

FINDING A WAY OUT: IMPROVING THE ASSISTANCE NETWORK FOR FINANCIALLY DISTRESSED STUDENT LOAN BORROWERS

December 2007



The Student Loan Borrower Assistance Project (SLBA)
is a program of the National Consumer Law Center (NCLC).

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Acknowledgments

The views expressed in this report are those of the author alone and do not necessarily reflect the views of its funders. This report is a release of the National Consumer Law Center's Student Loan Borrower Assistance Project [www.studentloanborrowerassistance.org]. The Student Loan Borrower Assistance Project is supported in part by The Project on Student Debt [www.projectonstudentdebt.org]. The author thanks Edie Irons and her colleagues at the Project on Student Debt for their valuable comments. Thanks also to Irv Ackelsberg, Carolyn Carter, Patricia Hasson, Patricia Smith and Mallory SoRelle for their substantive contributions and feedback. Although too numerous to list here, special thanks to all of the ombudsmen, financial aid directors, and other advocates who responded to our surveys and interview requests for this report.

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EXECUTIVE SUMMARY

There is a severe shortage of assistance resources for the growing population of financially distressed student loan borrowers. This report investigates the student loan borrower assistance network. We review the following critical categories of relief: information and outreach, counseling, and direct assistance and legal representation. We discuss the strengths and weaknesses of existing resource providers in each of these categories, followed by recommendations for their improvement.

Key topics and findings include:

Types of Assistance:

Information and Outreach

Students and their families do not get enough information about loan programs before they borrow. Helping prevent problems by providing up-front information about the cost of student loans is critical. Prevention will not work for everyone and it is not a panacea. It is, however, a tremendously important step that can save many borrowers from falling into the often inescapable default spiral. Many borrowers also report lacking information after they borrow.

Counseling

The existing counseling requirements for federal loans are ineffective, simply one of many hoops students jump through to get their student aid checks. However, the poor track record of mandatory counseling should not obscure the potential benefits of targeted counseling for student loan borrowers.

Early intervention is essential because the costs rapidly pile up once trouble begins. Student loan collectors are allowed to charge enormous collection fees that are not even tied to the amount of effort expended. At the same time, interest accrues and the borrower is hounded by collectors and faced with the prospect of never-ending collection efforts.

Direct Assistance and Legal Representation

Not all student loan problems can be resolved through information and counseling. Direct assistance is also needed, especially when borrowers have disputes with their loan holders. The importance of direct borrower assistance has grown along with the complexity of the student loan programs.

Assistance Providers

Schools and Financial Aid Offices

School financial aid offices have traditionally been the main resource that students and their families look to for information about borrowing. However, financial aid offices and schools have for the most part not been involved in helping their students deal with debt once they leave school. We found that very few schools, if any, provide systemic assistance for former students who need help with student loan repayment.

Helping their former students avoid default is in the best interests not only of borrowers, but of schools as well. Lower default rates help schools avoid government-imposed sanctions and are a good selling point to attract incoming students.

Loan Holders

Besides routine account statements, most students only hear from their loan holders after they get into trouble. This is largely because most loan holders in the federal loan programs do not have financial incentives to intervene early when problems arise. Congress responded innovatively to this problem in part by giving the Department of Education the authority to develop and sign voluntary flexible agreements (VFAs) with guaranty agencies. The VFA model has shown very encouraging results. Yet, the Bush Administration has proposed to eliminate it in its last two budget plans, citing concerns about costs.

The VFA model highlights the important ways in which loan holders can do more than just collect from borrowers. They can also be part of the solution in providing information and counseling assistance. Loan holders may also provide direct assistance, as many have done with ombudsman and customer advocate units. This report includes a survey of eleven ombudsmen and customer advocates units, including the federal ombudsman.

The report highlights the helpful dispute resolution assistance offered by ombudsman offices. We strongly recommend that the federal ombudsman office continue to receive support and funding from Congress and the administration. However, there are limits to what ombudsman or customer advocates can do with respect to providing direct assistance. The key issues discussed in the report are:

1. Loan Holder Mediators Are Not Borrower Representatives.

Loan holder ombudsmen work for and with loan holders. Although they can be neutral mediators, they are not and do not purport to be borrower representatives. There is an inherent limitation to this model related to the dependency relationship between guaranty agencies and lenders.

A neutral mediator can help many borrowers, particularly those with less complex questions and certainly those that need basic information about their accounts. However, there are many situations where borrowers need advocates that are clearly on their side. This is particularly true in cases where there are varying interpretations of rules and regulations. In these situations, borrowers need representatives who will present the most aggressive

interpretation of the rules. Unless pushed, our experience is that the ombudsman and customer advocates will not take the most aggressive positions on behalf of borrowers.

2. Loan holders are also collectors.

Even borrowers who wish to repay or exercise other rights are often shut out because of problems with overly aggressive and often abusive collection agencies.

3. Nonlawyer ombudsmen cannot provide legal advice.

Nonlawyer advocates can provide very useful direct assistance for borrowers. Regulation of these services is essential to ensure that the advocates are accountable to consumers and that they have the appropriate level of expertise. However, there are limits to these services. Nonlawyers are prohibited from providing legal advice. Given the dearth of legal assistance for student loan matters, overreaching by nonlawyer advocates is understandable but not always helpful. Providing some assistance is not always better than none if the advice is inaccurate.

Non-profit Credit Counselors

There is potential to develop student loan counseling services within the non-profit credit counseling and housing counseling industry. Many agencies have well-trained counselors who have experience dealing with financially distressed consumers.

Despite the potential, there is risk involved with bringing credit counselors into the student loan counseling world. One challenge in expanding the role of credit counselors is ensuring that only legitimate non-profit agencies provide these services. Credit counselors must also change their traditional service model which focuses mainly on assisting consumers with credit card debt problems. In addition, credit counselors are accustomed to placing consumers in standardized credit card debt management plans. This type of “one size fits all” approach will not work with the complex federal student loan programs. Finally, credit counselors, like financial aid staff, often lack specific student loan expertise.

For-Profit “Student Loan Assistance” Companies

There are a growing number of private companies that purport to provide student loan counseling or specific loan services such as consolidation. Many of these companies have names that appear to be neutral or even non-profit. Upon further investigation, we found that many of these agencies are actually selling products such as loan consolidations.

This report emphasizes the problems with relying on for-profit companies to fill the gap in borrower assistance services. Transparency is key and companies that engage in deceptive business practices should be the target of aggressive private and public consumer protection enforcement.

Legal Assistance

There is a severe shortage of free and affordable legal resources in this country. Among the resources that do exist, few legal aid programs handle student loan cases. We called fifteen Legal Services Corporation-funded legal aid programs in diverse geographical areas to explore the level of

student loan services. Only four of these programs (less than 25%) stated that they assist clients in student loan cases.

The lack of legal resources is acute for moderate and middle income borrowers as well. There are few lawyers who specialize in student loan matters. It is difficult to make a living handling student loan cases. Unlike other consumer cases, the key student loan-related statutes do not have private enforcement rights or attorney fees provisions. It is less clear why so few legal aid organizations, *pro bono* lawyers, and law school clinics provide assistance with student loan cases.

Legal aid programs can and should do more to represent student loan borrowers. There is almost always something an advocate can do to assist clients. Even with increased commitment, legal aid programs cannot meet the huge demand for services. To help meet this need, we call on Congress to fund a pilot project that sets up a neutral, non-profit entity to provide direct assistance to borrowers in trouble.

SUMMARY OF RECOMMENDATIONS TO EXPAND ASSISTANCE FOR BORROWERS

Schools, loan holders and credit counselors can and should do more to assist student loan borrowers, particularly in providing information and counseling services. They may also provide direct assistance in certain circumstances.

Funding is a problem for all of these programs. Creative solutions should be considered, including possible public funding or support from higher education institutions to meet the need. Regardless, we do not believe that an effective program can be built through funding from lenders. This will create improper incentives and conflicts of interest that are not in the best interests of borrowers.

It is more difficult to close the gap in direct assistance services for borrowers. One solution is for lawyers, including legal aid and *pro bono* programs, to expand their services and provide legal assistance for student loan borrowers. Self-help legal information can also be useful. However, self-help materials are not a substitute for individualized legal advice.

Existing legal resources are insufficient. Legal aid programs are under funded and restricted in what they can do. Few assist student loan borrowers. To help meet this need, we call on Congress to fund a pilot project that sets up a neutral, non-profit entity to provide direct assistance to borrowers in trouble. Private funders could also offer assistance as long as there is no funding from conflicting interests, such as student lenders. This would be a borrower advocate program that would work in collaboration with ombuds, counseling and other mediation entities. Counselors in the borrower advocate project should be under the supervision of a lawyer who is knowledgeable about student loan law and keeps up with new developments. Depending on resources, the pilot project could begin in a few areas or it could be available more broadly. It should include an evaluation mechanism to measure borrower satisfaction and track borrower progress over time. The pilot project is a first step toward building a strong student loan borrower assistance network.

