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How Congress Can Fix Student Loan Repayment

By Colleen Campbell March 2019



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Introduction and summary

Students borrowed approximately \$91 billion in federal loans in 2018, bringing the total outstanding loan balance to nearly \$1.5 trillion.¹ For many, college would not have been possible without such readily available financing, but the burden of debt has become too much. More than 1 million borrowers default every year,² and millions more are stuck in what feels like an endless cycle of interest payments³ and benefits applications.⁴ Borrowers of color, in particular, are struggling to repay their debt, exacerbating long-term inequities and causing higher education to be more of a gamble than was promised.⁵

All of these woes are part of the college affordability crisis, but they are also part of a more arcane problem: The United States' federal student loan repayment system is broken. This year, however, Congress has a chance to fix it.

The stars seem to have aligned for a long-overdue reauthorization of the Higher Education Act (HEA),⁶ the country's primary legislation governing postsecondary education. Senate Education Committee Chairman Lamar Alexander (R-TN), who plans to retire at the end of the current congressional session, will likely be motivated to burnish his legacy by passing the first HEA reauthorization in more than a decade.⁷

Since HEA was last updated in 2008, the loan system has moved to 100 percent direct lending through the federal government.⁸ This completely federalized system has resulted in many benefits: less on-the-ground industry influence in lending;⁹ repayment programs that are unavailable in the private market;¹⁰ and, though it may seem ironic given the current dissatisfaction with the repayment system, stronger consumer protections.¹¹ Perhaps most importantly, the transition to direct lending saves the federal government roughly \$6 billion per year—funds that have resulted in an infusion of \$36 billion of mandatory funding into the Pell Grant program over the past 10 years.¹²

Nevertheless, now that direct lending has been the primary federal loan system for nearly a decade, it is time for a major revamp to address modern problems.

Some of the problems with repayment are due to the confusing design of programs and benefits meant to ease the burden of debt for borrowers. For example, borrowers looking to have their loans forgiven for work in public service must meet four eligibility thresholds,¹³ and those who seek reduced monthly payments must weigh five different income-based repayment plans.¹⁴ Congress must address these complexities, but it is equally important to correct the circuitous structure of the repayment system itself as well as to improve oversight of the administrators of that system.

Through a reauthorization of the HEA, Congress must:

- Put an end to default and collections agencies
- Codify standards for loan servicing
- Improve oversight and transparency at the Office of Federal Student Aid (FSA)

This report highlights new evidence of the inadequate government oversight of student loan servicers before detailing specific steps that Congress can take to meet each of the three goals listed above. Together, these reforms would compel the U.S. Department of Education and its contractors to put borrowers first and could be life changing for Americans with student debt, allowing them to experience fewer negative repercussions to borrowing, more affordable payments, and full realization of the benefits of higher education.

New evidence of poor oversight

FSA administers the federal student loan program and is responsible for collecting more than \$1.1 billion in outstanding debt from 34 million borrowers.¹⁵ The current structure of the repayment system—where private contractors “service,” or manage, borrowers’ accounts—has been in place since 2010, two years after the last HEA reauthorization.¹⁶ But the contracts that bind those servicers are overdue to be replaced, and FSA has worked for five years across two administrations to replace them—with little forward movement.¹⁷

Though FSA is in its fourth iteration of plans for the new repayment system, elements have stayed consistent over time, such as creating a single website for borrowers; improving consistency across servicers; and allowing FSA to be more agile and strategic in solving issues that arise.¹⁸ The system, which is now called the Next Generation Financial Services Environment (NextGen),¹⁹ was relaunched in January 2019 after running into lawsuits and protests from servicers and debt collectors trying to protect their bottom lines.²⁰

There is a lot at stake. Payments to student loan servicers and debt collectors cost the federal government roughly \$2 billion annually,²¹ and any changes to the system could cut current contractors out. But a question that has lingered for years is the ability of FSA to oversee these entities.²² And, unfortunately for FSA, a damning report filed by the Department of Education’s Office of the Inspector General (OIG) provides fresh evidence that FSA is failing to properly protect the interests of borrowers.²³

The report highlights several instances of FSA's failure to oversee loan servicers, the private contractors that collect payments; provide counseling; and process benefits for 34 million borrowers. Over the 18-month period that OIG examined, each of the nine loan servicers:

- Failed to inform some borrowers of all their repayment options. One servicer failed to do so in more than 10 percent of the calls that FSA monitored.
- Incorrectly calculated some borrowers' payments, which could result in borrowers paying more per month, making their payments less affordable. It could also result in borrowers paying less than they owe, which would cause additional interest to rack up.

