Testimony before the

U.S. Senate Committee on Health, Education Labor and Pensions

“Strengthening the Federal Student Loan Program for Borrowers”

March 27, 2014

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The National Consumer Law Center (NCLC) thanks the Committee for holding this hearing and inviting us to submit this testimony on behalf of our low-income clients. The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations that represent low-income and older individuals on consumer issues.[1] NCLC's Student Loan Borrower Assistance Project provides information about student loan rights and responsibilities for borrowers and advocates. We also seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable.[2]

In my work as the Director of NCLC's Student Loan Borrower Assistance Project, I provide training and technical assistance to attorneys and advocates across the country representing low-income student loan borrowers. I have written numerous reports on student loan issues and am also the principal author of NCLC's *Student Loan Law* practice treatise.

I provide direct representation to low-income borrowers through Massachusetts-based legal services and work force development organizations. I also have daily contact with a wide range of borrowers through our student loan web site. Because of my extensive experience representing student loan borrowers and working on student loan matters, I have served as the legal aid representative at a number of Department of Education negotiated rulemaking meetings.

Promoting Equal Access to Higher Education and Improving the Federal Student loan Program

The federal student aid programs began during the 1960s as a way to improve access to education for lower-income individuals. In 1965, on signing the Higher Education Act, President Johnson said, "[The Higher Education Act] means that a high school senior anywhere in this great land of ours can apply to any college or any university in any of the 50 States and

[1] In addition, NCLC publishes and annually supplements practice treatises which describe the law currently applicable to all types of consumer transactions, including *Student Loan Law* (4th ed. 2010 and Supp.).
[2] *See* the Project's web site at http://www.studentloanborrowerassistance.org.

not be turned away because his family is poor."[3] President Nixon echoed this message in 1970, stating that "No qualified student who wants to go to college should be barred by lack of money."[4]

Measured by these goals, student aid policy has failed. College completion rates in the United States have been flat since the 1970s among all sectors of higher education. Lack of completion is a particular problem among lower-income individuals. The shocking reality is that despite all of the money spent on financial aid, the difference in college graduation rates between the top and bottom income groups has widened by nearly 50% over two decades.[5] U.S. Education Secretary Duncan has admitted that college access disparities are "actually worsening."[6] As the *New York Times* reported, this growing gap "…threatens to dilute education's leveling effects."[7]

Closing the access gap depends in large part on improving the federal student loan system. Although federal student aid is not made up of loans alone, student loans are the centerpiece of federal aid and are unavoidable for most students and their families. This is mainly because college costs have risen faster than family incomes and available grant aid. To compound the problem, the lowest income borrowers tend to borrow the most.

It is not just the levels of debt that cause problems, but the levels of financial distress due to unmanageable student debt. There are nearly 39 million borrowers carrying over $1 trillion in federal student loan debt.[8] About $120 billion of federal student loan debt was delinquent in 2012--a 30.5% increase from fiscal year 2011.[9]

These problems are exacerbated by a draconian collection system that provides little or no opportunity for a fresh start if a student borrower does not succeed in college the first time around. The challenges are even greater given the changing demographics of college students today. **Most students do not follow a straight line from high school to a four year college to graduation.** Only 15% of undergraduate students live on campus. Three in ten works full-time and one in four have their own children.[10] Federal student aid policy must reflect and accommodate the reality that "non-traditional" students are now the majority of college students.

The government has nearly boundless powers to collect student loans, far beyond those of most unsecured creditors. The government can garnish a borrower's wages without a judgment, seize his tax refund, even an earned income tax credit, seize portions of federal benefits such as Social Security, and deny him eligibility for new education grants or loans. Even in bankruptcy,

[3] Quoted in Peter Sacks, *Tearing Down the Gates: Confronting the Class Divide in American Education* (2007).
[4] *Id*.
[5] Tami Luhby, "College Graduation Rates: Income Really Matters." CNN Money (Nov. 28, 2011).
[6] Quoted in Omari Scott Simmons, "Lost in Translation: The Implications of Social Capital for Higher Education Access" 87 Notre Dame Law Review 205 at 210 (Nov. 2011).
[7] Sabrina Tavernise, "Education Gap Grows Between Rich and Poor, Studies Say" New York Times (Feb. 9, 2012).
[8] Statistics discussed in Rohit Chopra, Consumer Financial Protection Bureau, "A Closer Look at the Trillion" (Aug. 5, 2013); "Explainer: Changes to Federal Student Loan Interest Rates" (June 21, 2013).
[9] U.S. Department of the Treasury, "U.S. Government Receivables and Debt Collection Activities of Federal Agencies," Fiscal Year 2012 Report to the Congress (March 2013).
[10] HCM Strategists, "The American Dream 2.0" (2013).

most student loans must be paid. Unlike any other type of debt, there is no statute of limitations. Even those who can make some payments face serious damage to their credit reports or ability to get credit for critical purchases such as cars and homes.

This is unacceptable and unsustainable. Schools may be profiting as tuition continues to rise and private servicers and collectors may be profiting due to borrower misfortune, but we should not be growing our student loan system on the backs of defaulted borrowers or measuring success by private profit rather than student success.

My testimony focuses on improving the federal student loan program through a multi-faceted approach. There is no one solution to help more students succeed in college, borrow as little as possible, and manage debt. My testimony highlights the following key recommendations:

1. Target aid to the neediest students and reduce reliance on loans.
2. Encourage success and prevent defaults by:
    - Holding schools accountable. (The best way to prevent default is through student success),
    - Improving information and counseling,
    - Simplifying the federal student loan system, and
    - Creating an automatic income-driven repayment (IDR) option in late stage delinquency and studying other options.
3. Create a servicing and collection system based on borrower service, not private profit, and make it transparent.
4. Hold the government and contractors accountable through rigorous public and private enforcement.
5. Give borrowers the opportunity for a fresh start.
6. Restore a student loan safety net.
7. Mandate research and innovation.

