. The Department explained its view that these regulations preempt State law regarding the conduct of these loan collection activities.

In 2009, the United States intervened in *Chae v. SLM Corporation*, 593 F.3d 936 (9th Cir. 2010), a case in which plaintiffs sought to apply State consumer protection laws to a FFEL Program loan servicer, to explain that the State laws on which the plaintiffs relied conflicted with Federal law. (Brief of Plaintiff-Intervenor-Appellee, *Chae v. SLM Corp.*, 593 F.3d 936 (9th Cir. 2010) (No. 08-56154).) The Ninth Circuit concluded, among other things, that the precisely detailed provisions of the HEA "show congressional intent that FFELP participants be held to

clear, uniform standards.” (*Chae*, 593 F.3d at 944.) The court held that State-law claims alleging misrepresentation were preempted by the HEA’s express preemption of State-law disclosure requirements, and that other State-law claims “would create an obstacle to the achievement of congressional purposes” and were therefore barred by conflict preemption principles. (*Id.* at 950.)

The Department issues this notice to clarify its view that State regulation of the servicing of Direct Loans impedes uniquely Federal interests, and that State regulation of the servicing of the FFEL Program is preempted to the extent that it undermines uniform administration of the program.

B. Direct Loan Program

Congress created the Direct Loan Program as part of the Student Loan Reform Act of 1993 (Pub. L. 103-66). Under the program, the Federal government is the direct lender to the borrower and is responsible for all aspects of the lending process from loan origination through repayment, including the proper servicing and collection of the loan. In signing the Master Promissory Note for the loan, the borrower promises to repay the loan and any applicable interest and fees according to the terms and

conditions outlined in the HEA, the Department's regulations, and the Note. (20 U.S.C. 1087e.)

Congress provided that the program would be administered by the Department through student loan servicers, directing the Secretary to enter into contracts for loan "servicing" and for "such other aspects of the direct student loan program as the Secretary determines are necessary to ensure the successful operation of the program." (20 U.S.C. 1087f(b)(4).) The HEA directs the Secretary to award servicing contracts only to entities "which the Secretary determines are qualified to provide such services" and "that have extensive and relevant experience and demonstrated effectiveness." (20 U.S.C. 1087f(a)(2).) When procuring such services, the Department must, with specific exceptions, abide by "all applicable Federal procurement laws and regulations," which include the Federal Acquisition Regulation (FAR). (20 U.S.C. 1087f(a), 1018a.) To achieve its goals of streamlining and simplifying the delivery of student loans and of saving taxpayer dollars (See 139 Cong. Rec. S5585, S5628 (1993)), Congress designed a program in which servicing would be "provided at competitive prices" by entities "selected by and responsible to the Department of Education." (20 U.S.C. 1087f(a)(1); H.R. Rep. No. 103-111, at 107 (1993).)

The HEA and the Department's regulations provide comprehensive rules governing the Direct Loan Program, and the Department's contracts with loan servicers further specify the program's rules and requirements. As the United States recently noted in the Statement of Interest in *Massachusetts v. Pennsylvania Higher Education Assistance Authority*, "The Department's contract with [the loan servicer] is voluminous--spanning more than 600 pages and including provisions governing [the servicer's] financial controls, internal monitoring, communications with borrowers, and many other topics." (Statement of Interest at 5.) In its contracts with loan servicers, including task orders and change requests issued under those contracts, the Department specifies in detail the responsibilities and obligations of the servicers for Direct Loans and the benefits provided under that program such as Public Service Loan Forgiveness and income-driven repayment plans.

Recently, States have sought to impose requirements on servicers that conflict with Federal statutes, Department regulations, and these comprehensive contracts. Most notable are State regulations requiring licensure of Direct Loan servicers in order to perform work for the Federal government. "A State may not enforce licensing

requirements which, though valid in the absence of federal regulation, give 'the State's licensing board a virtual power of review over the federal determination' that a person or agency is qualified and entitled to perform certain functions, or which impose upon the performance of activity sanctioned by federal license additional conditions not contemplated by Congress." (*Sperry v. Florida*, 373 U.S. 379, 385 (1963) (quoting *Leslie Miller Inc. v. Arkansas*, 352 U.S. 187, 190 (1956)) (footnotes omitted).)