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INTRODUCTION: THE PROBLEM OF STUDENT LOAN DEBT

As the cost of financing our nation's higher education system falls increasingly on students and families, student loan debt is rising at alarming rates. By the time they graduate, nearly two-thirds of students at four-year colleges and universities have student loan debt. In 1993, by contrast, less than one-half of four-year graduates had student loans.¹ There was an eight percent increase in average student loan debt levels of graduating seniors between 2005 and 2006 compared to an increase of about four percent in starting salary offers for graduating seniors.²

There are many reasons for these increased debt levels, including:

1. **Loans are an expensive way to finance higher education.** This is especially true of private loans, a growing alternative to federal government loans. In 2006-07, private student loans constituted about 24% of education loans.³ Unlike government loans, there are no interest rate caps for private student loans, and key borrower protections are left to the discretion of the various lenders.
2. **Grants and scholarships have not kept up with the cost of education.** In 2006-07, undergraduate students received 46% of their funding from grants and 49% in the form of loans, including private loans. The proportions for graduate students were 33% grants and 64% loans.⁴
3. **The cost of higher education continues to grow.** According to a 2007 report from the College Board, college prices have consistently outpaced the general rate of inflation.⁵ Most states are devoting fewer resources to public higher education.
4. **The loan limits on federal government loans have not kept up with the cost of higher education.**
5. **There are huge holes in the safety net for distressed borrowers.** Many borrowers, including those who do not finish school, attend scam vocational schools, or face unexpected life traumas, are unable to repay their loans.

¹ The Project on Student Debt, "Quick Facts About Student Debt", available at: http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources_4_4_06.pdf.

² The Project on Student Debt, "Student Debt and the Class of 2006" (September 2007), available at: http://projectonstudentdebt.org/files/pub/State_by_State_report_FINAL.pdf.

³ See generally College Board, "Trends in Student Aid 2007" (2007), available at http://www.collegeboard.com/prod_downloads/about/news_info/trends/trends_aid_07.pdf.

⁴ Id.

⁵ Id.

The government has extraordinary powers to collect student loans, far beyond those of most unsecured creditors. The government can garnish a borrower's wages without a judgment, seize tax refunds (even an earned income tax credit), seize portions of federal benefits such as Social Security, and deny eligibility for new education grants or loans. Even in bankruptcy, most student loans must be paid. Unlike any other type of debt, there is no statute of limitations.

All of these factors have contributed to a growing population of over indebted student loan borrowers. To make matters worse, there are not enough programs to help borrowers who run into trouble. In a June 2006 paper, NCLC advocated a range of strategies to expand and improve these programs.⁶ A summary of these recommendations is attached to this report at Appendix A. Similar options are necessary to ease the burden of private student loan borrowers.

Policy reform is essential. The importance of equal access to higher education cannot be over-emphasized. Higher education is the primary means for upward mobility in this country. In the meantime, there are many helpful strategies that are theoretically available to distressed borrowers, especially federal loan borrowers. Unfortunately, in practice, many of these programs remain elusive and underutilized. Many borrowers do not know about these programs. Others are denied relief because there is no reliable source of assistance to help them navigate the increasingly complex student loan collection system. This is particularly disturbing because many borrowers could be spared the worst consequences of student loan distress if they knew about their rights and if they had assistance in enforcing those rights.

Through the National Consumer Law Center's Student Loan Borrower Assistance Project, we work with borrowers and advocates assisting borrowers every day. Here are just a few examples of the human cost of student loan problems and the lack of effective relief:

Maria is in her mid-40's with three children and a disabled husband. She went to college in the late 1980's and early 1990's, first at a for-profit vocational school and later to the University of Massachusetts. She held a number of jobs to help pay for tuition, received grants and also had to take out government loans to cover the remaining costs. She completed one year at the vocational school, but was dissatisfied with the education. She transferred to UMass and tried for two years to juggle work and school. She was unable to handle the stress and decided to drop out. Over the years, she has been in and out of repayment. Once her husband became disabled, she was simply unable to make any more payments. She takes care of her husband and children and works part-time at Home Depot. She has no funds left over for student loan repayment. Meanwhile, fees and interest have accrued to the point where her student loans are at least three times what she originally owed. A few of the lenders have sued and taken judgments. Maria has to go to court at least twice each year to explain why it is a hardship for her to repay. She has nowhere to turn.

Although Maria has no funds or assets at this point that the government can collect, she also has no reasonable expectation that the collection will ever stop. Eventually if she gets Social Security or a better paying job, the government will take portions

⁶ See National Consumer Law Center, "No Way Out: Student Loans, Financial Distress and the Need for Policy Reform (June 2006), available at: <http://www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf>.

of those. She suffers the daily distress of collection letters and the negative implications of damaged credit that further prevent her from getting ahead.

*

Joanne filed a chapter seven bankruptcy about five years ago due to the failure of her small business as well as unexpected medical problems. She was allowed to get out from under these debts and get a fresh start through bankruptcy. Unfortunately, the same relief is available only for the most desperately distressed student loan borrowers. Joanne is not one of the most desperate. She has been able to get back on her feet and now works for a state agency in Texas. The problem is that her student loans went into default while she was in financial distress. She has been trying to repay ever since, but the amount owed has ballooned by over \$15,000. It will probably take her the rest of her life to repay the \$50,000 that she still owes, and even an entire lifetime may not be long enough. Joanne understands that she is responsible for repaying. She just wishes that she had known about her options to slow down the default process and not been penalized so heavily for her period of financial distress.

The situation can be even worse for private loan borrowers because of the high cost of many of these loans and the unpredictability of variable interest rates. These problems are exacerbated by the lack of standardized repayment and other borrower-oriented work-out options. Unlike federal loans, private student loans have no mandated flexible repayment, cancellation or other programs. Private student loan borrowers are at the mercy of their loan holders.

This report investigates the student loan borrower assistance network. We review the following critical categories of relief: Information and outreach, counseling, and direct assistance and legal representation. We discuss the strengths and weaknesses of existing resource providers in each of these categories, followed by recommendations for their improvement.

TYPES OF ASSISTANCE

Information and Outreach

Numerous studies confirm that students do not get enough information about loan programs before they borrow. In a 2007 report, Consumers Union describes the confusion experienced by many students and their families in the student loan process.⁷ “With three different loan programs”, the report notes, “and unlimited direct-to-consumer marketing of private student loans, it’s not surprising that students and parents make uninformed decisions that cost them more than necessary.”⁸ Consumers Union highlighted the importance of early information to help students and their families compare the costs of different college funding sources.⁹

⁷Consumers Union, “Helping Families Finance College: Improved Student Loan Disclosures and Counseling” (July 2007), available at <http://www.consumersunion.org/pdf/CU-College.pdf>. (Hereafter “Consumers Union July 2007 Report”).

⁸ Id. at iii.

⁹ Consumers Union July 2007 Report.

Helping prevent problems by providing information about the cost of student loans is critical. Prevention will not work for everyone, and it is not a panacea. It is, however, a tremendously important step that can save many borrowers from falling into the often inescapable default spiral.

Many borrowers also report lacking information after they borrow. The importance of information and communication with borrowers after credit is extended is reinforced by a profile conducted by the University of Illinois, Chicago of student loan defaulters. The most commonly cited reason for defaults was lack of information.¹⁰

The quality of the information is crucial. Not only must the information be accurate, it must also be unbiased. If offered by lenders, the source of the information should be clearly disclosed. This is not always the case. For example, many of the web sites and other resources providing information about different types of loans are directly affiliated or receive referral fees from lenders. According to Robert Shireman, executive director at the Project on Student Debt, searching for reliable information about student loans is similar to shopping for a used car, “Truly impartial sources are hard to find.”¹¹

Counseling

Counseling for federal loan borrowers is mandatory when borrowers first incur loans and after they withdraw or graduate. Initial counseling is supposed to occur prior to the release of the first loan disbursement.¹² The counseling may be in person, by audiovisual presentation, or by interactive electronic means. The Direct Loan program allows schools to adopt alternative approaches for initial counseling. These alternatives must be designed to target borrowers who are most likely to default on repayment and provide them more intensive counseling and support services.¹³ Schools are also supposed to ensure that an individual with expertise in financial aid is reasonably available shortly after the counseling to answer questions. There are no similar counseling mandates for private student loans.

Many schools use outside contractors, including lenders and guaranty agencies, to fulfill these counseling requirements. The conflicts that have arisen in these arrangements have been under investigation by the New York Attorney General’s office and by Congress. One issue that has emerged is that borrowers are often not aware when they are being counseled by a lender rather than by the school.