There are many challenges highlighted in this testimony, but it is also important to recognize the positive developments, particularly in the government's successful transition to 100% Direct Lending. By most accounts, the origination process works well. Memories are short and too many have forgotten the costly abuses in the guaranteed loan program that ended in 2010. It is most important to look forward and focus on making the current programs work better for borrowers, taxpayers and society.

I. Target Aid to the Neediest Students and Reduce Reliance on Loans

This general goal should include incentives for schools to admit low-income students and help them succeed. Increased support for targeted grants, including Pell grants, is critical.

Although increased grant funds are necessary, we cannot solve the access gap through money alone. Many of the hurdles low-income individuals face go beyond financial issues.

There are social trends at work that may provide challenges that are just as significant. We urge Congress to consider testing programs that address the additional challenges so many low-income students face. [11]

II. Encourage Student Success and Prevent Defaults

A. Hold schools accountable

One of the most effective ways to prevent defaults is to incentivize colleges to improve student completion and success rates and hold schools accountable for consistently inferior outcomes. Borrowers are most likely to default if they do not complete college and if they are unemployed or earning low wages after leaving or graduating.[12]

It is worth exploring requiring schools to pay directly for student loan defaults. However, there are dangers for borrowers if schools pay off loans and then attempt to collect directly from students. Borrowers in these cases lose the various rights available under the Higher Education Act for federal student loans. Another option may be to adjust the cohort default rate thresholds and calculations so that more schools with default rate problems are sanctioned.

B. Improve Information and Counseling

Congress and regulators should look for opportunities to improve the timing, content and effectiveness of counseling. However, counseling and disclosures should not be substitutes for substantive reform.

This is an important area for additional study as there are mixed results on whether default aversion counseling actually prevents defaults.[13] In designing these studies, it is not enough to measure whether borrowers increase knowledge through counseling and other interventions. The focus should be on measuring borrower behavior over time after receiving counseling or other default aversion services.

As part of the information and counseling efforts, Congress and regulators should assess the effectiveness of the various ombudsman programs and consider expanding them. The Department of Education's ombudsman office, in our experience, can play a useful role in fostering communication and in some cases mediating disputes between the government and borrowers. We also urge creation of pilot programs to fund non-profit, neutral counseling entities and legal assistance programs.

C. Simplify the Federal Student Loan System

The Consumer Financial Protection Bureau's collection of complaints about private student loans indicates high levels of confusion among borrowers regarding their loans and the

[11] See generally National Consumer Law Center, "No Lost Causes: Practical Ideas to Help Low Income Students Succeed in College" (March 2014).
[12] See generally National Consumer Law Center "The Student Loan Default Trap: Why Borrowers Default and What Can Be Done" (July 2012).
[13] Id.

financial aid process. Many borrowers did not know the rules for federal aid eligibility and some could not identify whether they had federal or private loans.[14] We know first-hand how difficult it is to counsel distressed borrowers about the differences between IBR, ICR, ISR, PAYE and a host of other acronyms. Our clients and others like them all too often end up stuck in a bureaucratic morass when seeking solutions for financial distress.

Simplifying the servicer system will improve repayment rates and prevent defaults, as discussed in the next section. In addition we recommend:

1. **Establish a single portal for all borrower transactions**. Even if there are multiple servicers, all borrowers should receive communications that are clearly from the government, not from a private servicer or contractor who the borrower may or may not know and may not even associate with student loans. We agree with the Direct Loan Coalition that focusing borrower activity to a single site will improve the simplicity and transparency of the federal loan process.[15]

   This confusion has serious consequences. For example, the tax statements (1099s) after a disability discharge come in envelopes from the government contractor Nelnet. Those that we have seen do not specify that there is an important tax document inside or that it has anything to do with a student loan. Peg Julius from the Direct Loan Coalition testified that "Because the servicers are currently allowed to co-brand all mailings (either paper or e-mail) with their company name, students may not open the correspondence and thus, miss important information….This was not an issue when there was a single federal loan servicer and all correspondence was identified simply as "Federal Direct Student Loans."[16]

   The improved disability discharge system provides some important lessons in streamlining a government program. While not perfect, the program operates much more efficiently due to a series of legislative and regulatory improvements. The increased effectiveness is due in part to a simplified system where all borrowers apply for discharges through one servicer regardless of whether they have FFEL, Perkins or Direct Loans.

2. **Simplify the income-driven repayment programs.** There is too much complexity in the numbers of income driven repayment programs and other options. Streamlining these programs, including creating one IDR plan, will make it easier for servicers to provide quality assistance. We agree with the Institute for College Access and Success' (TICAS) proposal to consolidate the complex income-driven repayment plans into one new and improved plan.[17]

[14] Rachel Fishman, "What Borrowers Don't Understand About Student Loans May Hurt Them" Higher Ed Watch (June 18, 2012).
[15] National Direct Student Loan Coalition, "Reauthorization of the Higher Education Act: Proposals for Legislative Change" (September 2013).
[16] Statement of Peg Julius on behalf of the National Direct Student Loan Coalition (NDSLC) before the House Subcommittee on Higher Education and Workforce Training, Hearing on "Examining the Mismanagement of the Student Loan Rehabilitation Process" (March 12, 2014).
[17] See The Institute for College Access and Success, "Aligning the Means and the Ends" (February 2013).

