NASFAA
NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

PROTECTING BORROWERS & ADVANCING EQUITY

SYSTEMIC SOLUTIONS TO IMPROVE FEDERAL STUDENT LOAN SERVICING & REPAYMENT

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NASFAA
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The National Association of Student Financial Aid Administrators is a nonprofit membership organization representing more than 32,000 financial aid professionals at nearly 3,000 colleges, universities, and career schools across the country. NASFAA member institutions serve nine out of every 10 undergraduates in the United States. Based in Washington, DC, NASFAA is the only national association with a primary focus on student aid legislation, regulatory analysis, and training for financial aid administrators.

Acknowledgements

NASFAA would like to thank the policy experts and coalition members who assisted in the formation of these recommendations and provided feedback throughout:

American Association of Community Colleges

American Council on Education

Association of American Universities

Center for American Progress

Center for Law and Social Policy

Consumer Bankers Association

Education Trust

Higher Education Loan Coalition

Institute for Higher Education Policy

NASPA - Student Affairs Administrators in Higher Education

National Association of College Admission Counseling

National Association of College and University Business Officers

National Association of Independent Colleges and Universities

National Association of State Student Grant and Aid Programs

National College Attainment Network

National Consumer Law Center

National Governors Association

New America Higher Education Program

Pew Charitable Trusts

The Institute for College Access and Success

U.S. Chamber of Commerce

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Note: The recommendations presented in this paper are those of NASFAA and coalition members specifically listed in the individual recommendation sections and do not represent the views of Arnold Ventures. Participating in NASFAA's coalition or as a policy expert does not imply support of all findings presented in this report.

Executive Summary

The COVID-19 pandemic and the current political climate have thrust universal federal student loan forgiveness into the spotlight as a way to fix what some policymakers have dubbed a "national crisis": $1.6 trillion in outstanding student loan debt. Missing from the conversation, however, is the acknowledgement that unmanageable debt is a symptom of the shortcomings of our current student loan system rather than the cause. Through this work, funded by Arnold Ventures, NASFAA has developed thoughtful, systemic, targeted policy solutions to treat the underlying flaws in the current student loan repayment and servicing systems that lead borrowers into financial hardship while underscoring the benefits of a strong federal loan program.

The goal is for these recommendations to create systemic policy change by focusing on program design and delivery through five overarching objectives:

- Strengthen and simplify income-driven repayment programs so they protect borrowers and allow them to repay in accessible, realistic, and manageable ways.
- Reexamine the federal student loan system as a direct-to-borrower federal loan program, as opposed to a vestige of bank-based lending.
- Develop policies that both help and incentivize borrowers to meet their obligations and target resources toward borrowers who need assistance.
- Create policies that assist struggling borrowers, rather than further punish and hinder those who are already behind.
- Ensure policies are progressive — not regressive — for low-income students.

As a result of this work, NASFAA and coalition members, as noted in each individual section, put forth the following recommendations:

Student Loan Servicing

Recommendation #1: Require Federal Student Aid to develop and implement a comprehensive manual of student loan servicing practices. Require adherence to the guidance by all student loan servicers by adding an amendment to the loan servicing contracts containing the contents of the manual.

Recommendation #2: Federal Student Aid should immediately implement a single brand for all loan servicing operations and should use a single servicing system for all interactions with student loan borrowers.

Recommendation #3: Federal Student Aid should consider requiring all federal loan servicers to process Public Service Loan Forgiveness.

Recommendation #4: Federal Student Aid should identify best practices in student loan servicing and require their adoption by all servicers.

Recommendation #5: Federal Student Aid's chief operating officer should report directly to the secretary of education as part of an oversight board and collaborate with the undersecretary of education.

Recommendation #6: Amend the performance-based organization enabling language in the Higher Education Act to create a new role specific to student loan servicing.

Recommendation #7: The secretary of education must ensure Federal Student Aid follows a structured process when developing its five-year strategic plan, as described in the performance-based organization enabling language, and that the strategic plan and individual performance plans include measurable loan servicing goals and objectives.

Recommendation #8: Federal Student Aid and states should collaborate in their supervision of student loan servicers in an attempt to examine and eliminate any duplicative efforts already required at the federal level.

Recommendation #9: The Department of Education should identify and act on opportunities to effectively collaborate with stakeholder agencies.

Recommendation #10: Federal Student Aid should hire an outside agency to complete an independent financial analysis of the true cost of providing high-quality loan servicing.

Recommendation #11: The Government Accountability Office should perform a review of Federal Student Aid's procurement function to determine if it is using its procurement flexibility effectively and establish whether additional flexibility is necessary.

Recommendation #12: Federal Student Aid should increase the transparency of data regarding its Direct Loan portfolio and allow qualified researchers to access servicing data.

Student Loan Repayment

Recommendation #1: Consolidate the existing repayment plans into three options: a single income-driven repayment plan, a standard 10-year repayment plan, and an extended 25-year plan. Transition all borrowers into one of these three plans and sunset all other existing repayment plans.

Recommendation #2: Design a single income-driven repayment plan.

- Sub-recommendation 2A: Raise the poverty thresholds used to determine a borrower's discretionary income from 150% to 200% of the federal poverty guideline.
- Sub-recommendation 2B: Assess borrowers' income above 200% but less than or equal to 300% of the federal poverty guidelines at a rate of 5%, and assess borrowers' income greater than 300% of the federal poverty guidelines at a rate of 10%.
- Sub-recommendation 2C: Eliminate negative amortization for all borrowers, ensuring borrowers who are making payments on an income-driven repayment plan do not see their principal balance grow.
- Sub-recommendation 2D: Provide forgiveness of the loan's outstanding balance after 10 years for borrowers who have had a $0 income-driven repayment plan payment for 120 consecutive months, and after 20 years (240 monthly payments) for all other borrowers using income-driven repayment.
- Sub-recommendation 2E: Allow income-driven repayment plan payments made before a borrower consolidates to count toward income-driven repayment plan forgiveness.
- Sub-recommendation 2F: Allow all undergraduate and graduate borrowers to access the single income-driven repayment plan. Parent borrowers could access economic hardship deferments but would be ineligible for income-driven repayment.
- Sub-recommendation 2G: Mandate that all student loan debt forgiven or discharged under income-driven repayment plans is free from taxation.

Recommendation #3: Explore ways to reform the use of interest in the federal student loan programs to better align with their purpose of expanding postsecondary access.

- Sub-recommendation 3A: Drastically lower interest rates for all types of Federal Direct Loans (subsidized, unsubsidized, PLUS) to advance the program's primary goal of promoting postsecondary access.
- Sub-recommendation 3B: Restore graduate and professional student eligibility for subsidized loans so graduate students with financial need can access loans that do not accrue interest during their enrollment.
- Sub-recommendation 3C: Once the lower interest rates recommended in Sub-recommendation 3A are implemented, automatically adjust all outstanding federal student loans with interest rates higher than the new rate to match the new, lower rate.
- Sub-recommendation 3D: Eliminate negative amortization for all borrowers.
- Sub-recommendation 3E: Eliminate interest capitalization for all borrowers.

Recommendation #4: Eliminate student loan origination fees.

Recommendation #5: Maintain a single loan program for graduate/professional students with loan limits that allow students to borrow up to the in-state cost of attendance at public institutions. Allow additional borrowing based on earnings data for the student's program of study or a debt-to-income ratio.

Recommendation #6: Reform the parent Direct PLUS program by using a debt-to-income ratio to meaningfully assess how much a parent can responsibly borrow, and provide forgiveness of loan debt for parent borrowers who received PLUS when their incomes were at or near the poverty level.

Recommendation #7: Reform the Public Service Loan Forgiveness Program.

- Sub-recommendation 7A: Update the timeline for the Public Service Loan Forgiveness Program to provide rolling forgiveness opportunities, forgiving $5,000 in debt after each two years of time in public service.
- Sub-recommendation 7B: Ensure all borrowers who are eligible to benefit from the current Public Service Loan Forgiveness waiver can do so before the flexibilities are ended.
- Sub-recommendation 7C: Allow all Federal Family Education Loan borrowers who consolidate into the Direct Loan Program to count previous payments toward forgiveness under the Public Service Loan Forgiveness Program.
- Sub-recommendation 7D: Take steps to minimize borrower confusion and bolster public confidence in the Public Service Loan Program.

Student Loan Default

Recommendation #1: Bring all borrowers currently in default into good standing as part of the resumption of student loan repayment following the COVID-related suspension of monthly payments.

Recommendation #2: Moving forward, automatically enroll delinquent borrowers in income-driven repayment before they enter default, whenever possible.

Recommendation #3: Develop additional safety nets for struggling borrowers who are still at risk of falling into default despite being enrolled in income-driven repayment.

Recommendation #4: Allow defaulted borrowers who enroll and make a payment in income-driven repayment to immediately exit default.

Recommendation #5: Remove the one-time limit on rehabilitation of defaulted loans.

Recommendation #6: Eliminate acceleration of loan balances and use collections mechanisms only in extreme circumstances.

Recommendation #7: Eliminate interest capitalization for borrowers exiting default.

Recommendation #8: Delay credit reporting of default status to provide borrowers with additional time to return to good standing.

Recommendation #9: Remove default from the credit history of any borrower who exits default, and remove all default-related negative credit reporting the first time a borrower completes rehabilitation on a defaulted loan or exits default through the income-driven repayment pathway proposed in Recommendation #4.

Recommendation #10: Streamline, standardize, and reduce collection fees.

Recommendation #11: Automatically enroll borrowers exiting default through consolidation into income-driven repayment before they return to repayment.

Recommendation #12: Provide consistent, high-quality servicing to simplify and streamline transitions from default to repayment.