A report by the U.S. Senate Committee on Health, Education, Labor and Pensions noted that lenders frequently view the counseling sessions as an opportunity to market loan products to students rather than offering unbiased financial advice. The report cites a Citibank internal sales report that describes marketing during entrance sessions as part of its key strategies to increase business. A College Loan Corporation presentation describes how marketing to students in entrance sessions paid off in increased loan volume.¹⁴

¹⁰ U.S. Department of Education, Office of Student Financial Assistance, “Ensuring Loan Repayment: A National Handbook of Best Practices” ch. 3 (2000).

¹¹ Jonathan D. Glater, “Move Over, Orbitz”, *New York Times Education Life* at 10 (November 4, 2007).

¹² 34 C.F.R. § 682.604(f) (FFEL).

¹³ 34 C.F.R. § 685.304(a)(4).

¹⁴ See U.S. Senate Committee on Health, Education, Labor and Pensions, “Report on Marketing Practices in the Federal Family Education Loan Program” at 21-22 (June 14, 2007).

In addition to the conflict of interest problems, by most accounts, the existing counseling requirements for federal loans are ineffective, simply one of many hoops students jump through to get their student aid checks. In a 2007 survey, students reported to Consumers Union that counseling at the outset of school had not helped them make informed borrowing decisions.¹⁵ Research affirms that individuals tend to view the cost of borrowing in the most optimistic light at the front end and assume that they will not get in over their heads in debt.¹⁶ The Consumers Union study found that exit counseling was more useful, but students reported that it came too late for them to change their borrowing behavior.¹⁷

The poor track record of mandatory counseling should not obscure the potential benefits of targeted counseling for student loan borrowers. For example, in a phone survey of student loan borrowers, the Texas Guaranty Agency found that borrowers who remained in repayment were more knowledgeable about their repayment options. Those who were predicted not to default but did generally reported that the counseling they received was unclear or not helpful and most had not thought about flexible options such as deferments.¹⁸

Resources can be conserved by targeting counseling efforts at those most likely to benefit. Some guaranty agencies and schools have made progress in this area by developing models to predict which borrowers are most at risk of defaulting and by targeting more intensive efforts at these borrowers. Many focus on reaching borrowers immediately after drop-out since this is clearly a predictor of default.¹⁹

Early intervention is essential because the costs rapidly pile up once trouble begins. Student loan collectors are allowed to charge enormous collection fees that are not even tied to the amount of effort expended. At the same time, interest accrues and the borrower is hounded by collectors and faced with the prospect of never-ending collection efforts.

Early intervention programs should also include regular contacts with borrowers to provide information about new options. Borrowers need to know about choices they have once they begin to have problems with repayment. This is especially true of the federal loan programs, which have a relatively long period of delinquency (usually nine months) before a borrower is placed in default.

Access to relief can be more difficult in the private loan programs. These lenders do not generally publicize work-out options and offer relief only at their discretion. Some charge fees for borrowers that wish to apply for forbearances or deferments. Further, private student loans may go into default as soon as a borrower misses one payment.

¹⁵ Consumers Union July 2007 Report.

¹⁶ See generally Oren Bar-Gill, *Seduction By Plastic*, 98 Nw. U. L. Rev. 1373 at 1410 (Summer 2004).

¹⁷ Consumers Union July 2007 Report.

¹⁸ Texas Guaranty Student Loan Corporation, "Predicting Which Borrowers Are Most Likely to Default" (1998), available at: http://www.tgslc.org/publications/reports/defaults_texas/ins_intro.cfm.

¹⁹ See Texas Guaranty Student Loan Corporation, "Predicting Which Borrowers Are Most Likely to Default" (1998), available at: http://www.tgslc.org/publications/reports/defaults_texas/ins_intro.cfm; Michael Podgursky, Mark Ehlert, Ryan Monroe, Donald Watson, John Wittstruck, "Student Loan Defaults and Enrollment Persistence" (2000); Lawrence Gladieux and Laura Perna, The National Center for Public Policy and Higher Education, "Borrowers Who Drop Out: A Neglected Aspect of the College Student Loan Trend" (May 2005).

Direct Assistance and Legal Representation

Outreach and counseling are especially important in assisting borrowers with temporary difficulties, including those who have some resources to pay their loans, but need information about the most effective repayment programs. However, not all student loan problems can be resolved through information and counseling. Direct assistance is also needed, especially when borrowers have disputes with their loan holders. The role of direct borrower assistance has grown along with the complexity of the student loan programs. Student loan rights and remedies have become too complex for most borrowers to understand. Many borrowers need assistance not only to understand their rights, but also to exercise those rights.

There are very few advocates working specifically for borrowers. Borrowers in trouble keep citing this gap in resources, but they have not been heard. Their voices should be a part of whatever system is created to provide greater assistance. In the words of one borrower telling her story on the Student Loan Justice web site, “The most frustrating part is that there is no advocate for the students, no where to turn for help.”²⁰

There are many types of direct assistance. Informal assistance programs, such as mediation, can be very beneficial for many borrowers. The ombudsman process, described below, fits into this category. Informality can make resolution processes more efficient and flexible. On the other hand, formal adjudication systems are also necessary, particularly if there are disagreements or different interpretations of borrower rights. A key barrier to formal relief is that there are limited ways for borrowers to challenge adverse decisions. The main problem to enforcement of borrower rights is that courts have consistently held that there is no private right of enforcement under the Higher Education Act (HEA).²¹ Although we advocate the expansion of high-quality informal dispute resolution, these programs should not be seen as a substitute for private enforcement remedies.

Nonlawyer advocates can provide valuable direct assistance. These advocates may include counselors at school financial aid offices, loan holder customer service representatives, or non-profit credit counseling staff. However, there are limits to the types of assistance nonlawyer advocates can and should provide. This is because assisting student loan consumers almost always involves the provision of legal advice. Schools, loan holder customer advocate units, and credit counselors, for the most part, are not staffed by lawyers. As a result, they must be careful about violating state unauthorized practice of law statutes.

Nearly every state has a law limiting the practice of law to licensed attorneys. Most states have very restrictive interpretations, defining “practice of law” or “legal advice” as any information or advice that is conformed to a particular individual’s situation as opposed to general information. The range of activities by non-lawyers that fall into the category of “legal advice” is so broad that as Professor Deborah Rhode points out, millions of Americans violate these laws on a daily basis.²² The law is routinely violated because of the desperate need for legal services in this country and the severe lack of free and affordable services.

²⁰ See generally <http://www.studentloanjustice.org>.

²¹ See generally National Consumer Law Center, “No Way Out: Student Loans, Financial Distress and the Need for Policy Reform (June 2006), available at: <http://www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf>.

²² Deborah L. Rhode, *Access to Justice* at 87 (Oxford University Press 2004).

Financial counselors frequently cross this line, as do mortgage brokers and accountants and other advisers.²³ For example, we frequently hear from borrowers that they have spoken with credit counselors who have told them that they cannot discharge student loans in bankruptcy. In fact, student loans are dischargeable as long as borrowers can prove “undue hardship.” Although this is a difficult standard to meet, it is certainly not impossible. The likelihood that any particular individual can meet the undue hardship standard requires an evaluation of the borrower’s situation as well as an up-to-date understanding of the case law in this area. Given the dearth of legal assistance for student loan matters, this overreaching by nonlawyer advocates is understandable but not always helpful. Providing “some” assistance is not always better than none if the advice is inaccurate.

This report is not intended to resolve the debate over the appropriate role of nonlawyer intervention. However, we believe that the best solution would allow nonlawyers to assist student loan borrowers in limited ways. Borrowers can benefit if these practices are regulated rather than prohibited.²⁴ Regulation is essential. Nonlawyers must be accountable to consumers. In all cases, advocates must have an in-depth understanding of the complex student loan laws. They must develop referral resources for consumers that need assistance beyond the scope of their expertise or training.

We believe that a range of direct assistance models are possible and that different models can complement each other. Regardless, it is essential that there are some programs with advocates working solely on behalf of borrowers.

ASSISTANCE PROVIDERS

Schools and Financial Aid Offices

School financial aid offices have traditionally been the main resource that students and their families look to for information about borrowing. Under the traditional model, financial aid officers determine both the size of the financial package offered to a student and its shape.²⁵ In a 1007 report, Consumers Union found that in the vast majority of cases, students and parents relied on the financial aid office for information about paying for college.²⁶

Recent scandals in the student loan industry have uncovered serious conflicts of interest between many colleges and lenders. Investigations by New York’s Attorney General Andrew Cuomo and others have raised serious questions about whether the advice provided by financial aid offices is truly unbiased.²⁷

²³ Id.

²⁴ See generally Deborah L. Rhode, *Access to Justice* (Oxford University Press 2004); Deborah J. Cantrell, “The Obligation of Legal Aid Lawyers to Champion Practice by Nonlawyers”, 73 *Fordham L. Rev.* 883 (December 2004).

