



Preemptive Strike: Does Federal Law Displace State Regulation of Student Loan Servicers?

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The United States is responsible for a [large portfolio of student loans](#). According to [recent statistics](#) from the U.S. Department of Education (ED), almost \$1.5 trillion in federal student loans presently remains outstanding. For many years, the federal government’s role with respect to federal student loans was primarily that of a guarantor, as the majority of federal student loans “were originated by [private sector and state-based lenders](#)” through the Federal Family Education Loan Program (FFELP). [Since July 1, 2010](#), however, the United States has directly [owned and administered](#) the majority of newly issued federal student loans, which are now made through the Federal Direct Loan Program (FDLP). This development has [expanded the federal government’s role](#) in the student loan context, which has in turn raised weighty legal questions explored below.

To assist with the administration of student loans, the [United States](#) and [private lenders](#) alike commonly hire student loan servicers. These servicers often act as a “[middle-man](#) between lenders and borrowers” by performing functions like (1) communicating with borrowers and (2) collecting and processing loan payments. Some, however, have accused student loan servicers of engaging in an array of [undesirable conduct](#), such as [steering borrowers away](#) from favorable repayment plans, [failing](#) to provide borrowers crucial information regarding their loans’ terms, and [misallocating or misapplying payments](#). [Several states](#) and the [District of Columbia](#) have responded to these concerns by enacting new laws regulating student loan servicers. Moreover, several [state attorneys general](#) and individual [borrowers](#) have [filed lawsuits](#) against servicers under preexisting consumer protection statutes or state common law. Servicers of [federal student loans](#) have [argued](#) in response that existing federal laws governing student loan

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servicers—such as [regulations](#) promulgated by ED—leave [no room](#) for states to impose servicing regulations or standards of their own.

In March 2018, ED published an [interpretation](#) in the Federal Register articulating the agency’s position that state “regulatory regimes that impose new regulatory requirements on servicers of loans” are “preempted by Federal law.” [Various courts](#) have also weighed in on this issue, but have reached [divergent conclusions](#). Some commentators thus speculate that the [U.S. Supreme Court](#) may ultimately resolve this doctrinal split. This Sidebar thus reviews the legal issues surrounding the potential federal preemption of state student loan servicing laws and highlights relevant considerations for Congress with respect to how student loan servicers are regulated.

Student Loan Servicers and Federal Law

Various federal laws govern the selection and operations of student loan servicers. [20 U.S.C. § 1087f](#), for instance, provides that, with regard to certain student loans that the federal government directly issues, the Secretary of ED (Secretary) may only enter into student loan servicing contracts “with entities that have extensive and relevant experience and demonstrated effectiveness.” [Federal regulations](#) likewise [contain](#) several [provisions](#) concerning the servicing of certain categories of federal student loans. Additionally, the terms of a federal loan servicer’s [contract with ED](#) may also impose requirements on servicers with respect to issues like “financial controls, internal monitoring, [and] communications with borrowers.” Significantly, and of particular relevance to the recent judicial developments, federal law also contains a provision—[20 U.S.C. § 1098g](#)—that expressly exempts certain federal student loans made, insured, or guaranteed pursuant to the Higher Education Act of 1965 (HEA) from “any disclosure requirements of any state law.”

However, for the most part, federal law does not empower individual borrowers to enforce federal servicing regulations directly. The HEA, for instance, does [not itself provide](#) borrowers a right to sue a federal student loan servicer for violating the aforementioned federal laws. Instead, federal law primarily places the onus on [ED](#) to monitor the servicers it hires. Additionally, in 2017, the Consumer Financial Protection Bureau brought an [action—which remains pending in federal district court](#)—against one of the nation’s largest student loan servicers for allegedly engaging in unfair and deceptive conduct in violation of the [Consumer Financial Protection Act](#) (CFPA). However, that law, like the HEA, does [not](#) grant borrowers a private right of action to pursue violations of the CFPA. Thus, generally speaking, if borrowers wish to pursue a lawsuit against a federal student loan servicer directly, they must rely on a [state or local law](#) as the basis for their suit.

Student Loan Servicers and State Law

A [growing number of states](#) have enacted statutes regulating student loan servicers in various respects. The [District of Columbia \(D.C.\)](#), for instance, subjects student loan servicers to [licensing requirements](#) and supervision by an “[o]mbudsman who is responsible for resolving borrower complaints, developing a borrower bill of rights, monitoring and analyzing information and data from borrower complaints, providing information to student loan borrowers, and conducting examinations of student loan servicers.” [Connecticut](#) similarly imposes a panoply of licensing requirements and other regulations upon student loan servicers. A number of other states are likewise developing or considering [similar legislation](#). Some of these laws impose obligations and responsibilities upon student loan servicers that are different from or [broader](#) than those imposed under federal law.