Methodology

Outside Policy Experts

NASFAA contracted with four outside policy experts, two for loan servicing, one for repayment, and one for default, to conduct an analysis of current recommendations in each area, consider new ideas, and author a brief internal memo on their thoughts for improvement in each area. These internal memos informed the final recommendations put forth in this report. Once NASFAA drafted the recommendations, policy experts had the opportunity to provide feedback on proposed solutions in their subject area.

Coalition

As part of this work, NASFAA formed a coalition with associations, organizations, and think tanks from the higher education policy, advocacy, and research community. Over 30 groups were invited, and 21 accepted. This coalition participated in conceptualizing the recommendations by 1) providing any current work on the topics, if applicable, 2) participating in a listening session on each topic, and 3) providing feedback on draft recommendations in each area. NASFAA also invited the four outside policy experts to attend the listening sessions. After reviewing and incorporating feedback from the coalition into the final recommendations, NASFAA distributed them to the coalition for sign-on. Coalition members could choose to sign on in support of all servicing, repayment, and/or default recommendations as a group, or they could sign on to individual recommendations.

Student Loan Servicing

Background

Over the last several years, federal student loan borrowers, government oversight offices, higher education associations, think tanks, and members of congress have voiced concerns about disruptions, inconsistencies, and lack of quality servicing in the federal student loan programs. Due to an apparent lack of transparency around data and processes, it has been difficult to fully grasp the extent to which servicing issues exist and to understand the disparate practices between various servicers. A good deal of this may be attributed to the complexity of the student loan programs, the design of the loan repayment system, and the challenges presented by the large volume of student loans. Although they operate in an environment that is largely designed and controlled by the U.S. Department of Education (ED) Federal Student Aid (FSA) office, servicers have shouldered much of the blame for problems faced by student loan borrowers, even though some of that blame is unwarranted, such as blame for high interest rates, which is something servicers have no control over.

Congress established FSA in 1998 as a performance-based organization (PBO) with the passage of Higher Education Amendments to address significant issues with the management of student financial aid delivery at the time. The language in Part D of the Higher Education Act (HEA), which establishes the PBO structure, never specifically mentions student loan servicing,[1] which made sense at the time; ED had little to do with loan servicing in 1998, as nearly all loans were made through the Federal Family Education Loan (FFEL) Program and were serviced by the banks and other entities that held them. Pushed by the financial crisis of 2008 and the end of the FFEL Program, significant pressure was placed on FSA to scale their loan servicing capabilities. In 2009, FSA expanded from a single servicer to four large-scale student loan servicers. Since that time, Congress has mandated the inclusion of state-based nonprofit student loan servicers, FSA's servicing volume has continued to rapidly increase, and the complexity of student loan servicing has only deepened, making it clear that reforms are needed not only in the loan servicing process, but also in FSA's internal structure.

Calls for improvement to loan servicing have been coming from within ED for years, as in 2016 when then-Undersecretary of Education Ted Mitchell published a policy memorandum detailing ED's vision for the new loan servicing system, with plans for incentives for servicers aligned with the best interest of borrowers, improving consistency in communication to borrowers, expanding oversight, and releasing data on student loan and servicer performance. Then-Secretary of Education Betsy DeVos canceled the memo in 2017. During DeVos' time as education secretary, ED announced the Next Generation Financial Services Environment (Next Gen), a huge undertaking by the Trump administration to modernize the student financial aid application and repayment process. A portion of Next Gen was also a project to reform loan servicing by creating a single portal for borrowers to log into to manage their loans, and to downsize the number of loan servicers from nine to two. Under the Biden administration, the Consolidated Appropriations Act of 2021 again included a provision prohibiting the secretary of education from awarding funding for any work related to developing a new loan servicing system unless it included multiple servicers that contract directly with ED. As a result, FSA made the decision to cancel its solicitation to contract the two planned servicers, and no progress has been made since. Three loan servicers — FedLoan Servicing (PHEAA), Navient, and Granite State — who together manage nearly 16 million federal student loan borrower accounts, have since decided to not renew their contracts with ED.

Added to the struggles FSA and ED have had with loan servicing is the handling of the Public Service Loan Forgiveness (PSLF) Program, which eliminates (forgives) the remaining principal of federal student loans for borrowers who enroll in the program, work in the public service arena, and repay their federal loans for a certain period of time. The management of the PSLF Program has put servicers under severe scrutiny, as the Consumer Finance Protection Bureau (CFPB) reported that some student loan servicers have engaged in a pattern of providing inaccurate information to borrowers about their eligibility for the PSLF Program. Their report detailed misleading and deceptive practices by student loan servicers that may have hindered and delayed borrowers' entry to the PSLF Program and their ability to qualify for loan forgiveness.

While there is no question that servicing the federal government's 43 million borrowers and $1.6 trillion in student loans presents challenges, it also presents opportunities for improvement. The recommendations offered in this section pertain solely to loan servicing operations and do not address critical policy changes that could simplify the repayment process.

[1] The PBO language does mention loan servicers in the context of listing entities the ombudsman will work with to resolve complaints.

Recommendations

These servicing recommendations are put forth by NASFAA, the National Association of Independent Colleges and Universities, the National Association of College and University Business Officers, and the Higher Education Loan Coalition. Additional supporters of individual recommendations are listed below each recommendation.

Ensure Servicing Consistency for Borrowers

Loan Servicing Recommendation #1: Require Federal Student Aid to develop and implement a comprehensive manual of student loan servicing practices. Require adherence to the guidance by all student loan servicers by adding an amendment to the loan servicing contracts containing the contents of the manual.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: The concept of a "common manual" for student loan servicing is not new; however, it has never been implemented for the servicing of loans under the Federal Direct Student Loan Program. As it applies to Direct Loans, a common manual is a compilation of applicable program rules, guidelines, and loan servicing directives issued by FSA. Some of these rules are rooted in federal statute and regulation, while most are based on interpretations and decisions made by FSA. Much of this guidance and direction is unpublished and is not subject to public comment. Implementation of a common manual for Direct Loan servicing would bring needed order to the disorderly process of providing guidance to servicers on loan operations and would offer borrowers, policymakers, and other stakeholders a clear window into FSA's standards for loan servicing. The creation of a common manual would also encourage collaboration among servicers and help identify best practices that should become collective standards.

FSA has resisted the concept of implementing a common manual for Direct Loan servicing despite a 2017 mandate from Congress directing ED to "issue a common policies and procedures manual, including voluntary best practices, to help improve the consistency of servicing for student loan borrowers." However, in its 2019 Budget Request, ED argued that it did not need to comply with the requirement to develop a common manual because it would address the issue as part of its new procurement for student loan servicing: "One of the key goals of this procurement is to ensure that Federal student loan borrowers receive consistent high-quality service throughout the student aid lifecycle." (p. 13) This procurement is still on hold today.

The bulk of guidance on servicing processes and practices is provided to servicers via change requests, which are formal directives to servicers. In most cases, servicers may bill FSA for the work involved in implementing a change request at a price agreed upon by FSA and the servicers. Other times, guidance may be provided to servicers by less formal means, such as email or even via oral direction. It is possible that guidance varies from one servicer to another to accommodate the nuances of a servicer's system or practices or simply because a servicer asked a question not posed by other servicers.

As a result, no single repository exists defining all FSA requirements for servicing Direct Loans. This raises the possibility that borrowers in like circumstances receive disparate treatment depending on the entity servicing their loans. Conceptually, this is the exact opposite of the equitable treatment that underpins the federal system of student financial assistance. The direction included in the common manual should be published and available publicly, and it should have the same force as federal regulations and other published guidance. A common manual will also allow stakeholders to determine whether some of the problems identified with student loan servicing stem from flawed or inconsistent guidance that has been provided by FSA to the servicers.

Implementing a common manual should be a high priority for FSA, regardless of whether it issues a new contract for loan servicing or maintains its current contractors. Once a common manual is implemented, FSA must ensure all servicers implement updates to guidance or policy simultaneously to ensure equal treatment of borrowers regardless of which loan servicer handles their loans. Borrowers, regulators, servicers, Congress, relevant state entities, and other interested parties deserve a publicly accessible repository of all instructions and guidance regarding the servicing of student loans. Borrowers should expect common, enforceable standards for all servicing activities so they are treated fairly and equitably in all circumstances. A common servicing manual is the best route to achieving these goals promptly and efficiently and increasing transparency and accountability in servicing.

Adding detailed servicing guidelines, in the form of a common manual, as an amendment to the loan servicing contracts will increase adherence and transparency. Current loan servicing contracts do not contain detailed loan servicing requirements, but simply refer servicers to federal regulations and applicable state and federal laws. This leaves too much room for interpretation, and therefore variation, across federal loan servicers' practices. FSA has grappled with the balance of achieving consistency in loan servicing delivery versus preserving a competitive contract structure. Until recently, FSA has leaned hard into "protecting" the competitive environment. However, FSA can achieve a more balanced approach in which they provide detailed requirements on the service expectations for their loan programs and allow servicers to compete on how well they operate inside those constraints.

The most recent amendment to the federal loan servicing contracts seems to be nudging the servicers in this direction. The amendment incorporates a set of service level agreements (SLAs) that establishes minimum thresholds for performance and introduces a change to the allocation methodology to negatively impact the scores of servicers that do not meet a defined threshold.

Interaction Quality Monitoring and Accuracy are two of the four new SLA metrics. The contract does not appear to contain an Interaction Quality rubric that FSA will follow to determine monitoring scores. Similarly, the contract contains no other information on Accuracy. The contract must contain a clear set of requirements or expectations FSA will use when conducting accuracy reviews. Otherwise, it will be difficult for servicers to achieve expectations. It is possible that FSA has issued detailed guidance outside of the contract or issued one-off change orders to cover these topics; however, the guidelines not being part of the contract is part of the problem.

