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Government Code, § 6103

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN FRANCISCO

In the Matter of: THE PEOPLE OF THE STATE OF CALIFORNIA, by and through the Commissioner of Business Oversight, Plaintiff, v. PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY, d/b/a/ FedLoan Defendants.	CASE NO. COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF (FIN. CODE, § 28168 & CODE CIV. PROC., § 1608)

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State of California - Department of Business Oversight

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

The People of the State of California, by and through the Commissioner of Business Oversight ("Plaintiff" or "DBO"), allege the following on information and belief:

I. INTRODUCTION

1. The State of California has a vital interest in protecting its consumers and student loan borrowers. Presently, an estimated 3.8 million Californians hold more than $141 billion in outstanding college debt, holding an average balance of $37,500. These numbers only continue to grow - student loan debt is the fastest-growing category of debt in the United States. At the same time, it is widely documented and criticized that the student loan industry is underregulated and there is a need for regulatory oversight over student loan servicers who act as a critical link between borrowers and lenders in managing accounts.

2. Understanding this ballooning consumer protection interest, in 2016, the California Legislature passed into law the California Student Loan Servicing Act (Financial Code § 28100 et seq.), stating its intent to promote meaningful access to federal repayment and loan forgiveness benefits, empower borrowers with reliable information about their student loans, and ensure that borrowers received quality customer service and fair treatment. On July 1, 2018, the California Student Loan Servicing Act became operational and required all student loan servicers servicing student loans in California to become licensed with the DBO, whom the California legislature empowered to administer and enforce the provisions of the California Student Loan Servicing Act.

3. Defendant Pennsylvania Higher Education Assistance Agency d/b/a FedLoan Servicing ("PHEAA"), is a California Student Loan Servicing Act licensee as of November 5, 2018 (NMLS No. 1619466) and is one of the nation's largest student loan servicers, managing the accounts of over 900,000 student loan borrowers in California and over $35 billion in California student loan debt.

4. In 2012, the United States Department of Education ("ED") granted PHEAA the exclusive contract to service and administer the Teacher Education Assistance for College and Higher Education ("TEACH") Grant program, a federal financial aid grant program. The TEACH Grant program awards grants of up to $4,000.00 per year to "highly qualified" students who pursue

teaching careers in low-income schools in high-needs fields such as mathematics, science, foreign language, or special education. TEACH Grant recipients are required to meet and satisfy a set of specific eligibility criteria of the TEACH program. Failure to meet the eligibility criteria results in an automatic conversion of the TEACH Grant into a federal student loan, which the recipient is obligated to repay with interest charges calculated back to the date the TEACH Grant was made.

5. The DBO, exercising its powers in regulatory and supervisory oversight in examination and in furtherance of its duty to protect consumers, has requested documents and information concerning PHEAA's handling of the TEACH program reconsideration process and the California borrowers affected by it. PHEAA has refused to provide the DBO with the requested information, obstructing the DBO from learning how many TEACH Grant recipients reside in California and leaving the DBO unable to determine the number of teachers who continue to repay erroneously converted TEACH Grant loans despite qualifying for reconsideration.

6. The DBO now seeks permanent injunctive and declaratory relief, to compel PHEAA to comply with its duties under the California Student Loan Servicing Act, and provide the documents and information requested, so that the DBO may fulfill its statutory obligation to provide regulatory oversight and protect the People of the State of California.

II. DEFENDANT

7. Defendant Pennsylvania Higher Education Assistance Agency does business as FedLoan Servicing, and is a national student loan servicer, headquartered at 1200 North 7th Street, Harrisburg, Pennsylvania 17102.

III. JURISDICTION AND VENUE

8. This Court has jurisdiction over PHEAA. PHEAA services private and federal loans of California borrowers, and therefore intentionally avails itself of California's markets so as to render the exercise of jurisdiction of California courts over PHEAA consistent with traditional notions of fair play and substantial justice.