Irrespective of whether a particular state has enacted a law *specifically* regulating student loan servicers, many states have statutes and common law doctrines of *general* applicability that one could use to regulate a servicer’s conduct, such as [consumer protection statutes](#) and [common law claims for unlawful activities like fraudulent misrepresentation](#). In addition, state attorneys general in a number of

jurisdictions—including [California](#), [Illinois](#), [Mississippi](#), [Pennsylvania](#), and [Washington](#)—have invoked these laws to sue servicers who have allegedly engaged in deceptive conduct within a given state.

Federal Preemption and the ED’s Position

When both federal and state laws coexist in a particular subject area, questions of federal preemption arise. Under the case law interpreting the Constitution’s [Supremacy Clause](#), federal law can supersede conflicting state law in two central ways. First, statutory language that [expressly](#) addresses the scope of a law’s preemptive effect, such as [20 U.S.C. § 1098g](#), may be the basis to conclude that Congress intended federal law to invalidate certain state laws. Second, even if a statute is silent as to Congress’s preemptive intent, [implied](#) preemption principles can also displace state law. A statute can implicitly preempt state law where: (1) the scheme of federal regulation is so pervasive, or the federal interest is so dominant, that it can be presumed that Congress intended to supplant all state laws in a particular area (also known as “field preemption”); or (2) the state law [conflicts](#) with federal law by either making it impossible to simultaneously comply with both laws or by frustrating the purposes and objectives of the federal law.

Invoking these principles, ED [published an interpretation](#) in March 2018 announcing its position that federal law preempts a wide range of state laws that regulate federal student loan servicers. ED did not promulgate this interpretation through [notice-and-comment rulemaking](#); it instead published its interpretation in the Federal Register as an [informal guidance document](#). Among other things, ED claims that federal law displaces:

- State laws that “[impose regulatory requirements on servicing](#),” such as laws that “impose deadlines on servicers for responding to borrower inquiries” or “require specific procedures to resolve borrower disputes;”
- State regulations “requiring [licensure](#) of servicers” of certain federal student loans; and
- State requirements concerning what servicers must [disclose](#) to borrowers.

ED grounds its interpretation in a number of implied preemption theories, including [conflict](#) preemption (*i.e.*, that state servicing laws allegedly impede Congress’s objective of establishing [uniform federal loan servicing standards](#)) and field preemption (*i.e.*, that existing federal regulation is [comprehensive and adequate](#), leaving no role for additional state regulation). ED also relies on express preemption principles, arguing that [20 U.S.C. § 1098g](#)’s preemption provision [broadly bars states](#) from imposing disclosure requirements. ED “[interprets the term](#) ‘disclosure requirements’ under section 1098g . . . to encompass” not only written disclosures, but also “informal or non-written communications to borrowers.” In addition to issuing this interpretation, ED has also [submitted filings](#) in [several cases](#) asking courts to dismiss lawsuits against student loan servicers on preemption grounds or otherwise narrow or invalidate state regulations.

The Judicial Battleground

ED’s interpretation and its litigation position have fueled the debate between [states](#) and [borrowers](#) on one side—who claim that state servicing statutes may exist harmoniously alongside federal laws and policies—and the [executive branch](#) and [servicers of federal student loans](#) on the other—who claim that those state regulations irreconcilably conflict with supreme federal law. Federal district court cases have recently involved both (1) laws that specifically regulate student loan servicers and (2) laws of general applicability that plaintiffs have invoked against servicers.

State and Local Laws Specifically Regulating Student Loan Servicers

With respect to the growing trend of state and local laws specifically regulating student loan servicers, one recent case addressing preemption of such a law is *Student Loan Servicing Alliance v. District of Columbia*. In a challenge brought by an association of student loan servicers, last fall, the U.S. District Court for the District of Columbia addressed whether federal law preempted a D.C. statute and set of regulations that created a licensing scheme and standards of conduct for student loan servicing. As an initial matter, the court did *not* defer to ED's determination regarding the federal law's preemptive effect. The court **reasoned** that the ED interpretation consisted of informal agency guidance that was not sufficiently "thorough, consistent [or] persuasive" to warrant even *Skidmore* deference (for more on deference to agency legal interpretations, see this [CRS Report](#)), requiring it to perform an independent analysis regarding the underlying legal question. First, the court rejected the argument that the HEA precludes all state servicing law by occupying the field of federal student loan servicing regulation. Although recognizing the HEA's **comprehensive nature**, the court **relied** on precedent from a number of appellate courts holding that the HEA generally does not have field preemptive effect. Emphasizing Congress's intent, the court **observed** that Congress took care to explicitly preempt *certain* state laws in various provisions throughout the HEA, suggesting an intent to not supplant *all* state laws in the field.