The Government Accountability Office (GAO) published a report on FSA's management of contractors in 2015. A section of the report titled, "Lack of FSA Guidance and Instructions to Servicers Results in Inconsistent and Inefficient Services to Borrowers" highlights FSA's lack of organization and structure in providing guidance to its loan servicers. Later in this same report, in the section "FSA's Monitoring of Calls Between Servicers and Borrowers Has Methodological Weaknesses and Is Poorly Documented," GAO describes significant issues with FSA's sampling techniques and calls out a lack of quality documentation around call monitoring.

It has been six years since that report, but there is little public evidence to suggest the situation has significantly changed. This is why FSA should amend the current federal loan servicing contracts with detailed guidelines, including borrower interaction expectations. By including detailed guidelines as an amendment to the contract, FSA will provide and be able to enforce greater levels of accountability and transparency. It will give the public a clear understanding of how FSA expects the servicers to engage with their borrowers and service their accounts. It will also eliminate excuses from loan servicers who are not performing up to expectations. In short, it will align expectations across all stakeholders.

Loan Servicing Recommendation #2: Federal Student Aid should immediately implement a single brand for all loan servicing operations and should use a single servicing system for all interactions with student loan borrowers.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: Today, student loan borrowers must navigate a web of student loan servicers. While the 43 million Direct Loan borrowers have federal loans with federally mandated terms and conditions, their loans are serviced under a variety of names by private companies and state entities. Inevitably, this causes confusion for borrowers. This confusion is exacerbated when loans are transferred from one servicer to another — a process many borrowers equate with the loan having been "sold." This model is a vestige of the initial creation of the Title IV Additional Servicing (TIVAS) contracts in 2009, which were driven by the 2008 financial crisis combined with exponentially scaling loan servicing capacity with little time to spare. The proceeding few years found FSA servicing's environment in a state of flux with the addition of the not-for-profit servicers and the decommissioning of the prior Direct Loan servicer. Today, FSA's servicers are realigning their priorities as some exit their federal contracts and others reorganize. Reducing borrower confusion and achieving consistent quality loan servicing is now imperative.

Borrowers are entitled to clearly understand that their Direct Loans are federal loans and that the federal government holds the ultimate authority over how their loan is serviced. They are entitled to assurance that the handling of their loans and their individual circumstances does not vary from servicer to servicer. They are entitled to know that, in the case of problems or concerns, the federal government is the arbiter. All of this is currently muddled because of the lack of uniformity in the way servicers are identified and the way communications are labeled.

For years, FSA has hinted that a single brand would be implemented when it awarded new loan servicing contracts. As we know, this process remains delayed indefinitely. A single brand can and should be implemented regardless of whether new loan servicing contracts are in place or pending. It has been speculated that a reason FSA has resisted implementing a single brand is the significant cost associated with the change. If FSA requires these modifications, all servicers would be required to rebrand their services and would incur costs that could be reimbursed through the change request protocol. FSA may believe the cost is not worth it for something that might be superseded by new loan servicing contracts. However, as the timetable for awarding new contracts has lagged, that argument should no longer apply. There has also been a presumption that some servicers may be resistant to moving to a single federal brand for their Direct Loan servicing operations. This should not be a consideration, given the benefits to borrowers from this change.

Implementing a single brand is especially critical at this moment when there is significant disruption within the ranks of federal student loan servicers. In recent months, three servicers – FedLoan Servicing, Cornerstone, and Granite State – have all announced their intention to relinquish their federal loan servicing contracts. In addition, Navient has started to move its federal loan portfolio to another entity. This means more than 15 million borrowers have or will have their loans transferred to a new servicer. These borrowers will receive notices advising them of the change and will begin receiving correspondence from servicers with unfamiliar names. This is bound to cause confusion and result in unintended, unfavorable outcomes for some borrowers. Justifiably, borrowers may be wary of correspondence or other contact from an unknown entity. As a result, they may miss deadlines or instructions on how to establish new accounts, revise direct debit instructions, or redirect correspondence. By deferring the implementation of a single brand, FSA lost the opportunity to reduce confusion and increase the likelihood of a smooth, seamless transition for borrowers caught up in these loan servicing transfers.

FSA should also consider the cost implications of having multiple servicing brands. Having multiple servicing brands with multiple payment lockboxes, mailing addresses, and websites generates a significant amount of borrower confusion, and the existence of multiple servicing systems results in tangible differences among servicers in how accounts are processed. The existence of multiple servicing brands and systems creates additional costs for FSA, for example, when FSA requires servicers to make changes in response to revisions in law or regulation (implementing a new repayment plan, for instance), FSA must pay multiple times for the same work to be performed at each servicer. Because of the need to revise and reimburse multiple system providers, FSA might be reluctant to implement new policies that require complex revisions. In addition, it costs more on an ongoing basis to oversee, supervise, and audit multiple servicers and systems than it does a single provider or system, which in turn could introduce barriers to process improvements. As noted above, if FSA implements unified branding in the current servicing state, it will likely have to pay each servicer millions of dollars to execute the change. However, this is a one-time investment that can have long-term benefits for borrowers.

Loan Servicing Recommendation #3: Federal Student Aid should consider requiring all federal loan servicers to process Public Service Loan Forgiveness.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: Of the eight federal loan servicers, only one, FedLoan Servicing (PHEAA; soon to be MOHELA once PHEAA's contract ends December 2022), currently handles PSLF. The PSLF Program alone has nearly 1.3 million borrowers with eligible employment, requiring specialized service from the servicer to track borrower payments, review employment certification forms, answer questions, and then send their determination of the borrower's case to FSA for review to determine eligibility for forgiveness. While FedLoan has made significant improvements to its PSLF tracking system and its PSLF tools for borrowers, the PSLF Program as a whole continues to have issues, as the number of borrowers actually receiving forgiveness under the program remains low. Some of the denied applications can be blamed on borrowers not understanding the full requirements of forgiveness under the program and the lack of clear information made available by FSA and the servicers over the years.

Acknowledging that this undertaking would require time to allow all servicers to "ramp-up" their servicing platforms, once completed, the future effects of the improvements would be seen and felt by borrowers immediately. Mandating that all servicers of federal loans are responsible for the processing of PSLF would allow borrowers to avoid long wait times on the phone if they have questions about their eligibility or how to ensure they are in the appropriate repayment plan to be considered for forgiveness.

Spreading these special loan programs among all the servicers would also help remove a monopoly-type environment from servicing. If only one servicer is able to handle these programs, it removes their incentive to perform extraordinarily well, as they have no other competing servicers. It also eliminates a reluctance on the part of some servicers to counsel students regarding PSLF, as they would no longer be concerned with having those loans transferred to another servicer. Further, it would create continuity in servicing, removing the need to transfer the borrower account if a servicer decides to end its contract with FSA. As described in recommendation one, policy or guidelines for the servicing of these programs should be included in both a common manual of loan servicing and servicer contracts to ensure borrowers receive the same information from one servicer to the next.

Loan Servicing Recommendation #4: Federal Student Aid should identify best practices in student loan servicing and require their adoption by all servicers.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: Current FSA student loan servicing contracts do not promote the identification or adoption of best practices in student loan servicing. Best practices should be consistently identified by servicers and FSA and be implemented by all student loan servicers. In the context of student loan servicing, best practices can be viewed as servicing techniques or procedures that produce optimal outcomes for student loan borrowers, encourage efficiency in servicing, and promote compliance with federal rules and policies. This will foster continual advancement in student loan servicing with the potential for improving results for all borrowers and the federal government.

In crafting the initial set of contracts issued in 2009, FSA relied on a strategy of using broad measurements of loan servicers with the promise that those with better metrics would receive an increased volume of future student loans. As GAO stated in May 2016: "These contracts were awarded as part of Education's strategy to increase servicing capacity and improve performance by fostering competition among vendors" (p. 7). However, there is no evidence that this "competition" has resulted in better service to student loan borrowers.

We know some servicers perform certain tasks better than other servicers. For example, some servicers produce clearer and more understandable monthly billing notices, some are better at assisting borrowers and helping them resolve student loan delinquencies, and some have superior techniques for assisting borrowers when delinquencies reach the late stages before default. Qualitative differences exist between the websites maintained by each servicer and in the information resources they make available to borrowers. In addition, some servicers are better at reducing telephone hold times for borrowers and some utilize practices like "call backs" to improve their telephone customer service.

FSA has known for years about differences among student loan servicers that result in some borrowers receiving better customer service than others. This should never have been the intent of issuing a set of "competitive" contracts. The goal should have been to ensure that all borrowers have access to the best loan servicing practices available. What we have seen instead is that best practices have not been identified and implemented and minimal attention has been paid to equity in service quality.

To remedy this, FSA must initiate measures to identify best practices among servicers. This can be as simple as comparing, side-by-side, the correspondence issued by servicers to borrowers and making judgments regarding which is more effective and which provides borrowers with the information they need to navigate loan repayment. It can be as sophisticated as analyzing why certain servicers have lower rates of loan delinquency or higher rates of enrollment and re-enrollment in income-driven repayment (IDR) plans among all or certain segments of their borrowers. Because servicers maintain detailed data on their contacts with borrowers, FSA has the ability to look at every way a servicer interacts with borrowers, including how and when information was provided to and from the borrower, and can correlate those interactions with outcomes. FSA could also thoroughly examine servicers' quality control measures to help determine why some servicers have higher rates of compliance with federal policies. These are but a few of the many examples of how best practices can be identified.