According to the OIG, even when FSA finds such egregious mistakes, it essentially looks the other way. The report notes that if FSA brought an issue to a servicer and the contractor acknowledged and agreed to correct the error, FSA opted not to document the infraction in its tracking system. This has left an incomplete record of servicer compliance, making it difficult to build a case for sanctions or the termination of a contract. FSA has also failed to consider compliance with federal regulations and standards when evaluating servicers' performance, instead judging results only based on poorly administered borrower surveys and delinquency rates in servicer portfolios.

The OIG report makes clear that FSA's practices must change. As a precursor to improved oversight, Congress must first restructure the loan program. This would free up funds for improved administration and outreach while also creating opportunities to enshrine accountability and transparency standards for FSA and its contractors in federal law. The following sections detail steps that Congress should take to restructure the loan program.

Put an end to default and collection agencies

The current rules and structure of the loan system are based on a defunct lending structure. Before 2010, banks largely provided federal student loans. However, the federal government guaranteed these loans: Banks owned the loans unless a borrower defaulted, in which case the federal government paid for 97 percent of the loan.²⁴ These heavy subsidies essentially provided banks with complete risk assurance, which made participation in the federal program worthwhile.²⁵ Today, FSA always owns the loan, so those transfers are no longer necessary. But FSA still maintains contracts with private collections agencies (PCAs) to the tune of \$1 billion annually in mandatory funding.²⁶

This steep price tag does not buy the federal government much. Collections prioritize recovering dollars over supporting borrowers— a concept more aligned to the private market than to the government. In fact, the federal loan program is fundamentally different from the private market; it was created to provide financing for all students. The generosity of its programs—from income-based repayment to substantial options for postponing payments—is aligned with that vision.

The fact is, private collections agencies no longer need to be part of the system. The federal government already has extraordinary authority to collect debts it is owed, including through wage, Social Security, and tax garnishment. With some modifications to servicing, oversight, and compensation structures, getting rid of PCAs would free up funds and put borrowers in a better position to succeed. Most importantly, it would allow Congress to put an end to the concept of default.

A win for borrowers and taxpayers

The consequences of defaulting on student loans are steep, including damaged credit and assessment of collection fees of up to 25 percent of the loan balance. 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. Should Congress end the concept of default, FSA could still deter severely delinquent borrowers from not paying with the threat of some of the same credit reporting and collections mechanisms the current system provides, but borrowers would not be effectively banned from re-enrollment.

Eliminating default would temper some of the equity issues pervasive in the current loan system. Default disproportionately affects borrowers of color—particularly African Americans, nearly half of whom experience this outcome.²⁷ Students with children,²⁸ Pell Grant recipients,²⁹ and veterans³⁰ also experience higher default rates than their peers. Should default be discontinued, these communities would be less hampered by their debt, gaining a better opportunity to overcome other obstacles that they often face, such as racial wealth gaps and disparities in education funding.³¹

Taxpayers also stand to benefit. FSA pays collection agencies nearly the same amount to manage 7 million defaulted accounts as it pays loan servicers to manage 34 million nondefaulted accounts.³² Currently, servicers are paid a maximum of \$2.85 per month for borrowers who are not delinquent, an amount that declines as loans become more delinquent.³³ By contrast, PCAs are paid \$1,710 when they get a borrower to rehabilitate an account out of default, even if the borrower pays down just \$50 of the outstanding debt.³⁴ With redefault rates for federal loans as high as 40 percent,³⁵ it is clear that collections agencies are not doing borrowers, taxpayers, or the federal government any favors.

The role of servicers in a world without default

Shutting PCAs out of the loan system would free up \$1 billion that could be funneled into more intensive servicing.³⁶ To ensure that delinquent borrowers are appropriately managed, servicers could be given some of the authorities that PCAs have, such as the ability to garnish wages or tax refunds. In providing servicers with this authority, collections rules should be revised to remove FSA's ability to collect Social Security income and tax credits from low-income individuals; this recommendation was made in the Student Loan Borrowers' Bill of Rights Act of 2017.³⁷

Servicers should also be able to automatically enroll severely delinquent borrowers into an income-driven repayment (IDR) plan, which allow borrowers to cap their payments at a reasonable share of their incomes.³⁸ This would reduce long-term delinquencies, preventing the lowest-income borrowers from facing collections. This move would require additional data sharing between the departments of Education

and Treasury. Fortunately, the bipartisan Faster Access to Federal Student Aid (FAFSA) Act of 2018 proposed this arrangement.³⁹ The proposal was also included in the Trump administration's fiscal year 2019 budget, suggesting that new legislation is not necessary, and that funds to make this possible could instead be made through the appropriations process.⁴⁰

Finally, in a system where accounts are entirely managed by servicers, Congress can implement more borrower-friendly paths out of debt. It could require that involuntary payments made under wage and tax garnishments align with income-driven repayment plan standards, with those payments being counted as progress toward forgiveness. Perhaps most importantly, Congress could significantly reduce or eliminate collections fees as well as standardize fees across all paths out of default.