D. Create An Automatic IDR Option in Late Stage Delinquency

To help catch financially distressed borrowers before they fall into default, we recommend automatically enrolling borrowers in late-stage delinquency in IDR. Borrowers could opt out later if they choose. The Institute for College Access and Success (TICAS), for example, has recommended automatic enrollment in IDR at the six month delinquency mark.[18]

We urge Congress to be wary of the seemingly simple solution of placing all borrowers into a universal IDR program whether payments are made via payroll deductions or other means. It is critical to maintain choice for borrowers and recognize that IDR is not the best payment plan for everyone. Some borrowers will pay more over the life of their loans using IDR. IDR can also increase the amount of time borrowers have outstanding debt, which might impede access to other forms of credit. Further, even a low IDR payment is not affordable for everyone. For example, high private student loan debts are not even counted in the IDR formula. There should be other options such as hardship suspensions or deferments for these borrowers.

Automatic payroll deduction is an option often discussed to improve repayment. This option may seem simple and appealing, but this is not necessary the case. Small employers in particular may not be equipped to administer even a relatively simple repayment system and we have often experienced problems with both large and small employers mismanaging the wage garnishment process.

In addition, student loan debt is not the same as Social Security payments which are currently collected through payroll deductions. Borrowers often have legitimate defenses to student loan repayment. They must have a way to be able to raise these defenses rather than operate under a system that assumes that the debt is valid. For example, we had a client recently who attended a for-profit school in the Boston area for about one month. Despite promises of superior instruction and job placement, the entire first month of "instruction" involved the students sitting in a classroom reading job ads. The client left, but has a $10,000 outstanding loan. We intend to assist her if possible in challenging repayment based on legal claims against the school. This is not something that would arise in a payroll deduction for Social Security or Medicare. Finally, an automatic enrollment system must not penalize borrowers who are unable to work and/or not required to file taxes.

Congress should proceed carefully and avoid latching on to a seemingly simple, but not necessarily optimal solution. In addition, without proper design, there are the potential unintended consequences of losing leverage to incentivize schools to improve student outcomes. In promoting the idea of automatic IDR, a consortium of advocacy groups recently acknowledged that they a system of this sort would not necessarily solve the problem of college affordability or stem growing student debt levels.[19]

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[18] Id. at 65-66.

[19] "Automatic for the Borrower: How Repayment Based on Income Can Reduce Loan Defaults and Manage Risk" (2014).

III. Create a Servicing and Collection System Focused on Borrowers, Not Private Profit and Make it Transparent

Servicers and collectors must provide holistic counseling so that borrowers understand all available options. A well designed system focused on quality service will also help simplify the student loan system and ultimately save money. The goal is to encourage superior service through some competition without bombarding consumers with too much information.

A. Improvements in Servicing

In order to create an improved servicing system, we need more information about the current system, including information about contract structure and performance evaluation. We fear that the Department of Education is moving toward a model in which it justifies withholding basic information about private servicers because of supposed proprietary contract arrangements. This may work well for Department employees seeking to avoid accountability, but it does not work best for borrowers and taxpayers.

The goal of the system should be to provide quality service to borrowers. The current system is not meeting this goal among other reasons because there are too many servicers and too much variation in service. Most important, the Department of Education is not providing sufficient oversight to ensure that all borrowers receive quality service. <u>Regardless of whether there are multiple servicers or a single servicer, borrowers should have standard, quality service and the Department must award contracts based on metrics that focus on quality service.</u>

We urge the Department to consider different approaches. We believe that the system that emerges should likely involve multiple servicers competing for accounts. However, as discussed above, all borrowers should receive quality standard service and should be able to deal with the servicer through a single portal that clearly brands the student loans as a government product and service. The performance metrics must be relevant, rigorous and transparent. If there are multiple servicers, borrowers should be allowed to switch if they are not satisfied.

Unfortunately, consistent quality service is not the current borrower experience. Among other problems, we see servicers pushing borrowers into the quickest options, such as forbearance, rather than explaining and assisting borrowers to obtain more favorable long-term solutions, such as income-based repayment. Forbearances can be costly for borrowers because interest accrues during forbearance periods and because they must be renewed more frequently than most other options.

For example, I recently met with a financially distressed client who is barely managing to stay current on an old guaranteed consolidation loan (FFEL loan). She had been living in a domestic violence shelter for some time. She is temporarily living with a friend while her son lives with other family members. She is trying to get back on her feet and find work. It is difficult and she is only earning about $5,000/year. Yet when she called her federal loan servicer for help, they put her in a short-term forbearance. For the last several years, they have placed her in forbearances and deferments. She says that no one even mentioned income-based repayment (IBR). She called the servicer while I was in the room and sure enough, the representative mentioned another forbearance. The representative only mentioned IBR when I got on the phone and asked about it.

The servicers often complain that they are "stuck" and must push easier solutions because of flaws in the government servicing contract commission system. Essentially, servicers say that they are not paid enough to take the time to administer the more complex programs. This is unacceptable. When servicers enter into contracts with the government, they know what the commission system will be. Even if there are problems with compensation, those problems are not an excuse to deny borrower rights or provide inferior service. The company is not stuck. It can choose not to bid for a contract it deems unreasonable. In contrast, borrowers are truly stuck if they face servicing problems. They are not permitted to shop around and find better choices. The Department is unequivocal about this trap on the federal loan side. In on-line FAQs, in response to the question, "Do I select my loan servicer?" the Department's answer is No. [20]

The servicing system has become so confusing that an entire industry of for-profit "debt relief" companies has sprung up to supposedly provide the services that the free government servicers are failing to provide. Borrowers run the risk not only of paying exorbitant fees to these companies, but also of losing important rights. We released a report last year focusing on abuses in the for-profit student loan "debt relief" industry. [21] New York Governor Cuomo's new Student Protection Unit recently announced that it had sent subpoenas to thirteen of these "relief" companies. [22]

We have sent examples of poor service and legal violations to the Department of Education for years and more recently to CFPB. The Department has admitted to finding numerous problems with the performance of servicers such as Sallie Mae. For example, the Department responded to a request for information from Senator Elizabeth Warren in December 2013 with a long list of "issues" identified by the Department in audits and reviews of Sallie Mae. These issues with Sallie Mae's servicing of federal loans include defects in conversion to repayment, incomplete adjustments to borrower accounts when transferred from a previous servicer, and incorrect calculation of income for the income-based repayment program (IBR). The Department also listed problems with the company's servicing of FFEL loans uncovered in audits and review, including incorrect billings, due diligence errors, and incorrect repayment terms. However, the Department said that compliance issues have not risen to the level where "penalties were considered appropriate."