Once FSA determines that certain procedures or policies are producing superior results – best practices – it could then require all loan servicers to adopt these same practices. This would be accomplished through the formal change request process so these practices become contractual requirements subject to audit and evaluation by FSA. Subsequent contracts for loan servicing would require best practices identified by FSA at one or more loan servicers would be adopted by the other servicers through a no-cost change request. This will ensure best practices are put in place for all borrowers, regardless of the servicer to which they are assigned, and that servicers will all be incentivized to incorporate best practices into their operations and practices.

FSA Structural Changes to Improve Servicing

Loan Servicing Recommendation #5: Federal Student Aid's chief operating officer should report directly to the secretary of education as part of an oversight board and collaborate with the undersecretary of education.

Rationale: The performance-based organization (PBO) enabling language clearly states that FSA takes direction from the secretary of education, who also has oversight responsibility for the chief operating officer (COO). Other than the president, the secretary of education is the only one who can terminate the COO's employment.[2] Even though Congress intended for the COO to be directly accountable to the secretary of education, in practice the COO has often reported through the Office of the Undersecretary. While the Office of the Undersecretary is responsible for postsecondary education, its focus is on policy. The secretary of education is also advised to consult the COO for operational input in matters related to policy implementation.[3] While we support a working relationship between the undersecretary of education and the COO, having an unintended additional layer in the direct reporting line to the secretary of education could run a potential risk of the secretary receiving filtered or muted operational counsel on matters related to policy implementation and loan servicing issues. There may be an inclination to protect the secretary's time to preserve their focus on K-12 initiatives and other policy issues, but the size, complexity, and societal impact of FSA's student loan operations and portfolio warrant the secretary of education's time and attention.

When FSA was created as a PBO in 1998, it was meant to be "a results-driven organization created to deliver the best possible services." The FSA PBO was to be "held accountable for performance objectives that include: improving customer satisfaction; providing high quality, cost-effective services; enhancing the ability to respond to the rapid rate of technological change; implementing a common, open, integrated system for student financial aid delivery; and providing complete, accurate and timely data to ensure program integrity."

The PBO model is based on the premise that government agencies can be results driven, given additional flexibility often found in the private sector, and deliver consistently outstanding service to stakeholders. In the private sector, companies are accountable to their customers and to their partners. A large corporation is required to have a board of directors that guides its strategic direction and provides oversight of the performance of senior leadership.

FSA is one of three PBOs in the federal government, which also includes The United States Patent and Trademark Office (USPTO) and the Federal Aviation Administration's (FAA) Air Traffic Organization (ATO). Each of the three PBOs operates with a distinctly different organizational mission and function, but the nature of these agencies from an operational perspective led Congress to impose private sector characteristics on these public sector agencies. USPTO and FAA ATO, however, have much more robust internal and external accountability and oversight structures. The oversight committees at these organizations are tasked with examining agencies' policies, goals, performance, budget, and other operational considerations; developing substantive annual reports with open access to internal operational information; and having Senate-confirmed COOs or committees.

[2] See the Higher Education Act of 1965, as amended., Sec. 141(d)(3), https://www.govinfo.gov/content/pkg/COMPS-765/pdf/COMPS-765.pdf

[3] ibid.

Today, the FSA chief operating officer (COO) and other senior FSA leaders are not confirmed by the Senate nor are they accountable to students, institutions, or taxpayers. As designed in statute, the FSA COO reports directly to the secretary of education, but according to multiple government oversight reports,[4] this reporting structure does not appear to be increasing accountability or leading to improvements.

Like any organization, federal agencies must evolve with the times. Based on benchmarking against other federal PBOs (which have oversight boards); interviews with former federal officials and employees; and examinations by federal partners, Congress, the GAO, and other federal watchdog groups, it is clear that FSA does not always meet its original congressional objectives and for increasing accountability. FSA is in need of legislative reform that increases accountability through the secretary of education and an oversight board with Senate confirmation.

Loan Servicing Recommendation #6: Amend the performance-based organization enabling language in the Higher Education Act to create a new role specific to student loan servicing.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: The challenges facing FSA and issues plaguing the student aid programs are much different today than when Congress created and subsequently modified the PBO enabling language in 1998. Since the shift to 100% Direct Lending in 2010, FSA's loan servicing portfolio has grown exponentially in volume and complexity. In addition to loan servicing, FSA is still challenged with effective oversight of institutions of higher education and delivery of billions of dollars in federal aid funds year after year.

Congress should insert "providing quality student loan servicing for federal loan borrowers" as a specific PBO function, as described in HEA 141 (b)(2). The current PBO establishes only two required roles for FSA: 1) the COO and 2) the student loan ombudsman. In addition to the required roles, under the COO sits the Office of Student Experience and Aid Delivery, under which the ombudsman sits; Partner Participation and Oversight; Strategic Measures and Outcomes; and Strategy, Innovation, and Transformation, in addition to the newly added Next Gen FSA Program Office that oversees the development of the Next Gen Environment.

While there are positions that deal with the student loan programs, there are no current positions with a specific focus and responsibility for delivering quality student loan servicing, which is why Congress should also establish a new, required role of chief servicing officer. The size, scope, and impact of loan servicing requires a dedicated leader. The chief servicing officer should report directly to the COO. Candidates should be required to have direct experience leading in a complex operating environment, including vendor management, ideally in the financial services field or a related industry, and should be readily available and accountable to the public. The servicing function is much too complex to be led by someone who is also responsible for FAFSA application processing and loan origination and disbursement. The chief servicing officer's individual performance plan should incorporate the SLAs as described in the loan servicer contracts.

Loan Servicing Recommendation #7: The secretary of education must ensure Federal Student Aid follows a structured process when developing its five-year strategic plan, as described in the performance-based organization enabling language, and that the strategic plan and individual performance plans include measurable loan servicing goals and objectives.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: At the heart of any PBO should be well-functioning, tightly aligned strategic planning and individual performance management processes, which is exactly what Congress intended for FSA. The PBO enabling language lays out a prescriptive process for FSA to follow in developing its five-year strategic plan and requires the COO and senior managers to enter into annual performance agreements with measurable objectives. Substantial incentive payments for the COO and senior managers are tied to achieving these objectives.

FSA has received criticism for not following the processes required by the HEA and for not being rigorous in determining their objectives. The secretary of education should demand FSA accountability in diligently following this process. The process calls for consultation with all major stakeholders: students, institutions of higher education, Congress, relevant state entities, and other interested parties. Executive agencies associated with loan servicing, such as the Department of the Treasury and the Consumer Financial Protection Bureau (CFPB), should be considered in the consultative process. Hearing from and collaborating with this varied stakeholder group about strategy, inclusive of student loan servicing, on an annual basis is critical for achieving sustainable improvement. This annual discussion should include preparing the report to capture the prior year's results as well as refreshing the five-year strategic plan.

Given the size, scope, and impact of federal student loan servicing, clear servicing goals and measurable objectives should be included in the strategic plan. In addition, to enhance FSA's accountability for loan servicing, the COO and any senior manager with loan servicing responsibility should have measurable loan servicing objectives as part of their individual performance plans. To maximize shared accountability, these objectives should mirror the service-level agreement performance metrics in the servicer contracts.[5]

[4] See, for example, the following reports from the Government Accountability Office and Department of Education: https://www.gao.gov/assets/gao-18-587r.pdf, https://www.gao.gov/assets/gao-16-523.pdf, and https://www2.ed.gov/about/offices/list/oig/auditreports/fy2019/a05q0008.pdf

[5] See page 2 of the Amendment of Solicitation/Modification of Contract document at https://www.sec.gov/Archives/edgar/data/1258602/000125860221000070/exhibit10209d0012_mod001.htm

Ultimately, FSA is responsible for providing a high-quality loan servicing experience for borrowers in ED's student loan portfolio. FSA decided to outsource the operations of the servicing function for good reasons, but FSA and the COO have the overall responsibility for ensuring the quality of this function. Since ED cannot regulate itself, nor can other federal agencies regulate ED, shared servicing objectives are critical to drive accountability.

FSA Collaboration With Other Entities to Improve Servicing

Loan Servicing Recommendation #8: Federal Student Aid and states should collaborate in their supervision of student loan servicers in an attempt to examine and eliminate any duplicative efforts already required at the federal level.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: Federal student loan servicers today are subject to supervision and oversight by multiple federal agencies. In addition, recent years have seen a growing interest among the individual states in providing oversight of servicers and protecting student loan borrowers. Even in those states without specific statutes regarding student loan servicing, the more general consumer protection statutes give all states a role in supervising student loan servicing.

There has been little coordination between these entities as they attempt to supervise the federal student loan portfolio. Even within the federal government, there have been differences in approach and enforcement among FSA and the CFPB, for example, and there is no evidence that there has been coordination between the federal government and the states, either. While FSA has recently clarified that it believes states have a role to play in the oversight of student loan servicers, no guidance has been issued to states regarding oversight of federal loan programs and contractors. In a September 13, 2021, letter to U.S. Secretary of Education Miguel Cardona, 14 state attorneys general requested more clarification from and collaboration with federal regulators:

> "[W]e wholeheartedly support ED's view that the states play a vital role in servicer oversight and that the goals of the federal student aid program will best be served by a collaborative and multi-pronged regulatory approach that involves both federal and state oversight. We look forward to expanding and strengthening our partnership with ED as we continue working to increase servicer accountability and protect student loan borrowers" (p. 6).

While increased oversight and supervision of student loan servicers is likely to increase the level of consumer protection for borrowers, fully coordinated and shared efforts between federal and state agencies will produce better and more meaningful results. The goals of oversight should be to identify problem areas in loan servicing and identify corrective actions that need to be implemented to create a better situation for borrowers. Oversight must also ensure that student loan servicers are in full compliance with applicable law.