9. The violations of law alleged in this Complaint occurred in the County of San Francisco and throughout California.

10. Venue is proper in this Court under Code of Civil Procedure section 395.5 because PHEAA's student loan servicing activities include the San Francisco region and therefore PHEAA's liability arises in the County of San Francisco.

IV. FACTS

A. Federal Student Loans and the TEACH Grant Program

11. In efforts to expand access to higher education across the nation, the federal government enacted the Higher Education Act (20 U.S.C. §§ 1001–1155) in 1965. Under the Higher Education Act and related federal statutes and regulations, the U.S. Department of Education operates various programs to help students finance post-secondary education. (Pub. L. No. 89-329, 79 Stat. 1219). These include two main federal student loan programs: The Federal Family Education Loan Program ("FFELP") (20 U.S.C. §§ 1071–1087.4), a system of loan guarantees intended to encourage private lenders to lend money to students, and the William D. Ford Federal Direct Loan Program ("Direct Loans") (20 U.S.C. §§ 1087a–1087j), through which the federal government lends money to students directly. In 2008, Congress passed the Ensuring Continued Access to Student Loans Act, which authorized the Department of Education to purchase FFELP loans from private lenders. For those purchased loans, the Department of Education is now considered the "lender." In 2010, Congress passed the Student Aid and Fiscal Responsibility Act, which ended new loan originations under the FFELP and shifted new loans primarily to Direct Loans. As a result of these programs and laws, the federal government now makes, owns, or guarantees 92 percent of all student loans in the United States.

12. Under these various programs, federal student loans come with varying protections and borrower obligations not typical of traditional consumer loans or private student loans, including income-based repayment plans, loan forgiveness plans, forbearance options, and debt consolidation. Because of the specific requirements of each of these protections, loan servicing mismanagement can create obstacles to repayment, raise costs, cause distress and contribute to driving struggling borrowers into default.

13. In 2007, under the federal College Cost Reduction and Access Act (20 U.S.C. § 1070 *et seq.*), Congress established the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program to aid and incentivize highly qualified teachers to pursue teaching careers in low-income, underserved communities without incurring crippling student loan debt.

14. Under the TEACH program, TEACH Grants of up to $4,000 per year of education are awarded to students pursuing an undergraduate or master's degree in education. To qualify, TEACH Grant recipients must display "high academic aptitude" by meeting certain minimum academic criteria as demonstrated through GPA or college admissions tests, and must agree to teach for at least four complete academic years within eight years after completing a course of study in a "high-need field," such a mathematics, science, special education, or foreign language, in a low-income school.

15. If the TEACH Grant recipient fails to complete the requisite service (teaching four years in a high-need subject in a low-income school) or otherwise fails to meet the eligibility criteria, the grants are converted into federal Direct Loans, which the recipient is obligated to repay with interest charges calculated back to the date each TEACH Grant was disbursed.

16. In order to show ongoing compliance with the TEACH Grant program, recipients must submit annual certification to show they have completed a full school year of qualifying service. Failure to annually submit proper certification forms results in a conversion of the TEACH Grants to federal loans with interest.

17. Under the Higher Education Act, ED contracts out the servicing of federal student loans to private companies who must, among other things, receive and apply periodic loan payments, maintain records, advise borrowers and handle repayment options, facilitate payoff, handle delinquent accounts, and administer loan forgiveness programs. (*See* 20 U.S.C. § 1088, subd. (c); 20 U.S.C. § 1087f, subd. (a).)

18. From 2008, when the first TEACH Grants were awarded, through 2012, ED contracted out the administration of the TEACH program to ACS, then a division of Xerox. In 2012, amid allegations of improper servicing practices, including the improper conversion of thousands of

TEACH Grants into federal loans by ACS, ED awarded the exclusive administration of the TEACH Grant program to PHEAA.