As the Inspector General and GAO recently reported, the Department has not followed up reports of problems with rigorous oversight. To date, we have been able to work out individual client situations, often in conjunction with ombudsman assistance, but have yet to see systemic reform.

[20] See http://studentaid.ed.gov/repay-loans/understand/servicers
[21] See National Consumer Law Center, "Searching for Relief: Desperate Borrowers and the Growing Student Loan 'Debt Relief' Industry" (June 2013).
[22] See New York State Department of Financial Services, "Governor Cuomo Announces New Student Protection Unit and Launches Investigation into Student 'Debt Relief' Industry" (January 22, 2014).

The CFPB's announcement in December 2013 that it will begin supervising large student loan servicers is a promising sign for borrowers.[23] The CFPB can help fill the gaps caused by a long history of lax federal oversight. The CFPB and Department of Education must work together to ensure that servicers are doing their jobs properly. State Attorney General offices also have an important role in protecting consumers in their states.

Additional Recommendations to Improve Servicing:

1. **Ensure that all borrowers receive quality servicing with a minimum of confusion.** We agree with the Direct Loan coalition that competition among a limited number of servicers can be healthy, but that too many servicers increase complexity and taxpayer cost.
2. **Address potential conflicts in the new program allowing borrowers to choose a servicer when consolidating**. **W**e are very concerned about the potential for abuse with this new consolidation system. We outlined these concerns in a letter to the Department of Education and CFPB dated March 6, 2014 and attached to this testimony. We have not yet heard back. Among other actions, the Department could prohibit third parties from making the choice on behalf of borrowers.
3. **Give borrowers the opportunity to switch servicers.** This will help spur healthy competition.
4. **Ensure smooth transitions if accounts must be transferred.**
5. **Provide public information about how servicers are evaluated, including detailed information about the current performance metrics.**
6. **Ensure that borrowers have access to monthly statements, fair billing and other basic consumer rights that exist in most other consumer credit markets.**
7. **Penalize servicers that violate higher education and consumer protection laws and fail to provide consistent quality service.**

B. Improvements in Collection

The Department of Education refers every eligible debt to one of 22 collection agencies. The business is a huge growth opportunity for collectors. According to one insider, "The student loan market is a $1 trillion opportunity for the ARM [debt collection] industry that is not going to decline anytime soon." [24]

We urge Congress to investigate this system, focusing on the cost to taxpayers and borrowers. **Outsourcing collection is not cheap. Taxpayers paid about $1 billion in commissions to private student loan debt collectors in 2011**.[25] Department projections show commissions growing to over $2 billion by 2016.[26]

Contractors are too often rewarded based on the amounts collected without regard to borrower rights. In our experience, <u>collection agencies routinely violate consumer protection</u>

[23] Consumer Financial Protection Bureau, "CFPB to Oversee Nonbank Student Loan Servicers" (Dec. 3, 2013).
[24] Mark Russell, "Student Loans: The ARM Industry's New Oil Well?" *Inside ARM* (Oct. 20, 2011).
[25] John Hechinger, "Obama Relies on Debt Collectors Profiting from Student Loan Woe," *Bloomberg* (March 26, 2012).
[26] Presentation of Dwight Vigna, Education Department, 2013 Knowledge Symposium (Nov. 2013).

laws and prioritize profits over borrower rights. The GAO report affirmed this unfortunate trend, finding that the Department documented instances where collection agency representatives provided false or misleading information to borrowers. According to the GAO report, when the Department found these violations, it simply provided feedback.[27] This is unacceptable. At a minimum, the Department of Education should have referred violations to other agencies that regulate debt collectors, including the CFPB. **The tender treatment of collection agencies breaking the law is in sharp contrast to the way borrowers are hounded forever when they run into financial distress**.

The government must balance the need to collect student loans and the need to assist borrowers. The current system heavily favors high pressure collection and collector profits, to the detriment of financially distressed borrowers seeking the help they so desperately need.

The main problem is that dispute resolution is not the primary mission of loan collection agencies. Debt collectors are not adequately trained to understand and administer the complex borrower rights available under the Higher Education Act, and the government does not provide sufficient oversight of their activities. There are certainly times when a borrower is uncooperative or has exhausted all options. In those cases, the loan holder may have no choice but to focus on collection efforts. Yet there are many borrowers who want to find a solution, but are stymied because they cannot get past the rude, harassing, and often abusive behavior of a collection agent.

As noted above, we have provided the Department of Education and more recently the CFPB with consistent examples of problems over the years with little or no response. The criticism has been more public recently from the Inspector General and GAO. The recent GAO report, for example, includes very important findings of Education's failure to monitor its contractors and conduct oversight. In addition, the Department's Inspector General issued a final alert memorandum in May 2013 informing the Department of concerns that Federal Student Aid (FSA) paid estimated commissions and bonuses to private collection agencies based on revised methodologies and without reviewing supporting documentation. FSA was unable to calculate the actual commissions earned due to problems with in-house systems and therefore relied on self-reported estimates during FY 2012.[28]

The Department and other loan holders often dismiss examples of bad behavior as "anecdotal" and point to low volumes of borrower complaints. This excuse does not take into account that complaints are relatively low in part because borrowers do not know how to complain. There is no clear information for borrowers about how to lodge complaints about collection agencies.[29] In any case, there should be no more hiding given the recent GAO and IG investigations confirming the widespread problems in oversight and management of private contractors. The GAO reported that with respect to rehabilitation, the Department did not have

