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Protecting Student Loan Borrowers by Ending Default

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Federal student loans make college possible for millions of students who would otherwise be shut out of higher education. But the Higher Education Act has not been modernized to align with our current 100% direct lending system.[1] While some of the problems with repayment are due to the confusing design of benefits and applications, it is equally important for Congress to update the structure repayment pipeline itself, and to improve oversight of the administrators of that system. To create a more borrower-centered, accountable, and transparent repayment system, Congress must:

- End student loan default, opening up funding and flexibility to improve loan repayment,
- Compel the Department of Education and its contractors put borrowers first,
- Authorize the CFPB to provide oversight and support for the student loan program,
- Restructure performance management and compensation for servicers,
- Give the public the opportunity to weigh in on changes that would impact borrowers,
- Guarantee regular publication of comprehensive information on the loan program,

Putting an end to default and collection agencies

The current rules and structure of the loan system are based on the defunct Federal Family Education Loan Program (FFELP).[2] But the fact is, that structure can be vastly simplified for both borrowers and the Office of Federal Student Aid (FSA). All of these efforts begin with putting an end to the concept of federal student loan default. When default no longer exists, private collection agencies (PCAs) can be removed from the system. Considering the federal government's extraordinary authority to collect debts it is owed,[3] it is hard to imagine why Congress would want to keep these entities in the system, as they only serve to add to the costs and industry influence in our federalized system.

The consequences of default are steep, including damaged credit, assessment of collection fees of up to 25 percent of the loan balance, and wage, social security, and tax garnishment.[4] Just as bad, borrowers are not able to receive any federal financial aid until they resolve the default, all but prohibiting them from re-enrolling in school and bettering their career prospects.

Eliminating default would temper some of the equity issues pervasive in the loan system. Default disproportionately impacts borrowers of color, particularly African Americans, nearly half of whom experience this outcome.[5] Students with children,[6] Pell Grant recipients,[7] and veterans[8] also experience higher default rates than their peers. Should default go away, these communities would be less hampered by their debt, thus gaining a better opportunity to overcome the obstacles they face.

Taxpayers also stand to benefit. FSA pays collection agencies almost $1 billion annually to manage 7 million accounts, nearly the same as it pays loan servicers to manage 34 million accounts.[9] Shutting PCAs out of the loan system would free up money that could be funneled into better repayment programs and more intensive servicing. To ensure that delinquent borrowers are appropriately managed, servicers could be given some of the authorities that PCAs have, like the ability to garnish wages or tax refunds, which would deter borrowers from going into default. In providing servicers with this authority, collections rules should be revised, as has been recommended in the Student Loan Borrowers' Bill of Rights Act of 2017, which removes FSA's ability to collect social security income and tax credits from low-income individuals.[10]

Servicers should also be able to automatically enroll severely delinquent borrowers into an income-driven repayment plan. This would reduce long-term delinquencies, preventing the lowestincome borrowers from facing collections. To make automatic IDR enrollment possible, additional data sharing between the Departments of Education and Treasury, but fortunately, the bipartisan Faster Access to Federal Student Aid (FAFSA) Act of 2018[11] proposed this arrangement, with the proposal even showing up in the 2019 Trump administration budget.[12]

Finally, in a system where accounts are completely managed by servicers, Congress can implement more borrower-friendly paths out of debt. Involuntary payments made under wage and tax garnishments could be made under the same calculations as income-driven repayment plans, with those payments being counted as progress toward forgiveness. Perhaps most importantly, collections fees could be significantly reduced or eliminated, as well as standardized across all paths out of default.[13]

Codifying standards for loan servicing

With collection agencies out of federal lending, servicers would then become the sole contractors that interact with borrowers. As such, Congress should take additional steps to ensure they are being effective and held accountable.

