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Written Testimony of Deanne Loonin, National Consumer Law Center's Student Loan Borrower Assistance Project in response to the September 8, 2008 U.S. Department of Education Notice of Invitation for Public Comment and Establishment of Negotiated Rulemaking Committees

The following testimony is submitted on behalf of the National Consumer Law Center's low-income clients. The National Consumer Law Center (NCLC) 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 elderly 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]

I. The Higher Education Agenda

Policies to improve the student financial assistance system should be based on the ten principles listed below. This list is followed by targeted recommendations to implement the Higher Education Opportunity Act (HEOA).

Principles:

1. **Target assistance to those who are unlikely to meet their educational goals without financial help.**[3]

2. **Improve information about student financial options and simplify the application process.**

3. **Eliminate predatory student lending.**
   The Higher Education Opportunity Act (HEOA) makes some progress in curbing predatory student lending. However, most of the new private loan provisions are additional disclosure

[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* (3d ed. 2006 and Supp.).
[2] *See* the Project's web site at http://www.studentloanborrowerassistance.org.
[3] This was a key recommendation in the September 2008 report from the Rethinking Student Aid Study Group, "Fulfilling the Commitment: Recommendations for Reforming Federal Student Aid."

requirements. Disclosures alone will never be enough to stop predatory lending and will never adequately protect consumers. Other reforms are needed that will limit the fees and rates that lenders can charge and therefore help eliminate unsustainable loans. New laws should also require fair underwriting standards, accurate and accountable loan servicing, ensure effective rights and remedies for borrowers caught in unaffordable loans, improve assistance to distressed borrowers and require lenders to report basic information about private student loan borrowing.

4. **Ensure access to flexible, income-based repayment and other debt management tools.**

We are particularly concerned about access to IBR for borrowers in default. A borrower in default can choose IBR but will not get out of default simply by making this selection. This is tremendously important because as long as borrowers remain in default, even while making payments, they are still subject to collection agency tactics, income tax seizures, federal benefits offsets, administrative wage garnishments and possible lawsuits. The current paths to get out of default through repayment are loan consolidation and rehabilitation. Access to both of these programs must be improved so that borrowers in default can get back into repayment through IBR. A general solution is to require loan holders to give borrowers the choice of selecting IBR before a default is declared. These issues are discussed in greater detail below.

5. **Set a maximum time limit for repayment for all borrowers and eliminate any adverse tax consequences for those who have balances written off.**

There should be a limit on the number of years all borrowers are required to repay federal student loans. This cap should apply regardless of the borrower's profession. A general income-based forgiveness limit is preferable to a laundry list of forgiveness programs tied to particular professions. This takes government out of the business of deeming which professions are the most socially productive and gives all borrowers the opportunity to make income-based repayment for a finite number of years. A first step toward this goal that can be accomplished through the rulemaking process is to lower the forgiveness period for the IBR and ICR programs from 25 to 20 years. It is also critical to ensure that there are no adverse tax consequences for any borrower that receives a write-off of federal student loans.

6. **Eliminate perverse collection incentives and limit collection agency involvement.**

Collection agencies and loan servicers are 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. 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.

The Department should limit the files it sends to collection agencies. At a minimum, borrowers that are already subject to extreme collection programs such as offset and have no other assets should not be pursued by collection agencies and should not be charged collection fees. If a borrower informs a collection agency that he believes he has a defense to the debt, that the amount is wrong, or that he wants to request a hardship waiver, the file should be immediately sent back to the loan holder. In addition, collection charges should be limited to only those fees that are bona fide and reasonable and actually incurred.

We also support development of a new system where loans held by lenders that are delinquent for a set period of time, such as six months, will be immediately assigned to the Department of Education. The Department would then be required to contact borrowers and offer them IBR to avoid default. At a minimum, if the FFEL loan holders continue to hold the loan, they should also be required to offer IBR at a certain stage of delinquency. Highlighting the IBR program does not preclude the borrower from later choosing other options, such as economic hardship deferrals or even trying to cancel their loans if they are eligible to do so.

7. **Create counseling assistance services for financially distressed borrowers that are not tied to lenders or guaranty agencies.**

In addition to improving Department of Education enforcement and oversight of private collection agencies, borrowers with cancellation or other options should be given proper advice so that they can pursue these options. The existing assistance network is insufficient. Legal aid and other programs are under funded and restricted in what they can do. Few assist student loan borrowers. To help meet this need, we advocate the creation of a neutral non-profit entity to provide direct assistance to borrowers in trouble. As long as no inappropriate strings are attached, funding could come from the government. 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. It would most likely start as a pilot project and would include an evaluation mechanism to measure borrower satisfaction and track borrower progress over time. This is a first step toward building a strong student loan borrower assistance network.