Codify standards for loan servicing

Should servicers become the sole contractors that interact with borrowers, Congress must take the steps detailed in this section to ensure that they are doing so effectively and giving borrowers the support they need. These steps include:

- Establishing a high expectation of performance aligned to objective measures of good servicing, including achieving better borrower outcomes, correctly transmitting information, and promptly and accurately processing paperwork
- Restructuring compensation to prioritize and guide funds toward higher-risk borrowers and servicers who rise to a high standard
- End specialty servicing

Establishing a high expectation of performance

A reauthorized HEA should require that servicers receive compensation based on their performance in relation to a high standard. Currently, servicers are measured in comparison to one another, ranked, and then allocated a share of new accounts; the system is based on the theory that competition for accounts—and therefore revenue—will drive servicers to perform better.⁴¹ In reality, however, servicers are the ones setting the status quo, providing FSA with little leverage to compel improvement. If compensation for contractors was instead tied to meeting high performance marks across several evaluative criteria, all borrowers could expect the same baseline standard of service.

FSA should also thoroughly review recordings of borrower calls and systematically track all contractor noncompliance. These records should be regularly audited and evaluated so that FSA can take appropriate actions against servicers in the event that it identifies a pattern of poor performance. FSA should also upgrade its own data and analytics capabilities so that it can quickly assess servicing issues and systematically correct errors across all accounts.

Finally, holding contractors accountable needs to be one of FSA's primary functions. The office maintains dozens of contracts with external entities that build and maintain software and data systems, among other activities. Many of the entities are the only providers of their particular service, making it very difficult for FSA to sever ties with them for poor performance. Therefore, Congress should require FSA to own and maintain technical proficiency with every piece of software that a contractor creates, which would ensure that FSA does not become beholden to any one provider.

Restructuring compensation

In addition to measuring borrower repayment outcomes by servicer, FSA should also compensate servicers for the quality of their work as well as for producing outcomes that ensure a more positive experience for borrowers. This can include measures such as the rate of enrolling repeatedly delinquent borrowers in an income-driven repayment plan; the provision of appropriate and accurate debt counseling; the correct calculation of repayment and interest amounts; accurate assignments of benefits; the efficacy of outreach efforts; and the processing of paperwork in a correct and timely manner.

Servicers should also be compensated at an elevated rate for keeping borrowers who are at a higher risk of default, such as noncompleters,⁴² in a current status. For all accounts—and particularly for this group—servicers should be required to share effective and innovative practices and ideas with FSA so that it can require all servicers to implement them for all borrowers, ensuring consistency and continuous improvement. Should one servicer consistently perform significantly better than its peers, that entity should be rewarded for setting the curve.

Ending specialty servicing

Federal law should also prohibit specialty servicing, which allocates all accounts of a certain type to one servicer. For example, FedLoan Servicing/Pennsylvania Higher Education Assistance Agency receives the account of every borrower who indicates an interest in participating in the Public Service Loan Forgiveness program.⁴³ Specialty servicing ensures that even poor performers continue to receive accounts. It also creates disincentives for other servicers to direct borrowers toward certain benefits, as it will cause them to lose the account. If servicers manage all types of accounts, FSA would be forced to issue guidance in a timely manner so that servicers can process benefits appropriately, providing more consistency and better service for all borrowers.

Improve oversight and transparency at FSA

The HEA designates FSA as a federal performance-based organization.⁴⁴ As such, it is required to run the aid programs efficiently, 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 a reauthorization of the HEA. Statute should clarify that students' well-being and satisfaction are top priorities for FSA and its agents. These suggested priorities are based on real concerns. In 2017, Navient, a servicer that holds 6 million borrower accounts, claimed in a court document that its responsibility was not to act in the best interest of borrowers but, rather, in the interest of the lender—in this case, the U.S. Department of Education.⁴⁵ This attitude cannot be justified, and Congress must make that clear through legislation.