When analyzing whether the D.C. law *conflicted* with the HEA, however, the court determined that D.C.'s licensing scheme posed an obstacle to ED's ability to select student loan servicers for certain federal student loans. Specifically, it reasoned that the D.C. law, by requiring the servicers to obtain a license from D.C., effectively served to "**second-guess**" the federal government's decisions to select and contract with a given loan servicer. The court's reasoning applied to **FDLP** loans and government-owned **FFELP loans**, but not to **commercial FFELP loans**, where private lenders own and make decisions concerning contracting with student loan servicers.

State Laws of General Applicability as Applied to Student Loan Servicers

A number of federal district courts over the past two years have also examined whether borrowers can use existing state consumer protection statutes and common law to sue federal student loan servicers when the servicers allegedly provide them with, for example, false or misleading information. The main issue in these cases has been whether Section 1098g's language prohibiting "disclosure requirements of any State law" preempts state law with respect to the servicers' allegedly deceptive communications. The debate has focused on whether applying the state's law in these cases requires the servicer to make additional or different "disclosures" within the meaning of Section 1098g.

On one hand, several federal district courts have held that Section 1098g does expressly preempt state laws of general applicability when applied to student loan servicers' allegedly false or deceptive communications. For example, in one Illinois case, *Nelson v. Great Lakes Educational Loan Services, Inc.*, the plaintiff claimed a servicer's call center employees steered her towards placing her loans into forbearance, while failing to adequately inform her of other long-term repayment options. Because federal regulations already prescribe the information that must be provided to federal student loan borrowers, the district court concluded that the plaintiff's state law claim would essentially impose additional disclosure requirements (*e.g.*, a requirement to disclose all options for repayment) on student loan servicers in conflict with Section 1098g. A federal court in Florida in *Lawson-Ross v. Great Lakes Higher Education Corp.* employed similar reasoning in a case where a loan servicer was alleged to have falsely assured the plaintiffs that they were on track to benefit from the Public Service Student Loan Forgiveness Program. Even though the plaintiffs argued that they had alleged an affirmative *misrepresentation* regarding their eligibility, the court construed the plaintiffs' claim as one for the servicer's failure to disclose *accurate* information regarding their eligibility, which it found to be impermissible under Section 1098g. In concluding as such, the *Lawson-Ross* court cited ED's interpretation, **concluding** that ED's views on the preemptive effect of federal law were "well-reasoned and sensible."

On the other hand, several federal district courts examining fairly similar claims (*i.e.*, allegations that servicers provided incorrect information to borrowers) have reached different conclusions from the *Nelson* and *Lawson-Ross* courts. These contrary holdings allowing the students' claims to proceed have viewed such claims as involving affirmative misrepresentations, which the courts distinguished from the mere failure to provide additional "disclosures" within the meaning of Section 1098g. Moreover, in *Pennsylvania v. Navient Corporation*, a federal district court in Pennsylvania ruled, in contrast to the *Nelson* case above, that the HEA did not preempt plaintiffs from asserting state law claims that a servicer had allegedly steered borrowers into forbearance while failing to inform them of other options. The court **reasoned** that the defendant's argument went "too far" in framing the plaintiff's claim as one for lack of disclosure, rather than a claim concerning unfair and deceptive conduct subject to the state consumer protection statute. The court further **distinguished** a Ninth Circuit case from 2010 on which *Nelson* and ED's interpretation relied—*Chae v. SLM Corp.*—because that case involved allegations concerning the misleading nature of written account statements and coupon books (*i.e.*, "highly prescribed standardized forms"), rather than the "affirmative misconduct" and types of communications regulated by Pennsylvania law. Appeals in the *Navient*, *Nelson*, and *Lawson-Ross* cases are currently pending.

Legal Considerations for Congress

Because congressional purpose "is the **ultimate touchstone**" when conducting any preemption analysis, Congress may respond to these conflicting judicial opinions by specifying to what extent it intends federal law to preempt state servicing laws. To illustrate, a section of the proposed **PROSPER Act** (H.R. 4508) introduced in the 115th Congress, **if enacted**, would have provided that the **servicing of particular categories of educational loans** would "**not be subject** to any law or other requirement of any State or political subdivision of a State" **with respect to**:

- "disclosure requirements;"
- "requirements or restrictions on the content, time, quality, or frequency of communications with borrowers, endorsers, or references with respect to such loans;" or
- "any other requirement relating to the servicing or collection of a loan made under" specified provisions of the HEA.

Alternatively, if Congress intends to limit the preemptive scope of federal law, it could consider enacting a **savings clause** that specifies that federal law does *not* preempt any state law that imposes more restrictive requirements on federal student loan servicers than those that already exist under federal statutes and regulations. Unless and until Congress acts on this issue, however, legal questions regarding the preemptive scope of federal servicing laws will be left to the courts to resolve. Depending on their content, the courts' legal rulings may in turn have public policy ramifications with respect to the uniformity of servicing regulations across jurisdictions and the level and type of oversight to which federal student loan servicers are subject.