8. Ensure relief for borrowers when their rights are denied.

Congress continues to pass new laws without ensuring that consumers can actually enforce those laws when problems arise. In practice, if a loan holder denies IBR, for example, there is not much a borrower can do. There are some good informal assistance channels, such as the ombudsman's office, but there is no private right to enforce the HEA. The same problem applies when collection agencies deny rights. Borrowers can seek damages in fair debt cases, but cannot require loans holder to comply with the law and provide the relief sought.

Key recommendations are for Congress to specify that borrowers and other parties with standing have a private right of action to enforce the HEA. In addition, the Department and other relevant state and federal agencies, including the Federal Trade Commission (FTC), must ensure that lenders and schools that are required to do so are complying with the FTC Holder Rule. Enforcement and oversight is especially important in the private student loan context. To ensure adequate appeal rights, each agency must establish fair hearing procedures that are truly fair.

9. Restore a Viable Safety Net.

A viable safety net is essential and necessary for borrowers regardless of how or why they got into financial trouble. 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 her tax refund, even an earned income tax credit, seize portions of federal benefits such as Social Security, and deny her 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.

While collecting funds is important for the government and taxpayers, there comes a point of no return where the government's ceaseless efforts to collect make no sense, monetarily or otherwise. Restoration of the safety net must include bankruptcy rights for student loan borrowers, restoration of a statute of limitations, limits on Social Security offsets and EITC offsets, and enforcement of fair collection rights. Further, all borrowers facing collection, regardless of the collection tactic, should have the right to a reduction or suspension of collection based on hardship. A viable safety net also requires improvements to the disability discharge system, as discussed in greater detail below.

10. **Rein in proprietary school abuses.**

The for-profit colleges and trade schools have succeeded in pushing Congress to significantly weaken federal rules that protect consumers and taxpayers. The negotiated rulemaking process is an opportunity to ensure that there are still some teeth left in the 90/10 rule, accrediting agencies requirements, and distance education provisions. Further, it is past time to eliminate the loopholes previously passed by regulation in the incentive compensation rules.

II. Recommendations for Implementing the HEOA

A. Disability Discharges

The HEOA made some key changes to the definition of total and permanent disability. The first change allows borrowers deemed disabled by the Department of Veterans Affairs (V.A.) to receive disability discharges. This is an important development and should go a long way toward streamlining the application process and providing prompt relief for a subset of borrowers. We believe that future reforms should set the same standard for Social Security recipients.

With respect to the current V.A. provision, we encourage the Secretary to allow a disability determination by the V.A. to result in automatic eligibility for the disability discharge. These borrowers should not be required to submit additional proof.

The other new provision in the HEOA states that borrowers may be considered totally and permanently disabled not only if they have a condition that is expected to result in death, but also if the condition has lasted for a continuous period of not less than 60 months or can be expected to last for a continuous period of not less than 60 months.

We believe that Congress' intent in passing this provision was to set a more realistic medical standard for the disability discharge process. Due to advances in modern medicine, it is rare for a physician to be able to state with absolute certainty that a debilitating condition will continue indefinitely or result in death, as is currently required. Practically, this means that many doctors are reluctant to sign the discharge form even if they have given a dire diagnosis. However, regulations that allow borrowers to regain eligibility for federal student aid implicitly acknowledge that a physician's honest evaluation at a particular point in time may change.[4] In fact, the Department has explicitly stated that advances in medical treatment may result in an improvement in the borrower's condition that could not be predicted at the time of the physician's certification.[5] The new standard recognizes these medical realities and we urge the Department to develop regulations in this spirit.

A problem with the HEOA provision is that it also states that the Department <u>may</u> establish additional safeguards to prevent fraud and abuse. We urge the Department <u>not</u> to exercise this discretion. There are already adequate safeguards in place to ensure the integrity of the program. Most important, the Department established a conditional discharge system after the issuance of the 1999 IG report.[6] More recent changes now in effect create a strictly prospective conditional period.

As a result of these changes over the years, the Department has adequate powers to ensure that only qualifying borrowers receive discharges. The Department now has a purely prospective three year period to evaluate whether borrowers have earnings beyond the allowable limits and to require borrowers to submit to in-person medical evaluations at government expense. Further, at the initial stages of the process, the Department may request appropriate medical information from the treating physicians. Extending this "conditional period" would be costly for borrowers, taxpayers, and the Department and is completely unnecessary.