B. PHEAA and the TEACH Grant Program

19. PHEAA was created in 1963 by the Pennsylvania General Assembly as a public corporation and government instrumentality. Although initially PHEAA's function was to fund student loans and grants for Pennsylvania residents, PHEAA's reach has expanded over the decades to become one of the nation's largest student loan servicers.

20. In 2009, PHEAA was the first contractor awarded a federal loan servicing contract by ED to service federally owned loans nationally. PHEAA services federal student loans and administers federal loan programs under the name FedLoan Servicing. PHEAA now manages over a quarter of the nation's $1.4 trillion student loan debt on behalf of various lenders for millions of borrowers nationally. As of December 2018, PHEAA services the loans of over 900,000 California student loan borrowers, amounting to over $35 billion in student loan debt.

21. After assuming exclusive responsibility for administering the TEACH Grant program, PHEAA continued the mismanagement of its predecessor ACS by failing to timely and properly process teachers' annual certification forms and failing to provide teachers sufficient time to resubmit or correct forms when additional information was required.

22. As a result, teachers who believed they had satisfied all their administrative obligations of submitting certifications for their TEACH Grants had their grants erroneously converted into federal loans.

23. Between 2008 and 2018, misadministration of the TEACH Grant program and servicing failures have caused grants held by more than 10,000 TEACH Grant recipients to be erroneously and improperly converted into federal loans with interest. (U.S. Government Accountability Office, *Better Management of Federal Grant and Loan Forgiveness Programs for Teachers Needed to Improve Participant Outcomes* (Feb. 24, 2015), available at http://www.gao/gov/products/GAO-15-314; U.S. Department of Education, *Study of the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program* (March 2018), available at http://www2.ed.gov.rschstat/eval/highered/teach-grant/final-report.pdf.)

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24. Notably, PHEAA was monetarily incentivized to allow or facilitate grant-to-loan conversions for TEACH Grant recipients because PHEAA earned more for servicing student loans than for servicing TEACH Grants. For example, under the terms of its 2014 servicing contract with ED, PHEAA was paid $1.05 per unit for "borrowers in TEACH Grant Status" and was paid more than double—$2.85 per unit—for borrowers "In Repayment" on a student loan. And if a TEACH Grant recipient complied with the requirements of the program and successfully discharged their TEACH Grant, PHEAA would lose a unit, i.e., would no longer be able to collect revenue for servicing that borrower.

25. In December 2018, after more than a year of public scrutiny and amidst pressure from the media, advocates, and federal lawmakers, ED acknowledged the erroneous TEACH Grant-to-loan conversions and announced a TEACH Grant reconsideration program, in which recipients whose TEACH Grants were erroneously converted to loans could apply for reconsideration. PHEAA, the federal loan servicer that initially serviced and mismanaged at least a portion of the TEACH Grant program, was designated by ED to administer the reconsideration process.

26. However, no additional oversights or checks were put in place by ED to oversee the administration of the reconsideration by PHEAA, and PHEAA was left to implement its own policies and procedures around this remediation.

27. Following ED's 2008 announcement of the reconsideration program to be administered by PHEAA to present day, neither PHEAA nor ED have released public information identifying the success of this initiative or assessing the number of teachers who continue to repay TEACH Grants that were erroneously converted into loans.

C. Lack of Federal Regulatory Oversight

28. The federal government's lack of accountability and oversight in the implementation of the remediation of the TEACH Grant program is not anomalous. It has been regularly documented that there is lax oversight and no consistent or market-wide federal standards for student loan servicing, and servicers have had wide discretion to determine and implement their own policies, much to the detriment of student loan borrowers.

29. According to a September 2015 report by the Consumer Financial Protection Bureau, student loan servicers engage in "a wide range of sloppy, patchwork practices that can create obstacles to repayment, raise costs, cause distress and contribute to driving struggling borrowers to default." (Consumer Financial Protection Bureau, *Student Loan Servicing, Analysis of Public Input and Recommendations for Reform* (Sep. 2015), available at http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf (student loan servicers engage in "a wide range of sloppy, patchwork practices that can create obstacles to repayment, raise costs, cause distress and contribute to driving struggling borrowers to default.")