[27] U.S. Government Accountability Office, "Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation" (March 2014).
[28] U.S. Department of Education, Office of Inspector General, "Federal Student Aid Paid Private Collection Agencies Based on Estimates," Control Number ED-OIG/L02N0002 (May 15, 2013).
[29] See Deanne Loonin & Jillian McLaughlin, "Borrowers on Hold: Student Loan Collection Agency Complaint Systems Need Massive Improvement." National Consumer Law Center (May 2012), p. 15-17.

data to track loan rehabilitation performance or data on the extent to which borrowers that rehabilitate stay out of default.[30]

In addition to pushing for greater oversight, we urge Congress to require the Department of Education to reveal how it measures collection agency performance. We have attempted for some time to obtain more information through FOIA requests, but have been stonewalled for the most part. <u>We are very concerned about the trend away from providing the public and legislators with the information needed to ensure that borrowers and taxpayers are protected.</u>

An accessible complaint system and increased transparency will not solve all student debt problems. However, improvement in these areas can help restore the balance between borrower rights and extraordinary government collection powers. The government has nearly unlimited power to collect student loans. At a minimum, the government must be accountable to the public about how it uses this power and how much it costs all of us in the long run.

We urge Congress to monitor the Administration's response to the recent GAO and Inspector General findings. It is past time to focus on fixing not just loan rehabilitation, but the entire federal loan servicing and collection system. The Administration was able to mobilize and implement the transition to full direct lending a few years ago. Now the government must put this same level of commitment to fixing the servicing and collection system.

We will know the collection system is working better if servicers and collectors start complying with existing laws and learn to explain these laws without bias to borrowers. The government must measure success on this basis instead of focusing only on higher collection levels.

Additional Recommendations to improve collection

1. **Eliminate private collection agencies from the dispute resolution role.**

   Until such time as the government identifies viable alternatives to private collection agencies, we call on the Administration to issue a moratorium on using private collection agencies for student loan dispute resolution. Congress should also act to prohibit use of private debt collectors and create a pilot program to study the effectiveness of other debt collection techniques.

2. **Provide public information about the cost of outsourcing to private debt collectors and about performance. Collection agency performance must be about more than dollars collected.**
3. **Monitor Department oversight of collection and require public information about how performance is tracked and the results**.

4. **Require information about the process for handling complaints against collection agencies and any disciplinary actions taken against those agencies.**

[30] U.S. Government Accountability Office, "Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation" at 20 (March 2014).

IV. Hold Private Entities and the Government Accountable through Rigorous Public and Private Enforcement

As the recent GAO and IG studies confirm, federal and state enforcement of HEA requirements has been generally lax. While government enforcement is important, borrowers cannot rely on public actions to get relief. Congress must act to ensure that borrowers have private enforcement rights, not only to challenge predatory school practices, but also servicer and collector abuses. <u>This requires amending the HEA to create an explicit private right of action.</u>

Congress has created many new and improved options for borrowers. The Department of Education also signs numerous contracts with servicers and collectors to provide essential services. Theoretically, these entities could lose their contracts if they do not comply with the law. But even if this occurs, there are no provisions requiring relief for borrowers harmed by these practices. For example, what happens if the lender, guaranty agency or school refuses to discuss loan rehabilitation even when a borrower clearly has a right to such a plan? Currently the borrower can complain to the Department of Education. Given documented problems with the Department's oversight, this is less than a complete solution even for those borrowers who persist and manage to speak to someone. Beyond complaining, it is virtually impossible for a borrower to enforce her rights. Even in the case of the now well documented breakdown in the Department's rehabilitation system, the GAO report shows in detail how most borrowers were left in the cold. According to GAO testimony, less than 10% of the estimated 80,000 borrowers affected by the delays in loan rehabilitation received assistance to make them whole.[31]

The lack of private enforcement shuts the door on borrowers seeking to access programs that they are entitled to under the Higher Education Act. This glaring problem also undermines the effectiveness of new borrower-friendly programs because loan holders and servicers are not held accountable when they fail to comply with the law.

Congress should also prohibit mandatory arbitration clauses in school enrollment and lending contracts. Mandatory arbitration provisions, buried in many kinds of consumer contracts, require consumers to waive their right to use the court system, and instead limit consumers to resolving their disputes with the lender or seller through a binding arbitration process. This constraint puts the lender or seller in a stronger position, because little discovery is available, the business can pick the arbitration service provider (and repeat players bring more business, leading to an incentive for the arbiter to rule for the lenders), and decisions cannot be appealed.

V. Give Borrowers the Opportunity for a Fresh Start

Current federal aid practices and policies hammer students who do not succeed the first time around. Draconian collection and default policies prevent individuals from getting a fresh start. It also impedes economic productivity by preventing many students from returning to school, succeeding, entering repayment on their loans, and entering the labor force.

[31] Statement of Melissa Emrey-Arras, U.S. Government Accountability Office, Testimony before the Subcommittee on Higher Education and Workforce Training, Committee on Education and the Workforce, House of Representatives (March 12, 2014).

I am always moved by how hard so many of my clients try even if they do not always succeed. Each client has an individual story and entire populations never fit into neat categories, but I can say that most of my clients keep their dreams of higher education alive even after repeated failures. This is why we need to provide them with the opportunity to start fresh.

Providing a fresh start recognizes the reality that everyone makes mistakes and that not everyone succeeds the first time around. The main difference for low-income individuals is that one slip can be the end of the educational journey. There is little or no margin for error or cushion when they fall.

The first step to a fresh start is, as discussed above, to ensure that borrowers are working with neutral entities, not aggressive collection agencies, in accessing programs to assist them.