Such licensing requirements "interfere[] with the federal government's power to select contractors" and to determine whether contractors are "responsible" under Federal law. (*Gartrell Const. Inc. v. Aubry*, 940 F.2d 437, 438 (9th Cir. 1991).) With regard to responsibility determinations of prospective contract awardees, the Department follows FAR Subpart 9.1 (48 CFR 9.100 through 9.108-5). The Department selects contractors for Direct Loan servicing under 20 U.S.C. 1087f and 1018a. State-imposed registration and licensure requirements conflict with these Federal authorities by adding to Federal requirements and are thus preempted. (See *United States v. Virginia*, 139 F.3d 984, 989 (4th Cir. 1998).)

For example, a State may purport to require a Direct Loan servicer, as a condition of licensure, to demonstrate that it has adopted certain business standards set by the State regulator; to meet certain financial responsibility requirements such as liquidity, financial solvency, capitalization, and surety bond requirements; and to submit to investigations, audits, and background checks by State authorities. Federal law addresses standards of responsibility for prospective contractors, and a State may not, "through its licensing requirements, ... review the federal government's responsibility determination." (*Gartrell*, 940 F.2d at 439.)

Some State servicing laws also purport to impose regulatory requirements on servicing that create additional conflicts with Federal law. For example, some State laws impose deadlines on servicers for responding to borrower inquiries and require specific procedures to resolve borrower disputes. Such laws establish deadlines for completing transfers of loans from one servicer to another and specific protocols for applying overpayments on loans. These are matters specified in the laws and regulations governing the Direct Loan Program as well as the contractual arrangements between the Department and the servicer. The Department has enforcement authority to

oversee servicer compliance with these requirements, and “this authority is used by the [Department] to achieve a somewhat delicate balance of statutory objectives.”

(*Buckman Co. v. Plaintiffs’ Legal Committee*, 531 U.S. 341, 348 (2001).) The interposition of State-law requirements may conflict with legal, regulatory, and contractual requirements, and may skew the balance the Department has sought in calibrating its enforcement decisions to the objectives of the program.

State servicing laws also may undermine Congress’s goal of saving taxpayer dollars in administering the Direct Loan Program. Some State laws purport to impose licensing fees, assessments, minimum net worth requirements, surety bonds, data disclosure requirements, and annual reporting requirements on the Department’s servicers that will increase the costs of student loan servicing, perhaps exceeding the amount a servicer receives on a per loan basis under its contract with the Department, and certainly distorting the balance the Department has sought to achieve between costs to servicers and taxpayers and the benefits of services delivered to borrowers. Additionally, where State servicing laws go beyond the requirements of Federal law in restricting the actions a servicer may take to collect on a loan, such laws impede the ability of the

Department to protect Federal taxpayers by ensuring the repayment of Federal loans. The Department's contracts require servicers to operate throughout the United States because loan borrowers are in all States. A servicer does not have the choice to refrain from operating in a particular State to avoid licensing fees and other costs imposed by the State. Rather, the States are using the servicers' compliance with Federal law and contracts to extract payments that benefit the State at the expense of the Federal taxpayer.

A requirement that Federal student loan servicers comply with 50 different State-level regulatory regimes would significantly undermine the purpose of the Direct Loan Program to establish a uniform, streamlined, and simplified lending program managed at the Federal level. As courts have recognized, Congress provided "a clear command for uniformity" in the HEA with respect to the FFEL Program, and then "created a policy of inter-program uniformity by requiring that 'loans made to borrowers [under the Direct Loan Program] shall have the same terms, conditions, and benefits, and be available in the same amounts, as loans made to borrowers under [the FFEL Program].'" (*Chae*, 593 F.3d at 945 (quoting 20 U.S.C. 1087e(a)(1)).) Indeed, "Congress's instructions to the

[Department] on how to implement the student-loan statutes carry this unmistakable command: Establish a set of rules that will apply across the board." (*Id.*) State regulatory regimes conflict with this congressional objective.

Uniformity not only reduces costs but also helps to ensure that borrowers are treated equitably and are not confused about the lending and repayment process. State-level regulation subjects borrowers to different loan servicing deadlines and processes depending on where the borrower happens to live, and at what point in time.