For this oversight to have maximum impact, the standards assessed and imposed on servicers must be uniform in nature. Myriad nuanced views of what constitutes compliance with servicing rules or standards will not further the goal of equitable treatment for all borrowers regardless of their state of residence or the loan servicer to which their loans have been assigned. Related to this, federal preemption must play a role in this collaboration and be agreed on by all parties. When federal and state policies disagree, for example, if FSA determines a number of times a delinquent borrower should be contacted, but states have conflicting rules about how many times someone who owes money can be contacted, federal law should preempt state law; otherwise we are left with an untenable way to administer a loan program.

To achieve these goals, states must be willing to collaborate with each other and with FSA. The starting point could be a state compact that would govern the audit and supervision of student loan servicers across state lines. Such compacts have precedent, including recent agreements like the Interstate Compact on Education Opportunity for Military Children, agreed to in 2008, and the Enhanced Nursing Licensure Compact, agreed to in 2018. In general, these compacts are drafted and agreed upon to add order to a potentially diverse system and, in some cases, to create and enforce a set of common standards. The regulation, oversight, and supervision of student loan servicers is ripe for this sort of approach. For a compact to work optimally, states must be willing to share findings with FSA and work in collaboration with each other and with FSA in levying fines or penalties to respond to audit findings.

Coordinated oversight and supervision of student loan servicing provides common sense improvement over the current uncoordinated approach. Coordinated oversight will be more efficient for all parties by eliminating unnecessary duplication and minimizing burden on the regulators and those being regulated. Having multiple supervisory bodies conduct redundant reviews, possibly with conflicting findings, does not further the goal of assuring rigorous oversight of loan servicers or equitable treatment of borrowers across the federal system.

A state compact and a federal state partnership begin with a single, comprehensive, universal audit guide for student loan servicing. A universal audit guide would ensure servicers are supervised under a single standard devised by the federal government and adopted by state supervisory and regulatory agencies. This would ensure that a supervisory review conducted by one entity (e.g., a single state or a federal agency) would produce findings that could be readily accepted by any other entity (e.g., another state or a federal agency). By sharing the results of reviews with federal and state partners, agencies can avoid duplicating each other's work and instead focus on areas that may not have been fully explored. A universal audit guide would also add to the assurance that borrowers receive equitable treatment regardless of where they reside or to which servicer their loans are assigned. A landscape where differential policies or requirements are in place because of differing underlying state statutes or differing interpretations of policy among federal agencies and non-federal partners can result in disparate treatment of like borrowers in similar circumstances. This undermines program equity and the rights of all borrowers to be treated fairly. The universal audit guide coupled with the common manual will go a long way toward ensuring equal treatment in student loan servicing.

A state-federal partnership also allows for coordination of penalties and corrective actions when those are warranted. Using the common manual and universal audit guide, all supervisory bodies will be able to assure their corrective action plans result in the servicer adopting the correct, current procedures. This will eliminate the possibility of multiple standards for servicing procedures and for potentially conflicting recommendations and directions in response to audit findings. FSA should be the final arbiter of any potential conflicts in guidance or direction.

Another benefit of a state compact and federal partnership is that it expands oversight capabilities and allows FSA to broaden the scope of its supervision. The state partners will be additional assets FSA can rely upon to identify servicing errors and flaws currently missed due to the limited resources of FSA. Adding state regulators in a coordinated fashion to FSA's arsenal will provide it with extra, reliable eyes in the field. This is a reasonable and practical way to respond to criticism that FSA has been unable to provide full, reliable oversight of loan servicing and protect the interests of student loan borrowers.

A coordinated federal-state approach to the oversight and supervision of student loan servicing should be adopted as soon as possible. FSA should lead this effort by convening relevant federal agencies and state regulators to assure prompt and proper implementation. Once adopted, FSA must provide ongoing coordination and communication to assure the maximum value of this approach and make modifications as needed.

Loan Servicing Recommendation #9: The Department of Education should identify and act on opportunities to effectively collaborate with stakeholder agencies.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: FSA and the CFPB have had a tumultuous relationship over the last decade. The CFPB has responsibility for oversight of all commercial lenders. Commercial lenders are still accountable to the CFPB for any function FSA chooses to outsource to vendors. Because ED is a federal executive agency, the CFPB does not have direct oversight of the only federal student loan lender in the nation. In 2013, the CFPB got around this obstacle by issuing a rule giving itself authority for oversight of large "nonbank" student loan servicers, which came at a time when FSA was transferring the accounts of 13 million borrowers in an effort to decommission their legacy servicer.

In 2020, ED and CFPB entered into a new agreement that describes a more collaborative relationship between the agencies moving forward. Thus far, this collaboration has centered around complaints and enforcement engagements. This area of collaboration is necessary and encouraged, but it is reactive in nature. It is encouraging to know the agencies will be sharing complaint trends to look for systemic improvements; however, more proactive interactions will better serve student loan borrowers.

ED and FSA should consult with the CFPB when developing new loan servicing policy or programs. The CFPB has consumer protection law expertise that must be considered when making student loan servicing policy and rolling out new programs. This type of consistent collaboration will hopefully avoid future complaints and confusion. The CFPB may be reluctant to engage in this proactive form of collaboration as it may put the agency in an awkward position regarding any borrower complaints or issues with a program for which they provided consultative expertise. However, avoiding complaints and issues should be the overall goal, not just publicly pointing them out. The best protection is prevention.

The Department of the Treasury, which provides ED with funds to make Direct Loans, is another key stakeholder agency. Treasury has a unique interest in understanding the short- and long-term forecasts of the performance of the federal student loan portfolio. The Department of Education Budget Office produces a micro-simulation model on the student loan portfolio that Treasury uses to monitor the cash flows related to the federal student loan portfolio. FSA has also worked with Treasury on improving access to the portfolio performance data through the Enterprise Data Warehouse and Analytics platform. FSA should also create configurable dashboards that provide near real-time insight into the performance of the student loan portfolio. In addition, FSA should explore improving analytical tools for Treasury as part of the Next Gen program.

Treasury also provides critical data-sharing for FSA through the data retrieval tool that allows FAFSA applicants to import necessary tax data into their FAFSA applications. This process has been a tremendous benefit to FAFSA filers. Treasury and FSA can improve and build on this relationship by enhancing tax data exchange as part of the IDR initial application and annual renewal process. In 2019, The FUTURE Act authorized this enhanced data sharing directly between Treasury and FSA, which will not only help borrowers enroll and stay enrolled in income-based repayment plans but will also significantly reduce fraud. If properly implemented, the FUTURE Act could also eliminate the need for many borrowers to take action annually to certify their IDR enrollment. It is critical that this work be completed, as it will lead to reduced delinquency and default rates and keep PSLF borrowers on track for loan forgiveness.

These relationships between ED, FSA, and stakeholder agencies, while necessary, are also complex and would require additional research to find the best methods, whether through legislative or other means, for ensuring the relationships are maintained and functioning in a way that best supports these alliances and the borrowers they serve.

Loan Servicing Recommendation #10: Federal Student Aid should hire an outside agency to complete an independent financial analysis of the true cost of providing high-quality loan servicing.

This recommendation is also put forth by the American Council on Education and NASPA - Student Affairs Administrators in Higher Education.

Rationale: It's no secret that loan servicing has become more complicated over the years with the addition of multiple servicers, multiple repayment plans, and special loan programs such as PSLF. Yet, today's payment structure is essentially the same as the one FSA established in 2009 for the first Direct Loan servicing contracts. Currently, servicers get paid a set amount per month per borrower, and the amount paid is based on the status of the borrower's account. FSA has decided to pay all servicers based on a single pricing schedule, although that is a policy decision and not a matter of law or regulation. Servicers receive the most for borrowers who are in current repayment, and there is a sliding scale for borrowers who become progressively more delinquent on monthly payments. Servicers receive reduced payments when loans are in forbearance, deferment, or grace period, as there is no active servicing to be done. Clearly, servicers have incentives for keeping borrowers in good, active repayment status, but there is math that can't be ignored. The current contract provides servicers with a reduced financial incentive to spend resources — both time and money — on trying to cure a loan delinquency, as it could cost the servicer more to attempt to pull a borrower out of loan delinquency than to let the borrower remain delinquent.

Completing a detailed financial analysis of the true cost of loan servicing would allow FSA to place incentives on the right aspects of loan servicing and avoid the possibility that servicers abandon borrowers needing the most critical intervention. The analysis should not only look at the current costs to servicers but also provide estimates on what it would cost to improve service for borrowers in the short- and long-term. The premium should be put where we want servicers to spend their time, meaning payments should align with policy goals. This would involve resolving questions like whether servicers should receive incentive compensation for assisting at-risk borrowers, be incentivized for enrolling and reenrolling borrowers in IDR plans, or be levied penalties when delinquency rates rise or IDR take-up rates fall.

While it is good to engender competition between servicers through allocations, the policy should also incentivize collaboration. This could possibly be accomplished by creating a bonus structure that rewards all servicers equally if the entire portfolio meets or exceeds certain metrics. This would create an environment where all borrowers receive better servicing without putting the onus on the borrower to advocate themselves for better servicing.

The federal student loan programs are complicated, and finding how to use its payment structure to optimize good servicing should be part of FSA's objectives. FSA should use the results reported through an independent financial analysis to examine the payment structure with the assistance of a major accounting or management firm. FSA should then determine whether alternative constructs could produce better results for student loan borrowers and make changes if justified by the findings. Lastly, the report resulting from the financial analysis should be made publicly available.