A. Study and Improve Existing "Get Out of Default" Programs

Rehabilitation and consolidation are the two main options currently available to federal student loan borrowers seeking to get out of default. Overall, consolidation is much faster than rehabilitation, mainly because a borrower in default does not have to make any preliminary payments to qualify. Further, there is no resale requirement. The faster process is especially important for borrowers seeking to go back to school quickly. In addition, with consolidation, borrowers do not have to make preliminary payments and so are not forced to negotiate "reasonable and affordable" payments with a collector. The main advantage of rehabilitation relates to credit reporting. However, this benefit is often oversold.

There is a dearth of research on the effectiveness of either consolidation or rehabilitation, particularly with respect to borrower success rates.[32] Department of Education staff confirmed in a phone call with NCLC that they did not know of any studies comparing the effectiveness of the two programs. This is particularly shocking since the Department collection contracts incentivize rehabilitation. The GAO also noted the Departments' failure to track the effectiveness of rehabilitation.[33]

We urge Congress to study these programs to evaluate effectiveness and in the meantime enact the recommendations below to ensure that the programs truly afford borrowers a fresh start.

Key recommendations:

1. **Eliminate the one-time limit on rehabilitation**.
2. **Eliminate the FFEL program resale requirement.** Because of this "requirement," borrowers who make the necessary payments can get stuck with no possibility of completing the rehabilitation simply because their guaranty agencies cannot find

[32] See generally "The Student Loan Default Trap: Why Borrowers Default and What Can Be Done" (July 2012).
[33] U.S. Government Accountability Office, "Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation" (March 2014).

buyers. At a minimum, agencies that cannot find buyers should be required to assign the loans to the Department of Education.

3. **Provide full credit reporting benefits**. Lenders should be required to erase all negative history in the borrower's credit report, not just the default notation. This is a much more complete "credit clearing" benefit.

B. Prevent Ballooning Loan Balances by Limiting Collection Fees

Collection charges should be limited to only those fees that are bona fide and reasonable and actually incurred. As long as collection agencies are still employed to collect student loan debts, Congress should act to limit the profits they earn on the backs of borrowers.

C. Provide a Fresh Start for Those Harmed by Predatory Schools

Through our work consulting with legal services and other attorneys across the country, as well as our direct representation work, we have seen a continuous stream of student loan borrowers who are struggling to pay 10, 20, and even 30-year old loans. The vast majority of these borrowers, including single parents, veterans, non-English speakers, first-generation students, and seniors, enrolled in for-profit schools in order to earn higher wages and improve their lives and the lives of their families. Too many of these schools, however, preyed on these borrowers' dreams by falsely promising high quality educations that would lead to high paying careers. By the time our clients reach us, their hopes and dreams have been shattered. Unable to find the employment promised, they face aggressive debt collection tactics for student loan debts they cannot afford to repay. Many of them have no way out.

A July 2013 *New York Times* article describes hundreds of borrowers (and maybe more) in New York City facing financial devastation due to loans incurred at a number of cosmetology schools that have been closed for years.[34] One of the borrowers summed up the trap she is in: "It would have been worth it," she said "for a school that gave me a future."

Although the Department of Education has recently worked at creating regulations designed to curb future abuses, these regulations do nothing to provide relief for the countless number of borrowers who have been harmed by fraudulent schools. The three main types of existing cancellations (or "discharges") that are intended to address fraud – closed school, false certification, and unpaid refund cancellations – are narrowly defined and provide relief to only a small subset of harmed borrowers. These cancellations are not available to borrowers harmed by other kinds of deceptive practices, including those that are prohibited by federal regulation. For example, a school may routinely pay admissions officers by commission, fail to provide educational materials or qualified teachers, or misrepresent a student's likelihood of finding a job or earning a particular salary after completion. All of these violations harm students, but none of them are currently included as grounds for student loan discharges.

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[34] Emily S. Rueb, "Beauty School Students Left with Broken Promises and Large Debts," The New York Times (July 28, 2013).

Congress and the Department of Education can fill in these gaps by creating a fresh start relief program. For too long, the risk of predatory school practices has fallen almost entirely on individual borrowers, who were not in a position to discover fraud and police schools before they enrolled. [35]

D. Use HEA Authority to Provide Relief for Private Loan Borrowers

Much of the statutory authority for private lending is outside of the HEA. However, the government can use the HEA as an oversight tool to protect private loan borrowers attending schools that receive Title IV funds. We recommend using this tool to require schools to certify private loans. As part of the certification process, schools should be prohibited from certifying loans that fail to provide basic consumer protections such as death and disability discharges.

VI. Restore a safety net for all ALL student loan borrowers

Collection should be targeted to those with resources to pay and there must be a safety net. This is critical for borrowers, but also for taxpayers. There are significant costs to taxpayers associated with pursuing the most vulnerable borrowers until they die. Under the current system, lenders and collectors profit as the government pays higher and higher collection fees.

At the National Consumer Law Center, we see and hear the human toll of the tattered student loan safety net every day from the low-income borrowers we represent. Here is just one example.

I had a client (Mr. A) who passed away last year at age 84. He was a veteran of the Korean War. After retiring from the insurance industry in his 70's, he was living alone, subsisting only on limited Social Security income.

Mr. A sought legal assistance because the government had started taking a large chunk of his Social Security income and he could no longer afford to buy the medications he needed for an array of serious health problems. It took a while to unravel the source of the offset because Mr. A insisted that he had never taken out any student loans to pay for education. He was correct that he had never taken out loans to finance his <u>own</u> education because he was able to use the G.I. bill. Instead, the offset occurred because of parent PLUS loans from the early 1990's. There was a large balance outstanding and Mr. A could not pay. His children could not help him financially either.

