Regulation Z – Private Education Loans

On August 14, 2009, the Federal Reserve published a final rule amending Regulation Z. The purpose of the final rule is to incorporate new disclosure, timing, and limitation requirements that apply to creditors that make private education loans. It also provides certain rights to covered borrowers.

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Links: Final Rule - TILA Private Education Loans - 8/14/09

Federal Reserve Model Forms and Samples:
- PEL Application and Solicitation Model Form H-18
- PEL Approval Model Form H-19
- PEL Final Model Form H-20
- PEL Loan Application and Solicitation Sample H-21
- PEL Approval Sample H-22
- PEL Final Sample H-23

The final rule provides for greater consumer protections and disclosures that must be made available to consumers that borrow money for certain educational expenses. These amendments implement provisions of the 2008 Higher Education Opportunity Act. Within Regulation Z, these loans are referred to as Private Education Loans (PELs). In this rule, the Federal Reserve outlined various new disclosure requirements, limitations, and model forms and samples.

One important provision within the final rule revises the types of loans that are covered by Regulation Z. While Regulation Z has historically exempted from coverage any credit that exceeds $25,000 (unless secured by real property or a consumer's principal dwelling), that $25,000 threshold does not apply to PELs. In other words, a PEL over $25,000 is covered by Regulation Z.

What is a Private Education Loan?

A PEL is a consumer loan made, in whole or in part, for postsecondary educational expenses (unless exempted) at a covered educational institution. A PEL does not include:

- A loan that is made, insured or guaranteed by the federal government;
- Educational expenses funded by credit card advances;
- Open end credit; or
- Real estate or dwelling-secured loans.

A covered educational institution may include, for example, a university or community college. It may also include an institution offering instruction to prepare students for gainful employment in a recognized occupation. A covered educational institution does not include elementary or secondary schools. Covered postsecondary educational expenses include tuition and fees, books, supplies, miscellaneous personal expenses, room and board, and an allowance for any loan fee, origination fee, or insurance premium charged to a student or parent for a loan incurred to cover the cost of the student's attendance.

What requirements apply to PELs?

At a high level, the PEL rules include the following disclosure requirements:

- Application disclosures (or with solicitations that do not require an application) that:
  - Are provided with any PEL application or solicitation; and
  - Include information about the cost of the loan, repayment terms and a statement that, if approved, the terms will not change for 30 days, except as permitted.
- Approval disclosures that:
  - Are provided before consummation on or with notice of approval; and
  - Include information about the interest rate, fees and costs, repayment terms, alternatives to PEL loans and the rights of the consumer.

- Final disclosures that:
  - Are provided after acceptance and before disbursement of the loan; and
  - Include interest rate information, fees, default or late payment costs, repayment terms and a statement of the consumer's right (and method(s)) to cancel.

Another important requirement for PELs is for financial institutions to obtain a **self-certification form** signed by the consumer before closing the loan. The institution may receive this directly from the consumer or through the institution of higher education. This rule applies to PELs that will be used for the postsecondary educational expenses of a student while that student is attending an institution of higher education. It does not apply, for example, in instances where a consumer is consolidating loans after graduation.

In addition to the specific disclosures required for PELs, lenders must provide the general closed-end TILA disclosures required by Section 18 of Regulation Z. Consumers have the right to cancel a PEL without penalty for up to 3 business days after the consumer receives the final disclosures. Because of this, loan proceeds cannot be disbursed until after the cancellation period expires.

What other rights and limitations apply?

The new rule contains various PEL-related rights and limitations that include:

1) The right of the consumer to accept the terms at any time within 30 calendar days from receiving the approval disclosures;
2) Limits on the creditor from changing the rates and terms during this 30-day period (unless permissible);
3) Limits on the creditor from co-branding any marketing materials with a educational institution, unless they have entered into an endorsed lender arrangement and it is not prohibited by law; and
4) Requirements that creditors that have a preferred lender arrangement with a covered educational institution provide certain information regarding PEL offerings.

Recommendations for Next Steps

1. As most institutions do not have documented educational lending practices, it will be important to implement a control that will help identify PELs. For example, PELs may come through your door as CD-secured loans where the borrower indicates the proceeds will be used for educational purposes. Besides identifying PELs, implementing a policy that complies with these guidelines or that includes a statement that the institution does not originate PELs is a good control.

2. Ensure lending staff are aware of the institution's policy and that appropriate training is provided.

3. If your institution originates PELs, work with your loan disclosure vendor to determine whether they support these loans and the required disclosures.

4. Within any quality control processes, implement procedures to review for disclosures, timing requirements, availability of terms, right to cancel requirements and timing of disbursements.

5. As applicable, ensure marketing staff are aware of the applicable restrictions.