²⁵ See generally Alan Greenblatt, “The End of Autonomy: How the Role of the Financial Aid Office is Changing”, in *Footing the Tuition Bill* (Frederick M. Mess ed. 2007).

²⁶ Consumers Union July 2007 Report.

²⁷ See, e.g., U.S. Senate Health, Education, Labor and Pensions Committee, “Report on Marketing Practices in the Federal Family Education Loan Program”, June 14, 2007. Available at: <http://kenedy.senate.gov/imo/media/doc/Student%20Loan%20Report.pdf>.

These are serious issues that must be addressed. Assuming these problems can be overcome over time, college financial aid offices as well as high school counselors should do more to provide students with information about financing their educations. Among other proposals, Consumers Union recommends that colleges develop profiles of student debt information for their students.²⁸ The information provided should include not only student loan default and other loan-related information, but especially for career-oriented undergraduate and graduate programs, information about average salaries for specific professions. For example, a social worker that chooses to go to a private graduate school may come out of school with as much as \$100,000 in student loan debt, both government and private. The schools that offer social work programs at these tuitions should have some responsibility to disclose the low salaries in the profession. The borrower also has a responsibility to think about whether a less expensive choice will better allow that borrower to work in this important profession.

Even with the best advice and counseling, many borrowers will get into trouble down the road. Financial aid offices and schools have, for the most part, not been involved in helping their students deal with debt once they leave school.

Schools are already strapped dealing with current and prospective students and generally do not have the resources to provide quality student loan repayment counseling for alumni. Further, financial aid officers are not necessarily trained in repayment and default management and prevention. Most schools have not seen financial counseling of students as their responsibility, focusing instead on getting students the funds they need to graduate.²⁹

There are exceptions to this general rule and further research is needed to assess the extent to which colleges are stepping in to help out former students. We interviewed a number of financial aid directors for this report. Directors at Direct Loan schools praised a program that is available through the Department of Education which provides information to schools about former students in late stages of student loan delinquency. This gives schools the opportunity to contact former students and try to work with them to resolve problems. Many FFEL lenders and guaranty agencies have similar programs.

A loan and personal finance education program at University of Missouri is part of a small, but growing group of educators reaching out to counsel student borrowers. Brigham Young University has developed a similar program.³⁰ They focus on preventing over-indebtedness. This is a much-needed service, but different than providing assistance after borrowers begin to experience problems. We found in our informal survey that very few schools, if any, provide systemic assistance for former students who need help with student loan repayment.

The school and financial aid directors we interviewed said that schools very commonly will work with lenders and guaranty agencies to help locate borrowers. In some cases, school staff will mediate between a borrower and lender or guaranty agency. This may involve “going to bat” for the borrower in cases where the school believes that the former student has a legitimate complaint and is not being treated fairly. However, all of the directors we interviewed acknowledged that school financial aid staffs do not have sophisticated knowledge of student loan repayment, cancellation, and postponement options. The students have already left the school and paid their fees and according to one director, this means that the schools have little incentive to commit the resources necessary

²⁸ Consumers Union July 2007 Report.

²⁹ See generally Leslie Wines, “Colleges Ponder Role in Loan Counseling”, *Baltimore Sun* (October 29, 2007).

³⁰ *Id.*

to provide these types of services. Many schools are sympathetic to the plight of borrowers after school, but they have not dedicated the resources nor do they necessarily see it as their role to assist these borrowers if they later run into financial trouble.

Schools can do more in this area. Helping their former students avoid default is in the best interests not only of borrowers, but of schools as well. Lower default rates help schools avoid government-imposed sanctions and are a good selling point to attract incoming students. There may also be a role for schools to provide direct assistance to borrowers. Some schools already do this, as described above, by mediating between loan holders and students. However, we do not believe that it is appropriate for schools to provide direct legal assistance to borrowers. School officials are not neutral, especially in cases where they are engaged in the collection process. In addition, they are generally not lawyers and can easily cross the line into providing unauthorized legal advice. To complement the services they offer, schools should expand their legal referral networks and provide information about these resources to borrowers that need direct assistance beyond the scope of the school's services.

Loan Holder Assistance

Information and Counseling

Borrowers are no longer students when they enter repayment. When trouble begins, the entity they hear from is the loan holder, not the school. To what extent this can be a positive experience depends a lot on who is doing the calling.

Many loan holders proactively provide information to borrowers about repayment and offer counseling as well. However, besides routine account statements, most students only hear from their loan holders after they get into trouble. This is largely because most loan holders in the federal loan programs do not have financial incentives to intervene early when problems arise. In fact, the incentives are reversed. Under the standard guaranty agency model, guarantors receive less compensation for preventing student loan defaults than for collecting on defaulted student loans. Approximately 60 percent of a guarantor's revenue under this standard model is derived from the collection of defaulted student loans, while less than 10 percent comes from default prevention and zero for delinquency prevention.³¹

A 2002 Government Accountability Office (GAO) report described the problem in greater detail. The traditional payments for guaranty agencies, according to the GAO, make it more financially beneficial for an agency to allow borrowers to default and then to try to collect rather than prevent default.³² Congress responded innovatively to this problem in part by giving the Department of Education the authority to develop and sign voluntary flexible agreements (VFAs) with guaranty agencies. Among other elements of the programs, VFA agencies are encouraged to set up new types of incentive payment agreements, in many cases rewarding agencies for preventing defaults rather than tying compensation to collection.³³

³¹ The National Association of Student Loan Administrators (NASLA), "Voluntary Flexible Agreement Report 2007" at 4, available at: <http://www.amsa.com/about/press/reports/index.cfm>.

³² U.S. General Accountability Office, "Federal Student Loans: Flexible Agreements with Guaranty Agencies Warrant Careful Evaluation", GAO-02-254 (January 2002).

³³ Id. The first generation VFA organizations include the following student loan guaranty agencies: American Student Assistance, California Student Aid Commission/EdFund, Great Lakes Higher Education Guaranty

The agencies participating in the VFA program tie federal payments to improved performance and portfolio management. The idea is to assist borrowers before they get into trouble. Since the approval of the first generation VFAs, the participating agencies report reductions in cohort default rates of as much as 47%.³⁴

The VFA model has shown very encouraging results. Yet, the Bush Administration has proposed to eliminate it in its last two budget plans, citing concerns about costs. According to news reports, the Department of Education sent letters in October 2007 to the VFA guaranty agencies that it was unilaterally terminating their agreements.³⁵ The VFA agencies counter that their fee structures not only benefit borrowers, but also save the federal government money over the standard guarantor funding arrangements. American Student Assistance, for example, estimates that it has saved the Department of Education and U.S. taxpayers \$40 million since its implementation in 2001. The lower number of defaults means fewer default claims paid out by the government.³⁶

The VFA model highlights the important ways in which loans holders can do more than just collect from borrowers. They can also be part of the solution in providing information and counseling assistance. Loan holders have also begun to provide direct assistance to borrowers, as discussed below.

Loan Holder Direct Assistance

A number of lenders and guaranty agencies, including the VFA agencies, have set up lender ombudsmen or customer advocate programs. Much of this activity began after Congress mandated the creation of a federal Department of Education ombudsman office. The federal ombudsman works with a caucus that includes over 200 student aid industry contacts. Some of the private lenders that have ombudsman programs operate in both the federal and private loan markets.

The federal ombudsman has fourteen staff. In FY 2006, they received nearly 17,000 cases. Of those, 4,663 were research cases requiring in-depth analysis. The top five issues in 2006 and 2007, in varying degrees of order were:

- Consolidation
- Account Balance
- Loan Cancellation/Discharge
- Repayment Plans/Amounts, and
- Default.

Corporation, and Texas Guaranteed Student Loan Corporation. In 2006, these agencies guaranteed a combined \$45 billion in student loans, including consolidation loans. See The National Association of Student Loan Administrators (NASLA), “Voluntary Flexible Agreement Report 2007”, available at: <http://www.amsa.com/about/press/reports/index.cfm>.

³⁴ The National Association of Student Loan Administrators (NASLA), “Voluntary Flexible Agreement Report 2007” at 5, available at: <http://www.amsa.com/about/press/reports/index.cfm>. The cohort default rate is the measure used by the Department of Education to determine whether schools should be sanctioned for high federal loan default rates. It tracks borrowers for just the first two years after they go into repayment.

³⁵ See Doug Lederman, “Ending an Experiment”, InsideHigherEd.com (October 16, 2007).

³⁶ The National Association of Student Loan Administrators (NASLA), “Voluntary Flexible Agreement Report 2007” at 9.