30. A February 2019 audit report issued by the Office of the Inspector General highlights the failure of the ED to provide meaningful accountability and oversight to federal loan servicers. The report criticized Federal Student Aid, the Department of Education's student loan unit, for failing to adequately supervise and penalize servicers in light of broad, systemic, and recurring noncompliance with servicing requirements. (U.S. Department of Education, Office of the Inspector General, *Federal Student Aid: Additional Actions Needed to Mitigate the Risk of Servicer Noncompliance with Requirements for Servicing Federally Held Student Loans* (Feb. 2019), available at https://www2.ed.gov/about/offices/list/oig/auditreports/fy2019/a05q0008.pdf.)

D. California's Student Loan Servicing Act

31. The California Student Loan Servicing Act was signed into law in 2016 and became operational on July 1, 2018. In enacting the California Student Loan Servicing Act, the California Legislature found and declared that "student loan debt is a national crisis" with more than 40,000,000 individuals in student loan debt exceeding $1.2 trillion. (AB 2251 (Ch. 824, Stats. 2016) Historical and Statutory Note under Financial Code § 28102, § 1, subd. (a).) The Legislature highlighted the paramount interests of over 4,000,000 California student loan borrowers, and the imperative need for state oversight of student loan servicers, who serve as a "critical link between borrowers and lenders in managing accounts, proceeding payments, and communicating directly with borrowers." The Legislature also noted there is "no consistent, market wide federal standards for student loan servicing." (*Id.* at subdivision (a)-(d).)

32. California has an immense interest in making sure California student loan borrowers are protected from harmful and abusive practices. As of the end of 2018, Californians owed $133 billion in student loans, more than double the amount owed one decade earlier. In 2017, 50 percent of California students graduated from college with student loan debt, and those students owed an average of nearly $22,785 each.

33. The California Student Loan Servicing Act applies to companies that manage or "service" student loans in California, designates the DBO to administer and enforce its provisions, and has three primary components: (i) licensure; (ii) examination; and (iii) enforcement. (Fin. Code, § 28100, et seq.) The student loan servicer rules and regulations became finalized and effective on March 28, 2019. (10 C.C.R. §§ 2032, et seq.)

34. The California Student Loan Servicing Act broadly defines "student loan" to mean "any loan made solely for use to finance a postsecondary education and costs of attendance at a postsecondary institution . . . ." (Fin. Code, § 28102, subd. (m)(1).) This definition encompasses both private student loans made by commercial institutions, such as banks, credits unions, and other types of lending institutions, and federal student loans, and no exception from licensure is otherwise made for the servicing of federal student loans in the California Student Loan Servicing Act.

35. PHEAA became licensed with the Department on November 5, 2018. After being granted a license, PHEAA submitted an amended application in December 2018 asking to withdraw the federal loan information it had previously provided. Around that time, PHEAA also submitted forms to surrender four branch licenses for branches that exclusively service federal loans in an apparent attempt to prevent Department from overseeing those branches. The Department has not accepted the surrender of those four branch licenses.

E. <u>California's Examination</u>

36. Financial Code section 28152 provides that "the commissioner shall examine the affairs of each licensee for compliance with this division. The Commissioner and his or her appointees may examine the books, records, and documents of the licensee…" (Fin. Code, §28152, subd. (a).)

37. Pursuant to statutory mandate and the Commissioner's authority and power, (Fin. Code, §§ 28108, subd. (a), &28152, subd. (a)), the DBO scheduled an on-site joint examination of PHEAA on the weeks of January 13, 2020 and February 3, 2020, in conjunction with the Consumer Financial Protection Bureau and the Connecticut Department of Banking.