These conflicts with statutes, regulations, Federal contracts, and congressional objectives suggest that State regulation of loan servicers would be preempted by Federal law. That result is even more evident where, as in the Direct Loan Program, State regulation implicates uniquely Federal interests. As the Supreme Court has recognized, "obligations to and rights of the United States under its contracts are governed exclusively by Federal law," and this area of Federal concern extends to "liability to third persons" that "arises out of performance of the contract." (*Boyle v. United Technologies Corp.*, 487 U.S. 500, 504-05 (1988).) Here, there is no question that the "imposition of liability on Government contractors will directly affect the terms of Government contracts," at the very least by

raising the price of such contracts, and "the interests of the United States will be directly affected." (*Id.* at 507.)

Moreover, "the civil liability of Federal officials for actions taken in the course of their duty" is another area "of peculiarly Federal concern, warranting the displacement of State law." (*Id.* at 505.) This area extends to the liability of contractors performing their obligations under contracts with the Federal government because "there is obviously implicated the same interest in getting the Government's work done." (*Id.*) Here, the loan servicers are acting pursuant to a contract with the Federal government, and the servicers stand in the shoes of the Federal government in performing required actions under the Direct Loan Program.

"[W]here the Federal interest requires a uniform rule, the entire body of State law applicable to the area conflicts and is replaced by Federal rules." (*Id.* at 508.) The disposition of federally held debt such as government-issued loans is a Federal interest that requires uniformity because State intervention harms the Federal fisc.¹

¹ See, e.g., *United States v. Scholnick*, 606 F.2d 160, 164 (6th Cir. 1979) (holding that "in any consideration of remedies available upon default of a Federally held or insured loan, Federal interest predominates over State interest" because of "an overriding Federal

Accordingly, the Department believes that the statutory and regulatory provisions and contracts governing the Direct Loan Program preclude State regulation, either of borrowers or servicers.

C. Prohibited Disclosure Requirements

Congress has provided that “[l]oans made, insured, or guaranteed pursuant to a program authorized by title IV of the [HEA] shall not be subject to any disclosure requirements of any State law.” (20 U.S.C. 1098g.) As a Federal district court recently explained, “Congress intended [section] 1098g to preempt any State law requiring lenders to reveal facts or information not required by Federal law.” (*Nelson v. Great Lakes Educ. Loan Servs.*, No. 3:17-CV-183, 2017 WL 6501919, at *4 (S.D. Ill., Dec. 19, 2017).) Federal law provides a carefully crafted disclosure regime specifying what information must be provided in the context of the Federal loan programs. (See, e.g., 20 U.S.C. 1078-3(b)(1)(F); 1083(e)(1) and (2); 34 CFR 668.41(b); 674.42; 674.31; and 682.205.) The Department interprets “disclosure requirements” under

interest in protecting the funds of the United States and in securing Federal investments”); *United States v. Wells*, 403 F.2d 596, 597-98 (5th Cir. 1968) (“The national loan program of the Veterans Administration cannot be subjected to the vagaries of the various State laws which might otherwise control all or some phases of the loan program.”).

section 1098g of the HEA to encompass informal or non-written communications to borrowers as well as reporting to third parties such as credit reporting bureaus.

The United States previously addressed the scope of section 1098g in its submission to the Ninth Circuit in *Chae*. A State-law claim based on "a purported failure of disclosure runs headlong into express statutory preemption provisions," according to the United States; "[s]uch additional requirements are barred whether they are enacted legislatively or implied judicially in the context of a tort suit." (Brief of Plaintiff-Intervenor-Appellee at 11.) In *Chae*, the court held that State-law claims alleging misrepresentation by a student loan servicer were "improper-disclosure claims" and, therefore, preempted pursuant to section 1098g. (*Chae*, 593 F.3d at 942.) The court found the "allegations in substance to be a challenge to the allegedly-misleading method [the servicer] used to communicate with the plaintiffs about its practices." (*Id.* at 942-43.) As the court explained, "the State-law prohibition on misrepresenting a business practice 'is merely the converse' of a State-law requirement that alternate disclosures be made." (*Id.* at 943 (quoting *Cipollone v. Liggett Grp.*, 505 U.S. 504, 517 (1992)).)