The Higher Education Act directs the ombudsman to “...receive, review, and attempt to resolve informally complaints from borrowers of loans...including, as appropriate, attempts to resolve such complaints within the Department of Education and with institutions of higher education, lenders, guaranty agencies, loan servicers, and other participants in the loan programs.”³⁷

We surveyed a number of these programs for this report. Eleven agencies, including the federal ombudsman responded to the survey that is attached as Appendix B.

Most ombudsman programs described their missions as providing neutral resources to help borrowers resolve problems. The federal ombudsman, interviewed for this report, was explicit that they are not advocates per se for particular borrowers, but advocates for a fair process. Ombudsman offices also describe the importance of providing information to borrowers, including those who are in repayment.

The sizes of the offices vary from just one staff member to over thirty in the case of Sallie Mae’s customer advocate unit. Sallie Mae received nearly 18,000 inquiries last year while other programs received just a few each month.

Some lenders and guaranty agencies prefer not to publicize their services for fear of opening the floodgates. In our survey, a number of lender and guaranty agency ombudsmen stated that they did not want us to list information about their services on our web site. The smaller offices exist mainly to respond to referrals from the federal ombudsman. To their credit, most of the larger programs display information about their ombudsman program on their web site. In addition, the federal ombudsman actively publicizes its services including through a federal student aid ombudsman newsletter and outreach brochures. In addition, information about the federal ombudsman must be provided in some of the collection notices sent to delinquent borrowers.

It is difficult to track borrower satisfaction with the ombudsman system. The federal ombudsman reports that all issues are resolved in the sense that the ombudsman does all that can be done to provide viable options and assist the customer. However, they caution that this does not mean that customers will always achieve their initially stated objectives.

A few agencies provided outcome data in response to our survey. One agency reported that in FY 2006, 27% of borrowers that sought ombudsman assistance were in voluntary repayment, 13% consolidated their loans, 8% paid the loans in full, 5% rehabilitated their loans 7% received discharges, 4% had their loans repurchased, and 36% had no change in status.

One of the VFA agencies with an active ombuds program, American Student Assistance, reports that 90% of the delinquencies in its portfolio are cured before they reach default. Further, since receiving its VFA, ASA has increased rehabilitation of defaulted loans from just over \$6 million in 2001 to over \$80 million in 2006.³⁸ Other VFA agencies have shown similar results.

Through NCLC’s Student Loan Borrower Assistance Project, we have had extremely positive experiences working with the various ombudsman programs to resolve federal student loan problems. The ombudsman staff have been respectful when we have intervened on behalf of

³⁷ 20 U.S.C. §1018(f).

³⁸ The National Association of Student Loan Administrators (NASLA), “Voluntary Flexible Agreement Report 2007” at 10-11, available at: <http://www.amsa.com/about/press/reports/index.cfm>.

borrowers and flexible in trying to work out solutions. Our experiences, however, may be atypical because our program and the advocates we work with contact the office as lawyers representing borrowers.

Our experiences have been much less successful on the private loan side. Most of the private lender customer advocates have been willing to provide information. However, each lender has its own set of possible work-out options. To date, the lenders have not provided standardized information about the programs they offer. Instead, they address each case on a case by case basis. Most lenders simply offer temporary forbearances rather than longer-term solutions such as reasonable and affordable repayment plans or loan cancellations. Some even charge substantial fees to borrowers who wish to apply for deferments or forbearances.

There are many positive aspects to the loan holder ombuds programs. We strongly recommend that the federal ombudsman office continue to receive support and funding from Congress and the administration. However, there are also limits, described below, to what ombudsman or customer advocates can do with respect to providing direct assistance.

1. Loan Holders Are Not Borrower Representatives

Loan holder ombudsmen work for and with loan holders. Although they attempt to be neutral mediators, they are not and do not purport to be borrower representatives. There is an inherent limitation to this model related to the dependency relationship between guaranty agencies and lenders. As effective as the guaranty agency ombuds offices may be, they are part of an overall guaranty agency structure in which lenders pay the agencies to recover loans. This conflict should be less prevalent among the VFA agencies, but still exists.

A neutral mediator can help many borrowers, particularly those with less complex questions and certainly those that need basic information about their accounts. However, there are many situations where borrowers need advocates that are clearly on their side. This is particularly true in cases where there are varying interpretations of rules and regulations. In these situations, borrowers need representatives who will help push the most aggressive interpretation of the rules.

For example, we have heard from many borrowers who contacted loan holder assistance units for help and were given forbearances rather than deferments even though they were eligible for deferments. Deferments for borrowers with subsidized loans are a better option because interest does not accrue while repayment is postponed. Our office was able to get deferments for these borrowers. Yet, when contacting customer assistance on their own, the borrowers were only told about the less advantageous options.

Similar problems regularly occur with the rehabilitation program. Many guaranty agencies, including the VFA agencies, promote rehabilitation as the best way out of default. As a result, borrowers are often told of this option. However, they are also generally told by collectors and by customer advocate and loan holder ombudsman offices that they must pay certain minimum amounts each month. This is not true. The regulations for loan rehabilitation very clearly state that no minimum payment should be required.³⁹

³⁹ See, e.g., 34 C.F.R. §682.405(b)(1)(iii)(B) (FFEL).

This problem derives in part from a system established by the Department of Education which provides compensation to collectors for setting up rehabilitation plans only if the plans require borrowers to make certain minimum payments. These systems conflict with the statutory and regulatory provisions that give borrowers the right to make reasonable and affordable repayments.

Some guaranty agencies claim that lenders will only purchase the rehabilitated loans if the balance is paid down sufficiently. In contrast, others report that they very rarely have problems reselling the loans. To compound the problem, collectors often assert that once a loan is successfully rehabilitated, borrowers must begin repaying the standard monthly payment amount rather than a lower, income-based amount. In fact, borrowers should be able to choose income-based repayment programs, such as the Direct Loan ICR, even if this requires them to first consolidate their loans with the Direct program.

A typical borrower has no idea that she can challenge the amount that a collector tells her she must pay in order to rehabilitate a loan. Advocates have been able to convince the Department of Education of this position in individual cases. However, most borrowers do not have advocates to assist them. Unless pushed, our experience is that the ombudsman and customer advocates will take the most aggressive positions on behalf of borrowers.

2. Loan Holders Are Also Collectors

From our experience, it is extremely difficult to get a guaranty agency or the Department to take a file away from a collection agency in order to help a borrower resolve a problem. This is true across the system, even with collection agencies working on behalf of loan holders that have high-quality customer advocate units. In many years of representing borrowers, we have never been directed to a loan holder ombudsman or customer advocate by a collection agency.

Even borrowers that wish to repay or exercise other rights are often shut out because of problems with overly aggressive and often abusive collection agencies. Private collectors have in some cases deliberately deceived consumers by misrepresenting themselves as the Department of Education. They have overcharged consumers for collection fees, used misleading tactics to track borrowers, browbeaten borrowers into unaffordable payment plans, threatened them with actions that they cannot legally take, and pressured consumers to borrow from relatives.⁴⁰

An April 2007 press release from the office of Senator Kennedy includes a letter sent to the CEOs of Sallie Mae and Nelnet regarding harsh and inappropriate collection tactics. According to the release, Senator Kennedy's office obtained information that these companies may have engaged in the following practices:

- Telling a borrower's spouse that the borrower would go to jail if he didn't pay--a blatantly false assertion;
- Putting a borrower into default who lost his home in a natural disaster, adding substantial default and collection fees to his loan balance, taking tax refunds, and garnishing his wages--all in violation of guidance from the Secretary of Education;
- Harassing a widower about illegitimate, forged loans under the name of his deceased spouse;
- Refusing to negotiate with borrowers about deferment;

⁴⁰ See generally National Consumer Law Center, Student Loan Law ch. 4 (3d ed. 2006 and Supp.).

- Regularly calling borrowers at their job after being instructed to stop;
- Harassing borrowers' neighbors, family and co-workers;
- Using abusive and profane language to intimidate borrowers;
- Attempting to collect debts not owed;
- Attempting to collect from deceased borrowers' families and relatives;
- Attempting to collect from elderly, disabled borrowers;
- Firing employees who attempt to help borrowers obtain information about their loan status;
- Instructing employees to give borrowers the "run around" rather than provide them with correct information on their loan status; and
- Intentionally sending loan payment notices to an incorrect address in order to force a borrower's account into default.⁴¹

Collection agencies and loan servicers are simply delegated too much authority to resolve disputes with borrowers. In the federal loan programs, they are given authority to act on behalf of the loan holder in everything from rehabilitation to information about discharges to loan compromises. Yet dispute resolution is not their primary mission. They are not adequately trained to understand and administer the complex borrower rights available under the Higher Education Act and there is insufficient oversight of their activities.⁴² As a result, consumers are deprived of important options to which they are legally entitled. Even worse, some collectors misrepresent these rights or steer consumers into options more profitable for the collector.