Instead, we believe that the Department should use its rulemaking authority to make improvements to the application and evaluation process. We agree with the importance of integrity in the program. The problem is that in practice, the Department all too often arbitrarily denies discharges to deserving borrowers rather than making decisions on the merits. We know this from our experience representing borrowers for many years. Our conclusions are affirmed by research conducted by a guarantor which found the Department's administration of the conditional discharge period to be inconsistent, fraught with redundancies, and replete with overly burdensome and continually changing processes and procedural demands on the borrowers, borrowers' doctors, lenders and guarantors. The research found that the applications for more than half of borrowers who were initially accepted for conditional discharge were ultimately rejected and returned to

[4] 34 C.F.R. §682.201(a)(6)(i),(ii).

[5] See 65 Fed. Reg. 65678,65681 (Nov. 1, 2000).

[6] U.S. Dep't of Education, Office of the Inspector Gen., Improving the Process for Forgiving Student Loans, (June 7, 1999) (ACN A06-80001).

repayment based on an ambiguous reason of "medical review failure." These conclusions mirror our experiences representing clients.

The problem is that the Department uses the "medical review failure" as a generic denial standard without further explanation. Borrowers should receive denials based on these grounds only if the agency has reviewed the borrower's medical information and decided that it was insufficient to prove a total and permanent disability. Unfortunately, in practice, this "catch all" designation is used for everything, including minor and easily resolvable technical problems such as a doctor's failure to provide a license number or the borrower's failure to sign the form.

The Department keeps costs down by rejecting borrowers for arbitrary reasons rather than focusing on making meritorious decisions based on medical evidence. Instead of blocking these applications through arbitrary hurdles, the Department should put resources into improving the medical evaluation system. In this way, borrowers who submit completed applications would be approved or denied based on whether they are in fact medically disabled. This is the way it should be.

Another problem is that the Department routinely requests additional information from physicians who have already signed discharge forms, often giving these doctors unrealistic time deadlines to respond (such as three days). It is difficult for many doctors to discern what is expected of them. In many cases, doctors are repeatedly asked for the same information.

We recommend the following reforms in the process, all of which can be accomplished through regulation:

1. **Require loan holders and the Department to provide explanations for denials.**

2. **Alert borrowers in writing if a doctor has not responded to follow-up requests for information.**

3. **Minimize paperwork requirements by getting as much up-front information as possible from doctors and giving them realistic deadlines to respond to requests for additional information.**

4. **Impose a time limit on the Department to make determinations once applications are assigned to them.**

5. **Enforce the requirement that collection must automatically cease once a completed application is submitted.**

6. **Clarify that borrowers may submit a copy of an original application to separate loan holders. The form already states that copies are acceptable. However, not all loan holders honor this provision.**

B. Repayment As A Way Out of Default

1. Rehabilitation

There are serious problems with the rehabilitation program. These problems could get even worse if the Department takes an improper interpretation of the HEOA provision that limits rehabilitation rights to one time per loan. We are not sure what Congress intended with this provision. Regardless, it should not be interpreted to mean that a borrower who successfully rehabilitates a loan can never rehabilitate again. This is legally untenable because a borrower who successfully rehabilitates a loan ends up with a new loan. The new loan holders routinely claim that the "old" loan is dead and the borrower is starting all over again. This means that if a borrower gets into financial trouble with the new loan, she should be able to access the rehabilitation option again if necessary.

In addition to preserving rehabilitation rights in this way, the Department should use the rulemaking process to ensure that borrowers are able to exercise their reasonable and affordable repayment rights. The problem in this area derives in part from a system established by the Department which provides compensation to collectors for setting up rehabilitation plans only if the plans require borrowers to make certain minimum payments. Yet borrowers have a statutory right to make reasonable and affordable repayments.[7]

The current system simply does not work well for low-income borrowers, many of whom will be trying to rehabilitate in order to use IBR. It does not work at the front end when the borrowers are wrongly denied reasonable and affordable repayment terms. If borrowers clear this hurdle, the next barrier arises when the loan is sold and the new lender requires a standard repayment plan rather than allowing the borrower to choose a more affordable plan. We believe that a borrower's post-rehabilitation repayment plan choice is information that in many cases the guarantor can secure prior to the completion of the borrower's rehabilitation period. This information could then be relayed to the purchasing lender at the time the loan is sold; allowing the lender to honor the borrower's choice immediately as well as ensuring that the repayment terms are appropriately aligned with the monthly payments required during the rehabilitation period.