I contacted the loan holder Sallie Mae to figure out a way to at least reduce the Social Security offset. We submitted detailed proof of Mr. A's income and expenses. It took hours to document these expenses. Sallie Mae eventually agreed to reduce the offset to an amount that allowed Mr. A to purchase most of the medications he needed to keep going.

[35] For more information about existing authority to create this type of program and ideas for legislative change, see National Consumer Law Center, "Promoting Higher Education Access and Success: Higher Education Act Reauthorization Recommendations" (August 2013).

I discussed the possibility of a disability discharge with Mr. A, but this proud man insisted despite all evidence to the contrary that he could still work. Even after the suspension of the offset, Sallie Mae kept placing the account with collection agencies. I asked the Sallie Mae representatives to take the file back from the collection agency. Among other problems, the constant phone calls and letters were very upsetting to Mr. A. The Sallie Mae representative said they cannot take files back from collection agencies, but they did agree to put our name on the account as the contact.

Eventually after numerous stints at nursing facilities due to declining health, Mr. A agreed to apply for a disability discharge and was successful. However, he missed the paperwork requiring him to document his inability to work for three years because he was not picking up his mail while he was hospitalized. We were able to restore the discharge, but then Mr. A received a tax statement claiming he owed taxes on the discharged amount. This was one of the most upsetting aspects of the case for Mr. A. We were in the process of proving his insolvency when he died.

Despite this human toll, there is a common view that aggressive collection is necessary to shore up the student loan system. An attorney filing lawsuits on behalf of the government to collect student loans stated, "For every dollar collected from defaulted student loans, it's money that can be used again for student loans or taken off the deficit or used for other issues."[36] One of the government's largest collectors, ECMC, justified aggressive collection practices by emphasizing that its efforts keep federal financial aid programs solvent.[37]

These statements emphasize keeping the loan programs alive, but at what cost? Should the federal government support a growing student loan program on the backs of defaulted borrowers? If the goal of federal policy is to hound defaulted student loan borrowers until they die, then Mr. A's case and others like them are policy successes. But we do not believe that this should be the goal.

Key reforms to restore a safety net include:

1. **Eliminate offset of earned income tax credits** (one of the most important programs that help working families keep working)

2. **Eliminate Social Security offsets.** Social Security helps give aging and disabled Americans peace of mind. Offsetting this lifeline is an extraordinary collection tool that should be eliminated.

   In the meantime Congress should increase the exempted amount from a flat $9,000/year to an amount that is sufficient for basic survival and tied to an annual index. The $9,000 limit has not been raised since the

[36] Ron French, "Michigan Goes Hard After Student Loan Defaulters" Bridge Magazine (May 15, 2012).
[37] John Hechinger, "Taxpayers fund $454,000 Pay For Collector Chasing Student Loans" Bloomberg (May 15, 2012).

legislation was passed in the mid 1990's. It is even below the current poverty level for a single person of $11,670.

3. **Eliminate the three year reinstatement period for borrowers in the Social Security Medical Improvement Not Expected category.** The Department of Education recently amended the HEA regulations to allow borrowers to provide certain SSA determinations as presumptive proof of disability discharge. However, the Department did not eliminate the reinstatement period for these borrowers. This is in contrast to the V.A. process in which certain veterans may receive discharges without a three year reinstatement period. Eliminating the reinstatement period for these most disabled borrowers will also save money by reducing unnecessary bureaucratic requirements and oversight.

4. **Place a moratorium on offset of borrowers receiving SSDI so that they can apply for disability discharges.**

5. **Restore Bankruptcy rights for all student loan borrowers**.

6. **Restore a statute of limitations for federal student loans**

   The elimination of the statute of limitations for government student loans in the early 1990's placed borrowers in unenviable, rarified company with murderers, traitors, and only a few violators of civil laws. Despite the governmental and social interest in pursuing criminals, statutes of limitations apply to nearly all federal criminal actions. Among other reasons, statutes of limitations are essential because of the serious problems and abuses associated with adjudicating old claims. The limitless pursuit of vulnerable student loan borrowers has serious human and financial costs.

7. **Eliminate adverse tax consequences for Borrowers Receiving Administrative Discharges**

   Under current law, borrowers obtaining discharges due to disability or death (e.g. for parents surviving their children) or after IBR forgiveness face potential tax consequences while most other borrowers obtaining discharges do not. The current insolvency system is insufficient to protect many vulnerable borrowers.

VII. Mandate Research and Innovation

One way to improve efficiency is to conduct more empirical research and pilot projects to find out what works. According to New America, higher education generally suffers from a lack of rigorous experimentation, both in terms of practice and policy.[38]

We urge the Department of Education to make long-term data available to researchers AND to conduct internal studies using this data. Requiring private lenders to report data on private student loans, potentially through the NSLDS system, would open up another set of data to study borrower behavior over time.

It is critical to isolate the main predictors of default by using appropriate regression analyses. This regression research should focus particularly on the extent to which lack of completion causes higher default. Studies should also include interviews and surveys of borrowers. Many of these studies will take time as borrowers are tracked over longer periods.

In addition to research mandates, Congress should require the Department of Education to release data about key federal aid metrics including extensive default rate information, effectiveness of post-default programs, costs of collection, commissions to collectors and servicers, and other critical information.

Giving borrowers a chance to get back in good standing may be less costly in many cases than the relentless gauntlet of collection tactics. We particularly need more information about the costs of the Department's collection programs.

Conclusion

The student loan programs work well for many students who are able to complete their educations and earn sufficient income after graduation to repay their debts within a reasonable period of time. Unfortunately, this scenario is becoming less common as borrowers get deeper into debt earlier in the process and do not know about available options that could help them avoid problems down the road. Once these problems begin, collection costs and fees accrue so rapidly and aggressive collection efforts hit so hard that many borrowers never recover.

While the student loan programs are here to stay, there are ways to alleviate the burden for the most vulnerable and lower income borrowers. Our higher education system and economic productivity depend on how we resolve these issues.