Here is one recent real-life example. An attorney in California had financial trouble earlier in his career. He ended up defaulting on his student loans. He is now making money and wants to get out of default and repay his loans. Although he is a trained lawyer, he has been unable to work with the collection agency, which has repeatedly threatened him and harassed him. Finally, the collection agency said that they would agree to set up a rehabilitation plan with him. However, they claimed that he would be required to make monthly payments that were unaffordable for him. They also refused to send him any paperwork ahead of time. The attorney requested that the agency return the file to his guarantor so that he could work with them. Both the collection and guaranty agency said that the attorney must work with the collection agency and that they would not return the file to the guarantor.

This case was resolved because we informed this borrower about the ombudsman office at the guaranty agency and because the ombudsman agreed to get involved. Although the collection agency and borrower were at an impasse and the collection agency was acting in increasingly aggressive and abusive ways, the borrower was never told that he could work instead with an agency mediator. Once the ombudsman intervened, the borrower agreed to a rehabilitation plan and is back in repayment.

⁴¹ Press Release, "Kennedy Questions Student Loan Lenders' Collection Tactics" (April 26, 2007).

⁴² See U.S. Department of Education, Office of Inspector General, Final Audit Report, Control Number ED-OIG/A19-D0002 (December 23, 2003).

3. Nonlawyer Ombudsmen Should Not Provide Legal Advice

Ombudsmen are generally not lawyers and are not always correct in their legal interpretations. In some cases, the ombudsman may agree with the borrower's interpretation, but will not have the power to change a conflicting agency view. The Department of Education ombudsman noted this issue in an interview. Guaranty agency ombudsmen may have more flexibility. In interviews for this report, a number of ombudsmen reported that if conflicts arise, they discuss the issue with their legal counsel and other "powers that be." They said that they will always investigate these issues, but agreed that the results may not always be to the borrower's satisfaction.

Nonlawyer advocates must not cross the line into providing unauthorized legal advice. Given the dearth of legal assistance for student loan matters, this overreaching is understandable, but not always helpful. Providing some assistance is not always better than none if the advice is inaccurate.

Keeping this caution in mind, nonlawyer advocates can provide very useful direct assistance for borrowers. Regulation of these services is essential to ensure that the advocates are accountable to consumers and that they have the expertise to provide direct assistance. They must also develop legal referral resources for consumers that need assistance beyond the scope of their expertise or training.

Non-profit Counseling Agencies

There is potential to develop student loan counseling services within the non-profit credit counseling and housing counseling industry. Many agencies have well-trained counselors who have experience dealing with financially distressed consumers.

Despite the potential, there is risk involved with bringing credit counselors into the student loan counseling world. Credit counselors traditionally assist consumers with credit card debt. Many have housing counseling units as well, but most do not provide student loan-related services. There are a number of reasons why most agencies are set up in this way. Most important, credit counseling agencies have traditionally received much of their funding from credit card lenders. In the past, this funding has usually come through a program called Fair Share. Under the Fair Share process, creditors voluntarily return to the agency a set percentage of the funds that are disbursed to them. Many creditors no longer use the Fair Share model and instead provide grants to credit counseling agencies based on a variety of performance criteria. Credit counseling agency directors report that these grants are tied to the agency's work with credit card accounts and generally do not take into account assistance they may provide consumers with other types of debt, such as student loans. The directors report that they are increasingly working with consumers with mortgage debt problems. This shift has occurred, they say, because of the demand for such services, but also because of the increased funding for housing-related counseling.

One challenge in expanding the role of credit counselors is ensuring that only legitimate non-profit agencies provide these services. There have been very serious abuses in the credit

counseling industry in recent years.⁴³ However, there are still many legitimate, effective credit counseling agencies. The Foundation for Credit Education recently developed a project to expand student loan counseling services among credit and housing counselors. NCLC's Student Loan Borrower Assistance Project is a partner in this project. Over 100 agencies have participated in the trainings and about forty have committed to providing some level of student loan assistance. The Foundation for Credit Education project provides training on student loan issues and follow-up assistance. Outcome results are not yet available.

Credit counseling agencies are accustomed to placing borrowers in standardized debt management plans, particularly for credit card debt. These types of plans do not yet exist for student loans, an issue that credit counseling agency staff repeatedly cites as a key barrier to increasing their student loan work. A debt management plan of this sort might be useful to help private student loan borrowers. Similar to credit cards, borrowers could then be presented with the standard work-out options offered by particular lenders. However, this type of system will not work for federal government loans where there are no "one size fits all" solutions. Instead, assisting borrowers with federal student loans requires an extensive knowledge of rights and remedies under the Higher Education Act. Most counselors do not have this level of expertise.

A related issue is that counselors do not keep up regularly on new developments in the student loan area. In our experience with the Foundation for Credit Education project, there are many counselors that provide very useful services. However, it is clear that they are not accustomed to doing legal research and ensuring that the information they give out is current and accurate.

Credit counselors must be able to develop systems to assist consumers without the benefit of standardized debt management plans. Follow-up assistance is almost always required to assist student loan borrowers. This model is much different than the traditional credit card counseling model. It is unclear whether credit counseling agencies can make the necessary adjustments and find sufficient resources to provide high-level student loan borrower assistance. There are some positive signs. However, with notable exceptions, reform has been slow to come in the credit counseling world.

Finally, counselors rarely have attorneys on staff and can easily fall into provision of unauthorized legal advice.⁴⁴ Nonlawyer advocates must not cross the line into providing unauthorized legal advice. Given the dearth of legal assistance for student loan matters, this overreaching is understandable, but not always helpful. Providing some assistance is not always better than none if the advice is inaccurate.

Keeping this caution in mind, nonlawyer advocates can provide very useful direct assistance for borrowers. Regulation of these services is essential to ensure that the advocates are accountable to consumers and that they have the expertise to provide direct assistance. They must also develop legal referral resources for consumers that need assistance beyond the scope of their expertise or training.

⁴³See generally National Consumer Law Center, "Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees, and Aggressive New Market Entrants" (April 2003), available at: http://www.nclc.org/issues/credit_counseling/content/creditcounselingreport.pdf.

⁴⁴ See generally Lea Krivinskas, "Don't File! Rehabilitating Unauthorized Practice of Law-Based Policies in the Credit Counseling Industry", *Amer. Bankruptcy L.J.* (Winter 2005).

For-Profit “Student Loan Assistance” Businesses

There are a growing number of private companies that purport to provide student loan counseling or specific loan services such as consolidation. Many of these companies have names that appear to be neutral or even non-profit. Upon further investigation, we found that many of these agencies are actually selling products such as loan consolidations. Much of the web advice about student loan options is provided by entities that are affiliated with particular lenders or are selling their own products. It is especially troubling when a company advertises that it provides comprehensive advice and services when in reality the only solution it sells is consolidation. One company very explicitly states on its web site that borrowers should consolidate student loan debt in order to get out of financial peril. No other options are discussed.

In fact, consolidation is not a good option for all borrowers and may not even be available to all borrowers. A particularly dangerous strategy is for borrowers to consolidate government loans into a private consolidation loan. Borrowers are not always told that they will lose their rights under the federal student loan program if they choose this option.

NCLC has collected contracts from a number of companies that claim to offer student loan debt assistance. One company charges a fee to help a borrower consolidate government loans. This is something that the borrower can do on her own without too much trouble. A small fee might be reasonable to get some assistance. However, this company’s contract required the borrower to pay a total of \$600 with an additional \$250 for borrowers in garnishment. Some borrowers are charged additional fees. Further, the contract is for a particular solution to a student loan problem. It does not provide evaluation services to help a borrower determine his best options nor does it take into account the complexity of student loan issues.

Other companies claim to offer a range of services to help borrowers with discharges, compromises, dispute resolution and consolidation. In our Internet search, none of these companies stated that they were lawyers or affiliated with lawyers.

A growing number of debt settlement companies are now offering “student loan counseling.” For example, JK Harris, a tax resolution firm and financial planner, issued a press release in October 2007 touting its assistance for a student loan borrower with nearly \$20,000 in student loan debt.⁴⁵ According to the release, the company assisted the borrower to consolidate his loans through the Direct Loan program and select a more affordable repayment plan. The guaranty agency initially objected to the company’s assistance. The release does not say how much the borrower paid for these services.

There is generally nothing wrong with consumers attempting to settle a debt if this makes sense for them. The problem is that most debt settlement companies solicit consumers who do not yet have lump sums to make settlements. Negotiation and settlement services are different from debt management mainly because the debt settlement agencies do not send regular monthly payments to creditors. Instead these companies generally maintain funds in separate accounts, holding the money until the company believes it can settle debts for less than the full amount owed.