The first step is restructuring performance management. Now, servicers are measured in comparison to one another, ranked, and then allocated a share of new accounts.[14] Instead, compensation for contractors should instead be tied to meeting high performance marks across several evaluative criteria, so that all borrowers could expect the same baseline standard of service. These measures should not just include borrower outcomes, but other objective criteria, such as the rate of enrollment of repeatedly delinquent borrowers into an IDR plan, providing appropriate and accurate counseling, correct calculation of repayment and interest amounts, accurate assignations of benefits, the efficacy of outreach efforts, and processing of paperwork in a correct and timely manner.

Servicers should also be compensated at a higher rate for keeping borrowers who are at a higher risk of default, such as non-completers,[15] in a current status. For all accounts, but in particular for this group, servicers should be required to share effective and innovative practices and ideas with FSA so that they can be implemented for all borrowers, ensuring consistency and continuous improvement.

Federal law should also prohibit specialty servicing, which allocates all accounts of a certain type to one servicer. For example, FedLoan Servicing/PHEAA receives the account of every borrower that indicates interest in participating in the Public Service Loan Forgiveness program.[16] Specialty servicing ensures that even poor performers continue to receive accounts and creates disincentives for other servicers to direct borrowers toward certain benefits, as it will cause them to lose the account.

Improving oversight and transparency at FSA

The Office of Federal Student Aid is designated by the Higher Education Act as a federal performance-based organization.[17] As such, it is required to efficiently run the aid programs, with an eye toward improving them for students while also reducing costs. These directives are often at odds, and student satisfaction is frequently sacrificed in the interest of penny-pinching.

It is important that Congress reaffirm FSA's commitment to students in HEA. Statute should clarify that student well-being and satisfaction are top priorities for FSA and its agents. To ensure FSA is complying with this edict, Congress can mandate the Consumer Financial Protection Bureau (CFPB) reclaim the supervision and enforcement roles it had in the past, but that were ended by Secretary of Education Betsy DeVos.[18] Instead of being just a cop on the beat, the CFPB can serve as a resource for FSA, providing expertise on consumer protection laws across a variety of markets. The CFPB can use its statutory authority to push on contractors when it may be infeasible for FSA to do so, whether due to policy or politics. It can also provide insight into what is happening on the ground and in states, elevating issues to FSA before they become unmanageable.

Congress must also give voice to consumers by requiring public comment on proposals that affect the experiences of borrowers or the design of the repayment system. Public comment, along with agency response, is a common practice throughout the federal government[19] and should be no exception for FSA. Congress can also direct FSA to work with expert entities to improve its borrower survey.[20] A revised, scientifically-administered borrower survey can better identify problems with servicing, rather than issues that arise from the complexity of the aid programs themselves.

Finally, Congress must increase data transparency at FSA. In the current regime, FSA publishes very limited data about the loan portfolio and the performance of its contractors.[21] In order to better evaluate the loan program and identify policy fixes, FSA should make public a de-identified, representative sample of the National Student Loan Data System.[22] It should also publish quarterly reports on servicer performance, investigatory actions, sanctions and complaints. FSA should also be required to annually report to Congress the state of the loan system, including metrics related to borrower satisfaction and contractor compliance. These areas should also be incorporated into FSA's annual report,[23] which would ensure they are regularly monitored and addressed.

The future of the loan system

FSA is currently reimagining the repayment system, termed the Next Generation Financial Services Environment (NextGen),[24] a change that will affect 34 million borrowers.[25] The proposed system features many benefits for borrowers: a single repayment portal, improved consistency across servicers, and more responsiveness to issues.[26] But the new system is now in its second iteration after running into lawsuits and protests from servicers and debt collectors trying to protect their bottom lines.[27] Congress must act now to solve this mess. Clarifying the authority and priorities of FSA, providing effective oversight, guaranteeing proper funding, and building in better transparency will ensure that borrowers - not servicers - are the true beneficiaries in the repayment system. While many other improvements are necessary for a better repayment system, these reforms would go a long way toward helping borrowers pay off their loans and build prosperous lives.

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