We urge the following reforms to the rehabilitation process:

1. **Prohibit all collection during the rehabilitation period.** Most collectors will agree to cease collection, other than routine billing statements, when asked, but they do not automatically do so. This should be standardized in the regulations. It is contrary to both borrower and loan holder interests to continue collection efforts while a borrower is making the effort to repay through rehabilitation.

2. **Use the IBR formula to determine reasonable and affordable rehabilitation payments.** In the FFEL program, lenders argue that they cannot do this because it may jeopardize their ability to resell the loans. To the extent this is true, a solution is to eliminate the resale requirement. As an alternative, in cases where there are no purchasers of the rehabilitated loans, the Department should be required to accept these loans in the Direct Loan consolidation program. Borrowers with very low monthly

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[7] 20 U.S.C. §1078-6(a)(1).

payments could even be required at the outset of the rehabilitation plan to agree to consolidate their loans with Direct Loans at the end of the rehabilitation period.

3. **Penalize loan holders who deny borrowers reasonable and affordable repayments or claim that minimum payments are required.**

2. Consolidation

Borrowers in default must also be able to access IBR through consolidation. The HEOA amends the statute to provide that borrowers in default on FFEL loans may consolidate with Direct Loans if they are unable to obtain a FFEL consolidation loan with income-sensitive OR income-based repayment terms.

This provision appears to confirm that FFEL consolidation lenders must offer borrowers IBR. We urge the Department to ensure that the regulations provide an "out" for borrowers to switch to Direct Loans if their FFEL lenders pressure them into accepting a different payment plan or otherwise block entry to IBR.

An additional hurdle that arises in the consolidation to IBR path is that while the Department (or other loan holder once IBR is available) is determining the income-based repayment amount, the borrower is told that she must make a payment that at least covers monthly accruing interest. This is an impossible situation for borrowers with very low incomes. Unfortunately, most of these borrowers do not know that they can request forbearance (or deferment if they are eligible) to put the account on hold until the income-based amount is determined. To address this problem and avoid losing borrowers who have just recently come out of default, the Department and other loan holders should automatically offer forbearances to borrowers for the period that the income-based repayment amount is being determined.

C. The Self-Certification Process

We urge the Department to aggressively monitor the "self-certification" process established in the HEOA. There is a significant risk that this process will encourage excessive borrowing and enable fraud by both lenders and borrowers. Additional reform is needed to limit conflicts of interest between lenders and colleges. The HEOA once again includes some good provisions in this area, but it does not eliminate the potential for abuse. Instead of encouraging colleges to include lenders and guaranty agencies in the loan counseling process as the HEOA could be interpreted to do, the Department should set clear parameters about appropriate levels of involvement. The Department should also develop and disseminate tools and information that give colleges good, independent alternatives to lender-sponsored information.

D. Disclosures

Regulations to implement the new disclosure provisions should be as clear as possible. This will be a considerable challenge given the volume of disclosures. Most important, borrowers need to know what the credit really costs. For federal loan disclosures, we believe that it is acceptable to highlight important options, such as income-based repayment rather than present an incomprehensible laundry list.

E. **Default Rate**

Agency review and public scrutiny of cohort default rates should focus on institutions where the rate is most likely to represent a real problem with institutional quality and compliance. This is not the cases at colleges where a low proportion of students have federal loans. We recommend that the Department more clearly distinguish between the institutions that are subject to the minimum sanction levels and those that would likely be exempt due to low participation rates.

F. ATB

The HEOA expands the ability to benefit eligibility criteria by allowing schools to consider students to have the ability to benefit from the instruction upon the student's satisfactory completion of six credit hours or the equivalent coursework. We are concerned about students who are admitted to schools and receive loans on this basis, but then are unable to complete the required credit hours. The false certification ATB discharge provision should explicitly apply to these borrowers so that they are not required to repay any loan obligations incurred in attempting to meet the ATB criteria through credit hours.

G. **PLUS Loan Evaluation and Bankruptcy**

The PLUS regulations improperly allow loan holders to consider a prior bankruptcy in determining eligibility for PLUS.[8] This conflicts with the provision in the Bankruptcy Code that prohibits the government, guarantors and lenders from discriminating against those who have not paid their student loans when those loans were discharged in bankruptcy.[9] This provision in the HEA should be eliminated in the rulemaking process.

Thank you for your consideration of these issues.

Submitted by:

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[8] 34 C.F.R. §§682.201(b)(4) (Grad PLUS Loans), 682.201(c)(2)(ii)(B) (Parent PLUS loans).
[9] 11 U.S.C. §525(c).