To the extent that State servicing laws attempt to impose new prohibitions on misrepresentation or the omission of material information, those laws would also run afoul of the express preemption provision in 20 U.S.C. 1098g.

D. FFEL Program Loans

The HEA and Department regulations governing the FFEL Program preempt State servicing laws that conflict with, or impede the uniform administration of, the program. State laws that require FFEL Program servicers to respond to a borrower's inquiry or dispute within a certain period of time, for example, conflict with the applicable Federal regulation that allows servicers 30 days after receipt to respond to any inquiry from a borrower. (34 CFR 682.208(c).) Deadlines for notifying borrowers of loan transfers between servicers similarly conflict with Federal statutes and regulations that allow for 45 days for notification. (20 U.S.C. 1078(b)(2)(F); 34 CFR 682.208(e)(1).) These deadlines are set after careful consideration of the need for timely responses and notifications to borrowers balanced against the time the servicer needs to ensure an accurate response and the costs of doing so. A uniform response time is also vital given

the congressional purpose to ensure borrowers are treated equally in the administration of the program.

The imposition of required dispute resolution procedures under State law would also conflict with the specific Federal regulations that govern the resolution of disputes raised by borrowers. (See 34 CFR 682.208(c)(3)(i) and (ii).) State laws that require servicers to communicate directly with the authorized representatives of a borrower could conflict with Federal regulations that mandate direct communications with borrowers and provide for specific exceptions when a FFEL Program participant such as a servicer is authorized to communicate with a borrower's representative. (See, e.g., 20 U.S.C. 1083(a); 1092c; 1077(a)(2)(H); 34 CFR 682.205(a)(1) and (b); 682.209(a)(6)(iii); 682.402; 682.210.)

Finally, the State servicing laws may conflict with two express preemption provisions applicable to FFEL Program Loans. Federal regulations "preempt any State law, including State statutes, regulations, or rules, that would conflict with or hinder satisfaction" of certain requirements regarding guaranty agency imposition of collection charges, reporting to consumer reporting agencies, and collection efforts on defaulted loans. (34 CFR 682.410(b)(8).) Federal regulations also preempt State

laws that would conflict with or hinder the efforts of lenders or their servicers to satisfy and comply with the due diligence steps for loan collection included in those regulations. (34 CFR 682.411(o)(1).) Recently enacted State servicing laws appear to conflict with these preemption provisions.

E. Existing Borrower Protections

The Secretary emphasizes that the Department continues to oversee loan servicers to ensure that borrowers receive exemplary customer service and are protected from substandard practices. First, the Department monitors servicer compliance with the Department's contracts, which include requirements related to customer service. These oversight efforts include, but are not limited to, call monitoring, process monitoring, and servicer auditing, conducted both remotely and on-site by the Department's office of Federal Student Aid (FSA). FSA has dedicated staff with the responsibility to ensure that servicers are adhering to regulatory and contractual requirements for servicing loans. For example, FSA reviews interactions between servicers and borrowers and compares the servicers' performance against a detailed Department checklist. FSA provides its performance evaluations to servicers through written reports and meetings and requires servicers to

alter their practices when needed to correct deficiencies. FSA also maintains direct access to servicer systems and therefore can review individual borrower accounts to evaluate the servicers' treatment of those accounts against regulatory and contractual requirements.

Second, the Department's procurement and contracting requirements incentivize improved customer service by allocating more loans to servicers that meet performance metrics such as high levels of customer satisfaction and by paying servicers higher rates for loans that are in a non-delinquent status such as those enrolled in an income-driven repayment plan. Poor-performing servicers lose loans in their portfolio to better-performing servicers.

Third, FSA maintains a Feedback System, which includes a formal process for borrowers to report issues or file complaints about their loan experiences, including problems with servicing. Borrowers may also elevate complaints to the FSA Ombudsman Group--a neutral and confidential resource available to borrowers to resolve disputes related to their loans.

The Department seeks to promote exemplary customer service for student loan borrowers, consistent with the framework Congress established for the Federal student loan programs.

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Dated: March 7, 2018.

Betsy DeVos,
Secretary of Education.

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