Student Loan Servicing Pricing

Loan Servicing Recommendation #11: The Government Accountability Office should perform a review of Federal Student Aid's procurement function to determine if it is using its procurement flexibility effectively and establish whether additional flexibility is necessary.

This recommendation is also put forth by the American Council on Education.

Rationale: FSA has been attempting to reconstruct the loan servicing contracts in an effort to improve service for borrowers with little success since 2017. FSA canceled solicitation #ED-FSA-17-R-001, the original solicitation to replace the TIVAS contracts, as part of an announcement in August of that year to roll out the next generation servicing environment. The original servicer recompete solicitation sought to reduce the number of loan servicers to one and establish a single brand. The next generation servicing environment solicitation had the goal of consolidating the loan servicing technology into a single system but with multiple "best of class" commercial technology organizations delivering different components of the overall system.

It is now 2022, and the next generation servicing procurement has started and stopped several times since its original release. The contracts with the existing loan servicers had to be extended to 2023 from the planned end date of 2019. The loan servicing environment remains largely the same with the exception of FSA abdicating more of its loan servicing and vendor management responsibilities across multiple entities and several servicers voluntarily exiting or planning to exit the contract.

Over the same time frame, FSA also struggled to restructure the contracts for private collection agencies, as they were ensnared in several protests and prolonged litigation that caused confusion and frustration for defaulted borrowers and student loan stakeholders. FSA recently informed the private collection agencies that defaulted accounts would now stay with the loan servicers and FSA would no longer use the agencies.

In both of these cases, procurement issues and delays hampered FSA's strategic plans to improve the overall loan servicing environment and resulted in continued issues for student loan borrowers. These procurement problems also cost taxpayers tens of millions of dollars in unplanned contract renewals and outside strategy consultants. Congress should consider asking GAO to review FSA's procurement processes and specifically how FSA is leveraging the flexibilities provided by the HEA. GAO should also comment on whether they believe additional flexibilities are warranted.

Loan Servicing Recommendation #12: Federal Student Aid should increase the transparency of data regarding its Direct Loan portfolio and allow qualified researchers to access servicing data.

This recommendation is also put forth by the American Council on Education, the Institute for Higher Education Policy and NASPA - Student Affairs Administrators in Higher Education.

Rationale: The databases of student loan servicers are rich and robust, and they hold the potential to provide great insight into how to improve loan servicing operations and procedures. FSA has shared only the tip of this data iceberg with the public. Over recent years, FSA has published information in its FSA Data Center, which has provided a window into the performance of the Direct Loan portfolio, including rates of enrollment in IDR plans, rates of forbearance use, delinquency rates, and other portfolio characteristics. Recently, FSA has even added some data on borrowers pursuing PSLF. However, the publicly available data do not tell us enough to understand how borrowers are faring under current program rules and servicing contracts and what policy or identify administrative changes could produce improved results for borrowers.

The establishment of the FSA Data Center as the repository for Direct Loan data has made it easier to access information posted by FSA and track trends in the portfolio composition and performance. However, that publicly available data remains quite limited. Student loan servicer databases contain many times more information than is currently being published. This information could be mined and analyzed to understand much more about the experience of student loan borrowers and about the practices of student loan servicers. A small step would be for FSA to increase the type and scope of the information it provides in the Data Center. This could include providing insight into differences in borrower outcomes by various borrower demographics, such as undergraduate vs. graduate, age, gender, and loan type. FSA should reach out to stakeholders, including Congress, to determine what information they believe should be included in the data center and what policy questions need to be addressed with data.

At times, we gain insight into the Direct Loan portfolio because other federal agencies request and publish data on student loan borrowers. An example of this was an examination of defaulted borrowers by the CFPB. As a follow up to a prior report, the CFPB requested detailed data from student loan servicers on the experience of borrowers who transitioned from defaulted status through loan rehabilitation and loan consolidation. The CFPB report provided insight into a struggling slice of the borrower population that had never been publicly examined by FSA, despite its relatively easy access to the same data. Servicers capture and store this and a great deal more information and, with FSA's permission, have been able to respond to requests from federal agencies and Congress for information that is not generally publicly available.

There are few examples where FSA has delved into its servicing data to examine portions of its student loan borrowers and made the results available to policymakers or the public. This lack of transparency regarding student loan borrowers and loan servicing makes it more difficult for policymakers and other stakeholders to make informed decisions or recommendations to improve borrower experiences with their loans. Improved data transparency would, for example, assist FSA and policymakers in increasing enrollment and reenrollment rates for IDR programs and provide a better understanding of borrowers' paths to repayment relief or potential loan forgiveness under those programs.

In a report from May 2016, the GAO concluded that FSA did not use data to determine the metrics by which it judges servicer performance or how it structures servicer compensation: "Officials [at FSA] said the agency did not document the criteria it used to develop and select the current performance metrics and compensation structure" (p. 33). By exploring its servicing data in more depth, FSA has the opportunity to revise and improve all metrics it uses to evaluate and compensate federal student loan servicers and determine the performance measures that will make a difference for student loan borrowers.

FSA would benefit from hiring its own staff to supervise and coordinate data analysis on student loan servicing and borrowers. Today, FSA relies primarily on contractors to perform its analyses, which limits FSA's direct understanding and control of the data and the resulting research. Policy development and operational changes supported by data need to be fully vetted by skilled FSA personnel who have in-depth familiarity with available data and program details and can direct further analyses. As part of this effort, FSA data systems should be evaluated and improved to assure they are able to handle these types of sophisticated data analyses.

In addition to encouraging or requiring FSA to improve loan servicing by conducting more robust analysis of its loan servicing policies and practices, FSA should make its student loan servicing database available to other organizations for research and exploration. Groups obtaining access should be screened to assure their legitimacy and expertise, and all data should be anonymized. Alternatively or in addition to the above, FSA could identify a group of research advisors that would have broad access to data and the ability to perform independent analyses that would be made available to FSA and policymakers. Findings from this research should be shared publicly. Bringing more skilled researchers to the task of evaluating student loan servicing will provide more insight into servicing practices and their impacts on student loan borrowers. This will allow for more attention to ideas that can improve the loan servicing experience for borrowers and guide FSA's approaches to the oversight of loan servicers.

The impact of servicing policies and practices on borrowers and borrower outcomes is not fully understood today, despite the existence of powerful data that can help answer questions and guide policy decisions. FSA must put more emphasis on analyzing loan servicing data and providing policymakers and the public more insight into its loan portfolio.

Student Loan Repayment

Background

Understanding why we have a system of income-driven repayment (IDR) for federal student loans and how it has evolved into a structure in need of serious reform requires looking at both the logic and principles out of which the system emerged and the gradual development of different repayment plans.

Beginning with National Defense Student Loans (NDSL) in 1958, federal student loans have generally been repaid through fixed monthly payments (NDSL offered a graduated repayment plan). When the Higher Education Act of 1965 (HEA) introduced the Guaranteed Student Loan program, it set the standard period of repayment to 10 years. The idea that the government should develop an income-driven repayment (IDR) system that might involve public subsidies emerged in economic discussions before the federal government introduced the first such program — Income Contingent Repayment (ICR) — in 1993, along with the Federal Direct Student Loan program.[6]

The most commonly cited source of the basic idea of making required payments a function of borrowers' earnings is the free-market writing of Nobel Prize-winning economist Milton Friedman. In his 1955 essay, "The Role of Government in Education," Friedman argued for a system in which lenders would essentially buy shares in students' future earnings.[7] A portion of the profit from borrowers who had high earnings would go toward subsidizing those with lower earnings. The program would be self-sustaining and would not involve government subsidies.

This concept received considerable academic attention in the early 1960s,[8] when James Tobin, another Nobel Prize-winning economist with very different ideological leanings, incorporated similar ideas into his design for Yale's Tuition Postponement Option in 1971. Like Friedman's ideal system, that program depended on some students subsidizing others — a characteristic that contributed to its failure.

In 1993, Alan Krueger and William Bowen wrote in the widely read (in the profession) *Journal of Economic Perspectives* about the importance of providing insurance for student borrowers against the possibility of low future earnings and ensuring that required payments be matched with ability to pay.[9] Like Friedman and Tobin, they were concerned about the variation in returns to postsecondary education that exists alongside a high average return. But these authors also expressed concern about the problem of adverse selection that would be associated with the type of program conceived by Friedman and Tobin: Students who expected high earnings would not be likely to participate. They suggested capping payments for high-earning students to counter this difficulty — a strategy that would involve government subsidies for borrowers with low earnings. (This idea provides insight into the origin of the cap at the level of payment under the standard 10-year plan in early IDR plans.)

From the beginning, federal IDR programs have been built on the concept of the subsidy for borrowers unable to repay coming from the federal government rather than from other borrowers. No borrower is asked to repay more than the amount borrowed plus interest. Taxpayers are responsible for any costs not covered by borrowers, who may have unpaid debts forgiven after a specified period.

As the original ICR program was being designed, the interaction of the program parameters was salient, and debates emerged about the optimal structure. A 1994 Congressional Budget Office Memorandum argued that four basic parameters describing an IDR program are interrelated: the amount of debt covered, the length of the repayment period, the share of income required for payments, and the interest rate. A financially sustainable program requires balance among these factors. If debt levels are higher, borrowers must repay for a longer time and/or pay a larger share of their incomes. Reducing the share of income required for payments will lead to unpaid debts unless the amounts of debt covered are lower, borrowers repay for a longer period, or the interest rate is lower. (A lower interest rate might generate an automatic subsidy from taxpayers to borrowers.) The details of the plan were controversial because of the tension between keeping the monthly payment amounts low and concern over payments not covering interest charges.[10] If one parameter is changed without another modification to balance it, the amount of unpaid debt and the required subsidy will grow.