⁴⁵ Press Release, “JK Harris Lends Illinois Man Helping Hand with Student Loan Troubles” (October 30, 2007), available at <http://www.expertclick.com/NewsReleaseWire/default.cfm?Action=ReleaseDetail&ID=18562>.

The main problems with debt settlement are: 1) The consumers targeted by debt settlement companies are generally the least likely to benefit; 2) Very few consumers ever complete a debt settlement program. In the meantime, consumers in debt settlement programs continue to face collection efforts. Their debts also continue to grow as creditors pile on fees and interest accrues; 3) Debt settlement fees are so high that the consumers do not end up saving much in the “reserve accounts”; 4) It is unclear what if any professional services most debt settlement companies offer to assist debtors.⁴⁶ There are also potential tax consequences if debts are written off.

We are wary of relying on for-profit companies to fill the gap in borrower assistance services. Transparency is key and companies that engage in deceptive business practices should be the target of aggressive private and public consumer protection enforcement.

Legal Assistance

Affordable lawyer resources could go a long way toward filling the gap in student loan borrower assistance services. Unfortunately, there is a severe shortage of free and affordable legal resources in this country. For example, the 2003 appropriation for the Legal Services Corporation (LSC), the government agency that monitors and funds free civil legal aid in the United States, amounted to less than \$7 per eligible client.⁴⁷ The lack of resources is compounded by restrictions placed on the types of cases LSC grantees can accept, including prohibitions on class actions and welfare reform advocacy.

The American Bar Association concluded in a 1994 study that in low-income households, 71% of situations that could be addressed in a legal forum did not find their way into the legal system. The percentage was 61% for modest income households.⁴⁸ Between 2000 and 2005, nine state studies were issued finding that low income persons received or sought legal help for between 9% and 18% of their civil legal needs.⁴⁹

In response, the legal services community has tried to maximize the number of cases handled, often by providing less intensive services to more clients.⁵⁰ The category of “limited legal services” includes services with less than full representation combined with no duty to do more.⁵¹ Limited legal services include telephone hotlines which as of 2002, were used by 140 legal aid programs in 45 states. Family, housing and consumer issues make up the overwhelming majority of cases handled at hotline sites.⁵² Evaluation of hotline services has raised serious questions. Nearly half of the hotline cases in a 2002 study had unfavorable outcomes. This was most likely to occur

⁴⁶ National Consumer Law Center, “An Investigation of Debt Settlement Companies: An Unsettling Business for Consumers” (March 2005), available online at:

http://www.consumerlaw.org/issues/credit_counseling/content/DebtSettleFINALREPORT.pdf.

⁴⁷ See Robert Bickel, “Limited Legal Services: Is It Worth It?”, 39 Colum J.L. & Soc. Probs 331, 338 (Spring 2006).

⁴⁸ Legal Needs and Civil Justice--A Survey of Americans: Major Findings from the Comprehensive Legal Needs Study (1994), available online at: <http://www.abanet.org/legalservices/downloads/sclaid/legalneedstudy.pdf>.

⁴⁹ See Legal Services Corporation, “Documenting the Justice Gap in America: The Current Unmet Civil Legal Needs of Low Income Americans” at 12 (September 2005), available at <http://www.lsc.gov/JusticeGap.pdf>.

⁵⁰ See Robert Bickel, “Limited Legal Services: Is It Worth It?”, 39 Colum J.L. & Soc. Probs 331, 338 (Spring 2006).

⁵¹ Id.

⁵² Robert Echols and Julia Gordon, “Recommendations and Thoughts From the Mangers of the Hotline Outcomes Assessment Study Project” (April 2003), available at http://www.clasp.org/publications/Hotline_MIE.pdf.

for consumers with less education or limited English proficiency.⁵³ The evaluators concluded that hotlines can be useful for many consumers, but alone can never meet legal needs.

Legal aid programs are less likely to handle personal finance and consumer cases, including student loan problems. The 1994 ABA study found that for both low and moderate income households, personal finance and consumer issues were one of the two most often mentioned categories of legal needs.⁵⁴ However, these issues were in the category of needs that individuals most often faced without legal or judicial help.⁵⁵ In general, bankruptcy counseling and representation are among the leading unsatisfied legal needs among lower-income populations.⁵⁶

We called fifteen LSC-funded legal aid programs in diverse geographical areas to explore the level of student loan services. Only four of these programs (less than 25%) stated that they assist clients in student loan cases.

Some programs that do not represent clients with student loan cases may provide information, including brochures on their web site. However, in our review of five legal aid web sites with information about student loans, we found numerous errors. Most errors occurred because the information had not been updated in some time. These findings indicate the dangers inherent in providing information about subjects that are not core to the program's work.

The lack of legal resources is acute for moderate and middle income borrowers as well. There are few lawyers that specialize in student loan matters. It is difficult to make a living handling student loan cases. Unlike other consumer cases, the key student loan-related statutes do not have private enforcement rights or attorney's fees provisions. The private bar is unlikely to step up as long as there are few claims to bring on behalf of student loan borrowers, particularly claims that provide attorney's fees. The main barrier to enforcement of borrower rights is that courts have consistently held that there is no private right of enforcement under the Higher Education Act (HEA). Largely by default, most private enforcement of student loan violations, to the extent it occurs at all, is through the federal and state debt collection laws. The federal law is the Fair Debt Collection Practices Act (FDCPA).⁵⁷ This type of enforcement is most appropriate and useful when abusive and harassing debt collection agency conduct is involved. However, there are severe limitations to using this law to enforce borrower rights. Most important, the FDCPA is an indirect way of obtaining relief. Seeking damages through FDCPA claims do not help borrowers get the repayment plans or discharges to which they are entitled.

It is less clear why so few legal aid organizations, *pro bono* lawyers, and law school clinics provide assistance with student loan cases. The situation is changing in some areas, but there is still much more to be done. The relative lack of assistance on student loan issues is surprising given that student loan law is not the most difficult area of law. Further, there is almost always something an advocate can do to assist clients. For the most part, representation in court is not required.

⁵³ Id.

⁵⁴ Legal Needs and Civil Justice--A Survey of Americans: Major Findings from the Comprehensive Legal Needs Study (1994), available online at: <http://www.abanet.org/legalservices/downloads/sclaid/legalneedstudy.pdf>.

⁵⁵ Id.

⁵⁶ Peter C. Alexander and Gary S. Gildin, "Bankruptcy Pro Bono Legal Assistance Programs: An Update", 2007 Ann. Surv. of Bankr. Law Part II §15 (September 2007).

⁵⁷ 15 U.S.C. § 1692. See generally National Consumer Law Center, Fair Debt Collection (5th ed. 2004 and Supp).

Legal aid programs can and should do more to represent student loan borrowers. Higher education is the primary means for upward mobility in this country. Ensuring access to education should be a primary goal of all anti-poverty programs, including legal aid.

Even with expanded commitment, legal aid programs cannot meet the huge demand for services. Their resources are severely strapped, as discussed above. In addition, legal aid programs have income guidelines that restrict services to the lowest income borrowers. To help meet this need, we call on Congress to fund a pilot project that sets up a neutral, non-profit entity to provide direct assistance to borrowers in trouble. This proposal is described in greater detail in the recommendations section below.

CONCLUSION

We call on the higher education community and policymakers to expand the assistance network for financially distressed student loan borrowers. Quick advice to borrowers is rarely sufficient. Instead, borrowers should have access to a range of services, from informational resources to mediation to borrower advocates that can provide a higher level of representation.

After all, these students followed our society's advice. They turned to higher education to better their lives and the lives of those around them. To deny them a helping hand when things go wrong, often because of events beyond their control, not only denies them justice, but also threatens the important national goal of equal access to higher education. Our higher education system and economic productivity depend on how we respond to their cries for help.

Specific recommendations are presented below.

RECOMMENDATIONS TO EXPAND ASSISTANCE FOR BORROWERS

Schools, loan holders and credit counselors can and should do more to assist student loan borrowers, particularly in providing information and counseling services. For example, credit counseling agencies and schools could offer on-line seminars about student loan debt. Perhaps colleges could even offer credit for such courses. To ensure quality, we recommend that a standardized course be developed that is approved by a neutral, non-profit entity with expertise on the range of student loan intervention strategies.

They may also provide direct assistance in certain circumstances. However, there are limits to these programs, discussed throughout this report. They cannot be everything to everyone. A particular concern involves nonlawyer counselors crossing the line into providing legal advice.

Funding is a problem for all of these programs. Creative solutions should be considered, including possible public funding or support from higher education institutions. Regardless, we do not believe that an effective program can be built through funding from lenders. This will create improper incentives and conflicts and interest that are not in the best interests of borrowers.

It is more difficult to close the gap in direct assistance services for borrowers. One solution is for lawyers, including legal aid and *pro bono* programs, to expand their services and provide legal

assistance for student loan borrowers. Self-help legal information can also be useful.⁵⁸ However, self-help materials are not a substitute for individualized legal advice.