Thank you for your consideration of these recommendations. Please contact Deanne Loonin (dloonin@nclc.org; 617-542-8010) with questions or comments.

[38] Stephen Burd, Kevin Carey, Jason Delisle, Rachel Fishman, Alex Holt, Amy Laitinen, and Clare McCann, New America Foundation, "Rebalancing Resources and Incentives in Federal Student Aid" (Jan. 2013).

ATTACHMENT

March 10, 2014

Rohit Chopra
Assistant Director and Student Loan Ombudsman
Consumer Financial Protection Bureau

James Runcie
Chief Operating Officer
Office of Federal Student Aid
U.S. Department of Education

Sent via e-mail

Dear Mr. Chopra and Mr. Runcie:

We have been following the Department of Education's plans to launch a new Direct Loan consolidation system. We understand from the January 7, 2014 announcement that the Department has begun implementing the first phase of this system and that the second is likely to occur this spring.[39] According to the announcement, most borrowers without loans in default should be applying for consolidation through the new studentloans.gov portal.

We have been unable to navigate the system because it requires a borrower PIN number. Based on the announcement and discussions with Department staff, we understand that borrowers will, for the first time, be required to choose a specific loan servicer as part of the consolidation application. This "chosen" servicer will be responsible for completing the consolidation application and acting as the borrower's general loan servicer. Borrowers will be able to choose between FedLoan Servicing (PHEAA), Great Lakes Educational Loan Services, Nelnet and Sallie Mae.

Although we agree generally with enhanced borrower freedom to choose servicers, we are very concerned about the potential for abuse with this new consolidation system. This could occur in a number of ways, including:

[39] We refer to this announcement:
http://www.ifap.ed.gov/eannouncements/010714NewDirectConsolidLoanProInfoPhaseOneTran.html

1. **Collection agency referrals:** Phase one does not include borrowers with loans in default. However, the current plan is to require these borrowers to use the new system once phase two is implemented. These borrowers are almost always dealing with a collection agency. Although borrowers should be able to bypass collection agencies and consolidate on their own, our experience is that the collection agencies pressure borrowers to allow the agencies to process the consolidation applications. Under the new system, we fear that these agencies will make servicer choices without consulting the borrowers.

   There is very serious potential for abuse. Kickback arrangements are one possibility. Even more directly, one of the servicers on the list, Sallie Mae, owns collection agencies.

2. **For-Profit Debt Relief Companies.** The National Consumer Law Center released a report last year focusing on abuses in the for-profit student loan "debt relief" industry. [40] New York Governor Cuomo's new Student Protection Unit recently announced that it had sent subpoenas to thirteen of these "relief" companies. [41]

   We found that the only "service" most of these companies perform, if they perform any service at all, is processing government loan consolidation applications on behalf of borrowers. This appears to be yet another area of potential abuse if these companies seek compensation to steer borrowers to particular servicers. Our investigation found that these companies generally do not provide reliable information to consumers. Therefore it would not be surprising if they selected servicers on behalf of borrowers without informing the borrowers about their right to choose servicers. Most of these companies seek powers of attorney to act on behalf of borrowers.

3. **School Referrals.** A number of our clients with loans in default have told us that for-profit school staff seeking to recruit them have offered to get their loans out of default for free. Many then tried to process loan consolidation applications on behalf of the borrowers. In some cases, we believe that the schools may be working with "debt relief" companies described above.

   In addition, many schools, both for-profit and non-profit, counsel students on handling loans after leaving school. In many cases, the schools are working with borrowers seeking to consolidate loans. It is unclear how these schools can counsel borrowers on comparing servicers and making informed selections.

4. **FFEL (Federal Family Education Loan or Guaranteed Loan) Conflicts.** Borrowers with FFEL loans often seek to consolidate into the Direct Loan program. All four of the "consolidation servicers" has a legacy FFEL portfolio. All but Sallie Mae were FFEL guaranty agencies, although Sallie Mae owns a guaranty agency. We fear that these agencies will steer borrowers into choosing them as the Direct Loan servicer, perhaps even inaccurately informing borrowers that they are required to keep the same servicer as they transition to Direct Loans.

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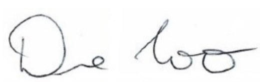
[40] See National Consumer Law Center, "Searching for Relief: Desperate Borrowers and the Growing Student Loan 'Debt Relief' Industry" (June 2013), available at: http://www.nclc.org/issues/searching-for-relief.html.
[41] See http://www.dfs.ny.gov/about/press2014/pr1401221.htm.

We are also concerned about the lack of information available to consumers to help them make servicer choices. The only information we know of showing servicer performance is the quarterly servicer survey information that is generally available only on the Department's Information for Financial Aid Professionals (IFAP) web site. [42] While imperfect, this information gives borrowers some sense of servicer performance. However, it is hidden on a site that consumers rarely visit or even know about. Further, we have noticed that the most recent information has not been posted. We have not seen an update since August 2013. There are media reports that the Department is making adjustments to some of the data categories. However, we do not understand why this would preclude the Department from continuing to release updated information in the other categories.

We are requesting that you send information about any and all information that is publicly available for consumers to learn about servicer performance. Please also indicate whether any information will be available in the future. Please be specific about this information. For example, can borrowers access the redacted transcripts from borrower satisfaction surveys? What other information is available?

In addition, we request that you contact us as soon as possible to explain any precautions the Department or other agencies have taken to avoid potential abuses and to provide information so that consumers can truly shop for servicers. This is particularly critical since once they make a choice, as far as we know, the Department will not let borrowers switch to a different servicer.

Sincerely,



Deanne Loonin

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[42] See, e.g., http://www.ifap.ed.gov/eannouncements/082213LSIQrtlyCustSatisSurveyBeginSept2013.html.