Guaranteeing public input

The OIG report illustrates why light must be shed on FSA's opaque practices. But that is just the tip of the iceberg. Current law prevents FSA from sharing information or garnering assistance from most public and private experts when putting together procurements, contracts, sanctions, and performance standards.⁴⁶ Typically, much of the help FSA receives is from contractors themselves,⁴⁷ which creates a clear conflict of interest.

The voices of consumers are too often left out of the conversation. To remedy this, Congress should require 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, and there should be no exception for FSA. A public comment process would ensure that borrowers, experts, and advocates have a say in the repayment system.

FSA should also be required to evaluate the efficacy of the borrower surveys it administers to judge servicers' performance.⁴⁸ This is currently the most heavily weighted performance criterion for servicers, meaning if servicers do not do well on the borrower survey, their likelihood of receiving accounts significantly decreases. However, the format and results of these surveys are not public, and the OIG report revealed that the survey has poor response rates of about 3 percent to 4 percent.⁴⁹ Such low response rates call into question the efficacy of these surveys as well as the information collected on them.

Re-establishing the CFPB as a partner

A few entities exist that can investigate or provide directives to FSA. Congress occasionally uses appropriations bills to compel FSA to implement certain policies, such as requiring FSA to contract with multiple servicers or evaluate servicers on common performance metrics.⁵⁰ The Government Accountability Office (GAO)⁵¹ and the U.S. Department of Education's OIG also investigate FSA, but it is clear that the FSA needs more help.

This is where the Consumer Financial Protection Bureau (CFPB) could be an important and effective partner. During the Obama administration, the CFPB had the ability to supervise and enforce consumer protection laws related to federal student loans, including the activities of FSA and loan servicers. This authority was bestowed through memoranda of understanding between the CFPB and FSA—memoranda that were Secretary of Education Betsy DeVos severed.⁵² Now, FSA's operations are virtually a black box, with the office overseeing itself.

In addition to overseeing FSA and its contractors, the CFPB can serve as a resource, providing expertise on consumer protection laws across a variety of markets. The CFPB can use its statutory authority to put pressure on contractors when it may be infeasible for FSA to do so, whether due to policy or politics. The CFPB can also provide insight into what is happening on the ground and in states, elevating issues to FSA before they become unmanageable.

Providing power to the public through transparency

Increasing data transparency is a critical part of improving FSA performance with regard to its servicing contracts and borrower satisfaction. Currently, FSA publishes limited data about the loan portfolios and the performance of its contractors.⁵³

In order to better evaluate the federal loan program and identify policy fixes, FSA should make public a representative sample of the National Student Loan Data System that does not include borrowers' personal details. It should also publish reports on servicer performance, investigatory actions, and sanctions on a quarterly basis. It can easily make available the database of complaints from its system as well as actions taken to resolve those complaints, similar to what exists at the CFPB.

FSA should also be required to annually report to Congress the state of the student loan system, including metrics related to borrower satisfaction and contractor compliance. These areas should also be incorporated into FSA's annual report, which would ensure that they are regularly monitored and addressed.

Conclusion:

The future of the loan system

With NextGen in the works, it is more important than ever for Congress to provide direction and oversight to FSA. So far, servicers and debt collectors have stymied attempts at reform, and all the while, borrowers have been stuck in a system that is not working for them.

Congress can resolve this mess now. 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.

About the author

Colleen Campbell is a director on the Postsecondary Education team at the Center for American Progress. She began her career as a financial aid administrator who counseled students on their loan repayment options. Realizing the need for systemic change, Campbell opted to pursue a career in policy and has published research on financial aid and the loan repayment in roles at the Institute for Higher Education Policy (IHEP) and the Association of Community College Trustees (ACCT). She has studied student loan servicing since 2010 and began publishing on the topic in 2015. Ms. Campbell holds a Master of Public Policy and a Master of Arts in Higher Education from the University of Michigan.

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Our Mission

The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action. Our aim is not just to change the conversation, but to change the country.

Our Values

As progressives, we believe America should be a land of boundless opportunity, where people can climb the ladder of economic mobility. We believe we owe it to future generations to protect the planet and promote peace and shared global prosperity.

And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

Our Approach

We develop new policy ideas, challenge the media to cover the issues that truly matter, and shape the national debate. With policy teams in major issue areas, American Progress can think creatively at the cross-section of traditional boundaries to develop ideas for policymakers that lead to real change. By employing an extensive communications and outreach effort that we adapt to a rapidly changing media landscape, we move our ideas aggressively in the national policy debate.