38. On December 12, 2019, in anticipation of the upcoming on-site examination on January 13, 2020, the DBO sent to PHEAA an examination request list requesting information, documents and complaints surrounding the TEACH Grant program. (Attachment A). (*See* Fin. Code, §§ 28108, subds. (a)-(b), & 28152, subd. (a))

39. On February 6, 2020, PHEAA provided a written response to the Commissioner, declining to produce the requested TEACH Grant documents and information; PHEAA cited two separate bases for its refusal. First, PHEAA asserts that the Commissioner's examination authority under the California Student Loan Servicing Act is preempted by the federal HEA. Second, PHEAA states that the student borrower records, while in its physical possession, are legally owned by ED, and PHEAA is prohibited from releasing them to the Commissioner pursuant to its contract with ED and the federal Privacy Act of 1974 ("Privacy Act") (5 U.S.C. § 552a *et seq.*). (Attachment B.)

40. On January 13, 2020, and again on February 3, 2020, the Department conducted an on-site examination of PHEAA, and again requested the TEACH Grant information and documents. Again, PHEAA declined.

41. In failing to produce requested information and documents pertaining to the TEACH Grant program as requested by the Commissioner of a licensee in examination, PHEAA, a California Student Loan Servicing Act licensee in the state of California, has failed to satisfy its statutory duties and submit to the examination requests and orders of the Commissioner, and has unduly restrained the Commissioner's ability to fulfill his statutory function to oversee the administration of the servicing of student loans in the state of California and protect California student loan borrowers.

FIRST CAUSE OF ACTION

(Preliminary and Permanent Injunction)
(Fin. Code, §§ 28130 & 28168)

42. The People reallege and incorporate by reference each of the paragraphs above as though fully set forth herein.

43. The People bring this action pursuant to Financial Code section 28168, subdivision (a), to enforce compliance with the California Student Loan Servicing Act.

44. Financial Code section 28130 provides that:

> A licensee shall do all of the following:
> . . .
> (b) File with the commissioner any report required by the commissioner.
> (c) Comply with the provisions of this division and any regulation or order of the commissioner.
> (d) Submit to periodic examination by the commissioner as required by this division and by regulation or order of the commissioner.

45. PHEAA, a licensee, is obligated and required to submit to all provisions of the California Student Loan Servicing Act, including but not limited to, submitting to the Commissioner's authority to conduct examinations and control documents, books, accounts, records, files, documents, information, or evidence. (Fin. Code, §§ 28108, 28130 & 28152.)

46. Pursuant to the powers and authority delegated to him under Financial Code sections 28108 and 28152, on December 12, 2019, the Commissioner requested certain information and documents in a pre-examination request. (Attachment A.) On February 6, 2020, PHEAA provided a written response refusing to produce the requested records. (Attachment B.) On January 13, 2020, the Commissioner conducted an on-site examination, at which time PHEAA again refused to provide access to the requested documents. Finally, on February 3, 2020, the Commissioner conducted a second on-site examination, at which time PHEAA for a third time failed to produce the books and records required by the Commissioner to complete his examination. More specifically, PHEAA declined to provide any and all information and documentation requested by the Commissioner pertaining to the TEACH Grant program in his efforts to ascertain the number of California borrowers effected by erroneous conversion to federal loans, the number of California borrowers

entitled to reconsideration under the reconsideration program, and PHEAA's administration of the reconsideration program.

47. Defendant and its agents, employees and representatives have engaged in an act or practice constituting a violation of a Financial Code section 28130, subdivisions (b), (c), and (d), in failing to file with the commissioner a required report, failing to comply with an order of the commissioner, and in failing to submit to a periodic examination of the Commissioner in his exercise of authority to examine and control the books, records, and documents of the licensee under Financial Code sections 28108, subdivisions (a) and (b), and 28154, subdivision (a). Defendant and its agents, employees and representatives will continue to engage in such violations unless this court compels compliance with the California Student Loan Servicing Act.