[6] In 1986, the federal government initiated a demonstration income-contingent repayment program at 10 postsecondary institutions. The project never achieved much support from students, colleges, or policymakers and was terminated with the 1992 amendments to the Higher Education Act. (Noell, J. and Rhind, C. [1994], *Issues in designing a federal program of income-contingent student loans.* CBO Memorandum. https://www.cbo.gov/sites/default/files/103rd-congress-1993-1994/reports/doc04.pdf)

[7] Friedman, M. (1955)."The role of government in education." In Solo, Robert A., ed., *Economics and public interest.* New Brunswick: Rutgers University Press. Reprinted in Milton, F. (1982). *Capitalism and freedom.* Chicago: University of Chicago Press, 1982, pp. 85-107.

[8] Shell, K., Fisher, F., Foley, D. K., and Friedlaender, A. F. (1968, March). "The Educational Opportunity Bank: An economic analysis of a contingent repayment loan program for higher education," *National Tax Journal,* 21(1), 2-45. This 1968 *National Tax Journal* article analyzed the idea of an Educational Opportunity Bank that would make loans to students in exchange for the pledge of a given percentage of annual gross income for a fixed number of years after graduation. The share of income charged would depend on the amount borrowed. The program would be coordinated with the federal income tax, minimizing costs of collection and making it feasible to collect income-contingent repayments over 30 or 40 years.

[9] Krueger, A. B., and Bowen, W. (1993, Summer). "Income-contingent college loans." *Journal of Economic Perspectives,* 7(3), 193-20.

[10] Schenet, M. A. (1995, January). *The Federal Direct Student Loan Program.* CRS Report for Congress. Congressional Research Service. Report No CRS-95-110-EPW,6 Jan 95.

Under the regulations for the ICR published July 1, 1994, payments depended on the amount of debt, with the share of adjusted gross income rising from 4% to 15%, but not to exceed 20% of discretionary income, defined as income exceeding 100% of the poverty line. The Internal Revenue Service was to provide the Department of Education (ED) with the tax return information necessary to calculate repayment amounts annually.[11] Under ICR, capitalization of interest cannot exceed 10% of the original principal amount, after which interest continues to accrue and must be paid but is not capitalized — one of the few provisions that has become harsher with the newer plans.

Probably because of the complexity of the ICR program combined with limited eligibility, relatively high expected payments, and lack of awareness of the program, ICR did not attract many takers.[12]

The creation of the Income-Based Repayment Program (IBR), which took effect July 1, 2009, marks the beginning of the move toward widespread adoption of IDR in the United States. The repayment rate was capped at 15% of discretionary income instead of 20%, and the threshold for beginning payments rose from 100% to 150% of the poverty line. Neither the link between debt levels and required payments nor the role of the IRS in providing income information survived in the new program.

As Direct Lending became established, with the federal government replacing private lenders in the federal student loan system, the idea that the government was responsible for the well-being of borrowers took hold and government subsidies for students became both more feasible and more expected.

The implementation of the current IDR plans has been gradual, with new versions introduced on top of the older ones, creating a complex and bewildering array of choices for borrowers. Modified plans introduced in 2012 and 2014 lowered the share of income required again, from 15% to 10%, and reduced the time to forgiveness to 20 years.

The newest plan, Revised Pay As You Earn (REPAYE), available since 2015, removed the partial financial hardship requirement, so borrowers are eligible regardless of their financial circumstances. But in contrast to the general trend, it includes a few adjustments that lead to higher payments for some borrowers. Those with graduate school debt must wait 25 years instead of 20 years for forgiveness, payments are not capped at the level of the standard 10-year plan, and married borrowers' payments are based on the combined income of the spouses even if they file separate income tax returns.

But over time most of the parameters of IDR have become more generous, providing clear evidence of the tension between a financially stable program with limited taxpayer subsidies and generous treatment of borrowers. More and more borrowers face increasing balances resulting from unpaid interest, largely because of the decline in required payments. Moreover, the idea that payments would be linked to the amount borrowed has not been part of later plans.

These straightforward trade-offs, which are rarely discussed explicitly today, provide a useful framework for evaluating proposals for modifying IDR formulas. The current debate tends to focus on making payments easier for borrowers. Advocacy focuses on combining lower payments with shorter time in repayment. Vocal senators support changes that would lower payments for borrowers, but not changes that would reduce public subsidies to borrowers who can afford to repay. But it remains true that, for example, lower payments will lead to fewer borrowers successfully retiring their debts.

And the logic underlying IDR remains the same: Despite the high average return to investment in higher education, it does not pay off for everyone and borrowers need insurance against low incomes. Payments linked to income are more affordable for borrowers, especially because of the tendency for earnings to be lowest in the years immediately following college. Unlike grants, which subsidize students based on their pre-college circumstances, IDR allows subsidies to be based on post-college circumstances.

The gradual modification of IDR has led to multiple such plans being available, in addition to the standard, graduated, and extended plans. In other words, borrowers now face a long and complicated list of choices about the best way to repay their federal student loans. As of 2021, 41% of borrowers were in the standard 10-year plan, which remains the automatic option if borrowers do not actively choose a different plan. Another 34% are in one of the IDR plans, and 14% are in graduated plans.[13] There is little doubt that the array of plans and the bureaucratic barriers to accessing them contribute significantly to the difficulties many borrowers face in successfully navigating the system.

On average, borrowers in IDR owe more than those in other repayment plans. In 2017, graduate borrowers comprised 30% of borrowers in IDR plans but only 15% of borrowers in fixed-payment plans. Moreover, among both undergraduate and graduate borrowers, those with larger debts are more likely to enroll in IDR, and once in that plan, they repay their debts more slowly. Although IDR does not eliminate default, borrowers in these plans default at much lower rates than those in other plans.

[11] ibid.

[12] US General Accounting Office. (1997, August). Direct student loans: Analyses of borrowers' use of the income contingent repayment option. (GAO/HEHS-97-155), https://www.gao.gov/assets/hehs-97-155.pdf. As of 1997, about 56,000 borrowers — 9% of Direct Loan borrowers in repayment — were enrolled in ICR. About 40% of these borrowers had been placed in this plan because they were in default on loans from the Federal Family Education Loan Program (p. 2).

[13] Federal Student Aid Portfolio Summary, National Student Loan Data System (NSLDS), available from FSA Data Center.

The FUTURE Act, passed by Congress in December 2019, addresses some of the barriers facing students repaying their loans. It makes it easier for the Department of Education to access IRS data, easing the burden on students who must verify their incomes when they enroll in IDR and every year thereafter to continue to have their payments linked to their incomes. Since more than half of borrowers required to recertify their incomes fail to do so on time, it is reasonable to believe that successful implementation of this ACT will increase the share of borrowers repaying through IDR.

Other recent changes likely to have a significant impact on loan repayment include the Biden administration's regulatory modifications of the Public Service Loan Forgiveness (PSLF) Program. Created in 2007, PSLF is designed to forgive unpaid loan balances for borrowers working full time in public service occupations after 120 monthly payments on qualifying loans in qualifying repayment plans. Bureaucratic difficulties and loan servicing problems have prevented many borrowers from receiving forgiveness. Eliminating some of the restrictions on which loans and which payment plans are eligible will likely eliminate outstanding debts for thousands of borrowers.

Considerations for Improving Student Loan Repayment

A full-scale reform of the federal student loan repayment system has the potential to minimize the need for the continual piecemeal modifications that have accumulated to create a complicated and ineffective system.

While federal student loan programs continue to be an integral piece for access to and funding for higher education for many students, policymakers should work to reduce reliance on federal student loans through increasing front-end investments in other aid programs, especially those that serve students from traditionally under-resourced communities. While the recommendations laid out in this report offer much-needed and long-overdue reform to the student loan system, expanding and bolstering funding for programs like the Federal Pell Grant that serve low-income students, and boosting support for other college completion and retention efforts must go hand-in-hand and are paramount to making higher education more accessible and equitable.

There is also an important role to be played by the federal accountability system, which should ensure that institutions are providing students with high-quality education that translates to positive employment outcomes and increased earnings. We must ensure an accountability system that guarantees students are receiving quality degrees and the skills needed in the job market, which in turn will help borrowers find gainful employment opportunities and be less likely to struggle repaying their student loans.

Recommendations

These student loan repayment recommendations are put forth by NASFAA, the American Association of Community Colleges, and the National Association of College and University Business Officers. Additional supporters of individual recommendations are listed below each recommendation.

Repayment Recommendation #1: Consolidate the existing repayment plans into three options: a single income-driven repayment plan, a standard 10-year repayment plan, and an extended 25-year plan. Transition all borrowers into one of these three plans and sunset all other existing repayment plans.

This recommendation is also put forth by the Higher Education Loan Coalition and NASPA - Student Affairs Administrators in Higher Education.

- Consolidate the existing IDR plans into a single income-driven repayment plan that borrowers can easily understand and navigate. See Repayment Recommendation #6 for additional details.

- Maintain a standard 10-year repayment plan and an extended 25-year repayment plan. The standard 10-year plan should be available to all borrowers, and the extended 25-year plan should be available only to borrowers who have more than $30,000 in Direct Loans (this is the same eligibility requirement as the current extended repayment plan). The standard repayment plan would be 10 years with fixed payment amounts, and the extended repayment plan would be 25 years with fixed payment amounts.