Existing legal resources are insufficient. Legal aid programs are underfunded and restricted in what they can do. Few assist student loan borrowers. To help meet this need, we call on Congress to fund a pilot project that sets up a neutral, non-profit entity to provide direct assistance to borrowers in trouble. Private funders could also offer assistance as long as there is no funding from conflicting interests, such as student lenders. This would be a borrower advocate program that would work in collaboration with ombuds, counseling and other mediation entities.

Counselors in the borrower advocate project should be under the supervision of a lawyer who is knowledgeable about student loan law and keeps up with new developments. This is because, as discussed throughout this report, even well-intentioned counselors may give erroneous advice about the often complex student loan programs.

Depending on resources, the pilot project could begin in a few areas or it could be available more broadly. It should include an evaluation mechanism to measure borrower satisfaction and track borrower progress over time. The pilot project is a first step toward building a strong student loan borrower assistance network.

⁵⁸ See, e.g., The Student Loan Borrower Assistance Project web site at www.studentloanborrowerassistance.org.

APPENDIX A

SUMMARY OF RECOMMENDATIONS FROM NATIONAL CONSUMER LAW CENTER, “NO WAY OUT: STUDENT LOANS, FINANCIAL DISTRESS AND THE NEED FOR POLICY REFORM” (JUNE 2006)⁵⁹

Preventing Defaults

The adverse consequences of student loan debt are particularly acute after a borrower defaults. However, the system is not set up to focus real resources and energy into default prevention.

Recommended solutions include:

- Evaluating what works and developing effective counseling programs.
- Fixing the perverse incentive structure that rewards guaranty agencies and other entities more richly when borrowers default than when they do not.

Flexible and Affordable Repayment

Counseling and communication efforts are only as effective as the alternatives they can offer. **Struggling borrowers need accessible, affordable and flexible repayment options to avoid default.** The most flexible options are available to borrowers prior to default. However, some of these options will be eliminated after July 1, 2006.

Recommendations to improve pre-default repayment programs include:

- Extending the income contingent repayment plan (ICR) that is currently available only through the Direct Loan program to Federal Family Education guaranteed loans (FFEL) or by developing a similar formula for FFEL repayment.
- Establishing a maximum time limit after which payments are no longer required.

2007 Update: The income-based repayment provisions in the College Cost Reduction and Access Act should go a long way toward fulfilling these

⁵⁹ The full report is available online at: <http://www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf>.

recommendations.⁶⁰ NCLC and other borrower advocacy groups have provided extensive testimony to guide the Department of Education as it develops regulations in this area. Among other recommendations, we recommend that the Department should harmonize the new income-based repayment program (IBR) and the existing income contingent repayment program (ICR) as long as this can be done in ways that do not disadvantage any borrowers. We also recommend that the same rights for borrowers in default should be available in the new IBR program, as in the ICR program. At a minimum, FFEL borrowers in default should be allowed to consolidate with FFEL and select an IBR if they prefer that option to consolidating with Direct Loans. They should also have the option, as they do now, to consolidate with Direct Loans and select an ICR or IBR.⁶¹ We also recommend that the Secretary set the maximum time limit for repayment at *20 years* for both IBR and ICR.

Post-Default Repayment

The current post-default repayment plans are helpful for some borrowers, but must be strengthened to ensure that borrowers understand their options and to best conform these options to borrower needs. There is a category of borrowers who slip in and out of default or fall into default just once due to temporary financial difficulties. These borrowers can often be restored to repayment status. Early intervention is particularly important because of the current policies that impose hefty collection fees and hand defaulted loan portfolios off to collection agencies early in the process.

There is another category of borrowers that is less likely to be able to get out of default. For these borrowers, it is critical to preserve a safety net so that people with disabilities, the elderly, victims of school fraud, and others who are in economic distress on a more permanent basis get relief.

Key recommendations and findings:

- **Rehabilitation:** Loan rehabilitation can be an important option for borrowers to get out of default and back into repayment, but it is limited by lenders and agencies improperly setting maximum amounts that borrowers must pay while in the process of rehabilitating loans. A recommended change is to allow borrowers to repay using

⁶⁰ P.L. #110-84. For a summary of the Act, see

http://www.studentloanborrowerassistance.org/uploads/File/policy_briefs/NewLawSummary.pdf.

⁶¹ A copy of NCLC's written testimony in response to the Department of Education's Notice of Establishment of Negotiated Rulemaking Committee is available online at:

http://www.studentloanborrowerassistance.org/uploads/File/policy_briefs/testimony_hearingNov07.pdf. The Project on Student Debt's testimony is available at: http://projectonstudentdebt.org/files/pub/11-07_Neg_Reg_Testimony.pdf.

the ICR formula during rehabilitation. In addition, all collection efforts must cease during the period that a borrower is repaying through a rehabilitation program.

- **Income Contingent Repayment:** Recommended changes to improve the income contingent repayment option include:
 - Allowing qualified borrowers in all of the main federal loan programs to access the ICR directly rather than through consolidation. Until this recommendation is put in place, borrowers should not be improperly denied access to Direct Loan Consolidation ICR.

Temporary Suspension of Payments

Deferments are essential tools for borrowers hoping to avert defaults. However, current deferment programs are in some cases overly restrictive and inconsistent across loan programs. The paper includes recommendations to restructure key deferments, such as economic hardship and unemployment deferments and to simplify the application process.

Despite the costs for borrowers, forbearances can also help reduce defaults. Among other recommendations, we suggest developing options for borrowers coming out of forbearance to restructure their loan terms.

Cancellation Programs

Currently, there are certain criteria and programs that allow borrowers to qualify for full or partial cancellation of their student loan debt. There are fraud-related cancellations including closed school, false certification, and unpaid refund; disability and death cancellations; and profession-oriented cancellations. While helpful for those who are eligible, these programs are very limited in scope and difficult for borrowers to find out about.

Recommendations include:

- Developing a cancellation that affords relief to all borrowers who attended schools that violated key Higher Education Act (HEA) provisions.
- Improving the current cancellation programs, including tying the disability standard to the standard used by the Social Security Administration or Department of Veteran's Affairs.

Bankruptcy Relief

Student loans are among the few unsecured debts that are generally not dischargeable in bankruptcy. Student loans can only be discharged if the debtor can show that payment of the loan will impose an undue hardship on the debtor and dependents. Courts have interpreted this standard very restrictively. We call on Congress to allow borrowers to discharge student loans in bankruptcy.

Relief from Collection

The widespread use of private collection agencies to pursue student loan defaulters, combined with significant expansions in the government's arsenal of collection tools, has led to abuses in student loan collection. There are also documented problems with training and oversight of third party private collectors. The use of private collectors adds substantial costs to the collection process and contributes to problems with both the amount of fees charged and when fees are imposed. This section includes detailed recommendations to ensure that borrowers are not discouraged from repaying because of uninformed and overly aggressive collectors and that all borrowers are treated fairly.

Recommendations Include:

- Developing a rigorous, public training process for collection agencies that includes information about all student loan rights as well as fair debt collection rights.
- Improving all aspects of enforcement and oversight of private collection agencies.
- Eliminating Social Security and federal benefit offsets.
- Only charging collection fees that are bona fide and reasonable and actually incurred in collecting against individuals.
- Re-imposing a reasonable statute of limitations on student loan collections. The elimination of the statute of limitations for student loans in 1991 placed borrowers in unenviable, rarified company with murderers, traitors, and only a few violators of civil laws. Even rapists are not in this category since there is a statute of limitations for rape prosecutions, at least in federal law and in most states.

Enforcing Borrower Rights

Even borrowers who are aware of their rights are often unable to enforce them. The main barrier to private enforcement is that courts have consistently held that there is no private right of enforcement under the Higher Education Act (HEA). Fair debt laws are an imperfect substitute for direct enforcement of borrower rights. Among other recommendations, we call on Congress to create an explicit private right of action to enforce the Higher Education Act. Borrowers must also have the right to appeal an adverse decision regardless of whether the decision is made by a guaranty agency, lender, or government agency.

APPENDIX B

SURVEY SENT TO OMBUDSMAN AND CUSTOMER ADVOCATE UNITS

Questions for Ombuds Programs

1. Please describe your mission in your own words.
2. When did your program begin?
3. How many staff do you have?
4. How many borrowers contact you each year? Please give whatever statistics you have.
5. If you track outcomes, please provide information about outcomes from the most recent two years if possible.
6. How do you publicize your services? Please list all ways in which borrowers can find out about your services.
7. Are you willing to post information about your services on NCLC's student loan borrower assistance project web site? If not, is the information available elsewhere on the Internet?
8. Are you willing to discuss your services further with NCLC?

Please return to Deanne Loonin at dloonin@nclc.org or by mail at the Boston address above.