SECOND CAUSE OF ACTION
(Declaratory Judgment)
(Code Civ. Proc., § 1060)

48. The People reallege and incorporate by reference each of the paragraphs above as though fully set forth herein.

49. PHEAA is obligated and required to submit to all provisions of the California Student Loan Servicing Act, including but not limited to, submitting to the Commissioner's authority to conduct investigations and examinations and control of documents, books and records (Fin. Code, §§ 28108, 28130 & 28152) and adhering to reporting requirements (Fin. Code, § 28108), and paying an annual pro-rata assessment of the proportion of Defendants' servicing activities in California, levied by the Commissioner (Fin. Code, § 28144).

50. PHEAA has refused to provide any and all information and documentation requested by the Commissioner pertaining to the TEACH Grant program, asserting that the HEA federally preempts the California Student Loan Servicing Act and therefore the Department may not administer or enforce the California Student Loan Servicing Act as they relate to federal student loans; and pursuant to its obligations under the Privacy Act and its contracts with ED, PHEAA may not release federal loan data to the Commissioner. Based on these contentions and PHEAA's efforts to abandon the branch licenses of branch locations that exclusively service federal student loans, Defendants will continue to refuse the Commissioner access to federal student loan documents,

books and records maintained in connection with the servicing of federal loans and in the administration of federal programs.

51. A present and actual controversy exists concerning the legality and enforceability of California's Student Loan Servicing Act, and whether it is preempted by federal law. A declaration is needed to determine the legal rights and duties of the parties under California's Student Loan Servicing Act.

52. The People seek a declaration that:

a. Defendants must comply at all times with all provision of California's Student Loan Servicing Act and the regulations promulgated therein, with respect to all student loans that Defendants service in the State of California, including federal loans.

b. The Commissioner of Business Oversight has the power and authority to administer and enforce all provisions of California's Student Loan Servicing Act and the regulations promulgated therein, which includes but are not limited to, the power to conduct investigations and examinations of documents, books and records relating to, require reporting of all student loans servicing activity in the state of California, including federal loans.

c. Defendants must pay an annual pro-rata assessment of the proportion of Defendants' servicing activities in California as levied by the Commissioner.

PRAYER FOR RELIEF

53. Plaintiff prays for judgment against Defendants as follows:

1) Pursuant to Financial Code section 28168, subdivision (a), for a preliminary and permanent injunction compelling PHEAA and its officers, directors, successors in interest, controlling persons, agents, employees, attorneys in fact, and all other persons acting in concert or participating with them, or any of them, to comply with section 28130, subdivisions (b), (c), and (d) of the Financial Code, and to file with the commissioner a required report, to comply with an order of the commissioner, and to submit to a periodic examination of the Commissioner in his exercise of authority to

examine and control the books, records, and documents of the licensee under Financial Code sections 28108, subdivisions (a) and (b), and 28154, subdivision (a).

2. Pursuant to California Code of Civil Procedure section 1060, subdivision (a), a judicial declaration that:

a. Defendants must comply at all times with all provision of California's Student Loan Servicing Act and the regulations promulgated therein, with respect to all student loans that Defendants service in the State of California, including federal loans.

b. The Commissioner of Business Oversight has the power and authority to administer and enforce all provisions of California's Student Loan Servicing Act and the regulations promulgated therein, which includes but is not limited to, conduct investigations and examinations of document, book and records relating to; require reporting of; and levy annual pro-rata assessments based on, all student loans servicing activity in the state of California, including federal loans.

3. Penalties in the amount of $2,500 per violation as set forth in Financial Code § 28172, in an amount according to proof.

4. Any other relief deemed just and proper by this Court.

Dated: _____

MANUEL P. ALVAREZ
Commissioner of Business Oversight

By_____
MARY ANN SMITH
Deputy Commissioner
Enforcement Division

State of California - Department of Business Oversight