- Make the single IDR plan the default option for borrowers entering repayment, and allow borrowers to opt into a standard/extended plan if they do not want to be in an IDR plan. Borrowers with a tax return on file could be seamlessly enrolled in the IDR plan. Borrowers who do not have tax returns on file would be given the opportunity to self-certify their income. If a borrower without a tax return on file does not self-certify their income in the first six months after their enrollment ends (i.e., during their grace period), they would be automatically placed into an IDR plan and given a $0 payment for the first six months of repayment. If, after six months of the $0 IDR payment and 12 months after their last date of enrollment, the borrower still has not self-certified their income, they would be transferred to the standard repayment plan.

- To ensure borrowers understand their repayment options, ED, through exit counseling, and servicers, through communications sent during a borrower's grace period, should notify borrowers of both the monthly and total amount they would pay under each plan. In addition to these personalized estimates, these communications should direct borrowers to resources, such as online calculators, to help them understand their repayment options. ED should also ensure borrowers are able to move between plans easily and quickly if they wish to do so.

- Congress and ED should take whatever steps are necessary to transfer all borrowers into one of the three plans proposed above (the single IDR plan, the standard 10-year plan, and the extended 25-year plan), ensuring to the greatest extent practicable that borrowers are not worse off in one of these three options than they are in their original plan. Once all borrowers have been transferred to one of the three plans, Congress and ED should sunset all other existing repayment plans to ensure all borrowers can benefit from the streamlined and simplified repayment system. This process should prioritize communication with borrowers and allow them to select which of the three plans they would like to enroll in. ED and servicers should provide borrowers with information on each of the three plans and notify them of which plan is most similar to the plan in which they are currently enrolled. Borrowers should be provided with sufficient time to opt into their plan of choice and sent frequent reminders about the deadline to select a plan. If a borrower does not opt into a new plan after sufficient time and notification to do so, they should be placed into the plan that will be most generous for them.

Rationale: Consolidating and simplifying the available repayment plans will make it easier to provide borrowers with personalized information to decide which plan is best for them, and it will help borrowers understand the benefits and protections inherent in our federal student loan repayment system. The repayment benefits and protections of the federal student loan programs are generous; however, multiple changes and tweaks over the years have created a tangled web of repayment options that can confuse borrowers. Because of this complexity, many borrowers who could benefit from certain repayment plans, like income-driven repayment, may never enroll because they are unable to compare and navigate these plans effectively. The myriad repayment plans also make it difficult for schools, loan servicers, and relevant state entities to communicate options to borrowers.

Keeping two of the non-IDR repayment plans allows flexibility and choice for borrowers who would prefer to be in a standard plan that allows them to know exactly what they will be repaying each month. In addition to giving borrowers the ability to make proactive choices about their repayment plan, one benefit of having both an IDR plan and the standard/extended option is that it helps identify groups of struggling borrowers to whom additional subsidies and support can be targeted. The consolidated IDR plan should be easy to enroll in and include generous terms and conditions that provide struggling borrowers with the safety net they need to remain in good standing during economically challenging times. These programs should be made available to all existing borrowers as well as prospective borrowers.

Some advocates have proposed consolidating the existing repayment plans to just two options: a single IDR plan and the standard 10-year plan. We propose maintaining the extended plan because some borrowers with higher balances may prefer a non-IDR option that provides them with a longer repayment period. For example, many high-earning borrowers with high balances will have no problem successfully paying off all their debt over time. However, because of the size of their balances, these borrowers would have an extremely high monthly payment under both the IDR plan (because of their income) and the standard 10-year plan (because of the short repayment term). Borrowers with more than $30,000 in Direct Loans currently have access to the extended plan, and we recommend preserving access to this longer repayment term for these borrowers. Providing an extended plan that offers the same predictability as the standard plan but over a longer period of time is a reasonable adjustment for the many high-balance borrowers who will still be able to repay the full balance of their loan.

Enrollment in an IDR plan has been shown to increase the likelihood of successful repayment outcomes, especially for struggling borrowers. As such, making IDR the default repayment plan for all borrowers, with the option to opt-in to a standard/extended plan, will provide an upfront safety net to quickly catch borrowers who are most likely to become delinquent and default on their loans. Some borrowers may prefer not to be in IDR and will still have the ability to select another plan. Making IDR the default repayment plan and requiring more savvy borrowers to go through the process of opting out of IDR brings significantly less harm to those borrowers than the alternative (and current practice) of requiring low-income borrowers to jump through hurdles to enroll in IDR when they are struggling. Put simply, if our ultimate goal is to give borrowers every possible chance to be successful and protect them from punitive consequences, it makes sense to put a safety net under everyone rather than require vulnerable borrowers to be aware of and take steps to enroll in IDR during already stressful times.

Repayment Recommendation #2: Design a single income-driven repayment plan.

This recommendation is also put forth by the Higher Education Loan Coalition and NASPA - Student Affairs Administrators in Higher Education.

Repayment recommendation #1 proposes consolidating the existing IDR plans into a single income-driven repayment plan, which would be the automatic option for borrowers entering repayment who do not opt into either the standard or extended plan. When developing this single IDR plan, policymakers should include the following provisions, listed as sub-recommendations:

- **Sub-recommendation 2A: Raise the poverty thresholds used to determine a borrower's discretionary income from 150% to 200% of the federal poverty guideline.**

  Rationale: The federal poverty guideline, a system used to determine eligibility and appropriations for many types of federal, state, and local aid, has been widely scrutinized by those who work in the fields affected by the calculation. Without revision, the efficacy of the poverty line as a tool to target and evaluate public policy interventions has been increasingly drawn into question, especially at the state and local level. To account for the metric's shortcomings, eligibility for many social safety net programs is now frequently set at 125%, 150%, or even 200% of the federal poverty guideline. Raising the threshold used in IDR from 150% to 200% will shield more of low-income borrowers' earnings from being included in their discretionary income. Spousal income should always be included in the calculation of IDR payments, except in unusual circumstances that make this infeasible.

States use a range of federal poverty thresholds to determine eligibility for benefit programs, and some market IDR to borrowers enrolled in certain programs and assist them in enrolling in IDR plans. As such, ED should notify relevant state entities of any changes to the thresholds used in the new IDR formula to allow states to modify their outreach efforts to better serve the populations who might be impacted by the adjustments.

- **Sub-recommendation 2B: Assess borrowers' income above 200% but less than or equal to 300% of the federal poverty guidelines at a rate of 5%, and assess borrowers' income greater than 300% of the federal poverty guidelines at a rate of 10%.**

  Rationale: Although all borrowers, including those with higher incomes, will benefit from lowering the assessment rate (currently 10%) on income that falls between 200% and 300% of the federal poverty guidelines, this will deliver an additional benefit to and lower monthly payment amounts for low-income borrowers. Maintaining the 10% assessment rate for income above the 300% threshold is more equitable than reducing the assessment rate to 5% for all discretionary income, which would cut payments by the same percentage for all borrowers and have a relatively larger impact on higher-income borrowers. For example, reducing the assessment rate from 10% to 5% for all discretionary income would lead to a much larger dollar reduction in the overall payment amount for higher-income/high-payment borrowers than the dollar reduction experienced by low-income/low-payment borrowers. Under this proposal, a borrower's monthly payment amount will be equal to 5% of their income that falls above 200% and less than or equal to 300% of the federal poverty guidelines plus 10% of their income greater than 300% of the federal poverty guidelines, divided by 12.

- **Sub-recommendation 2C: Eliminate negative amortization for all borrowers, ensuring borrowers who are making payments on an IDR plan do not see their principal balance grow.**

  This recommendation is also put forth by the Center for American Progress.

  IDR borrowers whose monthly payment is less than the amount they are charged in interest will have their monthly accrued interest charge reduced to an amount that is equal to their monthly principal payment, ensuring principal balances do not increase for borrowers making payments on an IDR plan.

  Rationale: Eliminating negative amortization is a well-targeted proposal that would greatly benefit those enrolled in IDR plans. It would provide a back-end subsidy that ensures the low-income borrowers who rely on IDR as a safety net do not face the demoralizing experience of seeing their principal balance grow despite making their required monthly payments. This will incentivize borrowers to continue engaging with the repayment system rather than becoming disconnected altogether. What's more, it is unlikely that borrowers whose monthly payment amounts are consistently less than their interest will successfully repay their debt before receiving forgiveness, so eliminating negative amortization will likely make little difference on the amount repaid to the federal government.

- **Sub-recommendation 2D: Forgive the loan's outstanding balance after 10 years for borrowers who have had a $0 income-driven repayment plan payment for 120 consecutive months, and after 20 years (240 monthly payments) for all other borrowers using income-driven repayment.**

  Rationale: One of the most common rationales offered for shortening time to forgiveness is that IDR borrowers who are making on-time payments should not have to watch their balances grow for 20 to 25 years, an experience that is undoubtedly demoralizing even if the borrower is on track to eventually receive forgiveness. Rather than shortening the time to forgiveness, we instead propose eliminating negative amortization altogether and have recommended several provisions to reduce monthly payment amounts for low-income borrowers, including shielding more of their earnings from being included in their discretionary income and lowering the assessment rate on income that falls between 200% and 300% of the federal poverty guidelines. Collectively, these recommendations will eliminate balance growth and make IDR payments more manageable for borrowers, addressing the primary factors that have motivated proposals to shorten the repayment period of IDR plans. IDR borrowers will now see their balances go down over the 20-year repayment period and never increase. These recommendations will also advance the primary goal of IDR: providing a safety net to support struggling borrowers through times of financial hardship.

  Reducing the time to IDR forgiveness to 5, 10, or 15 years across the board would result in a disproportionate benefit for borrowers. Most borrowers see their earnings increase throughout their career, and in many cases individuals see substantial growth from their first-year post-graduation income to their earnings 5 to 10 years into their career. This is especially true of those in some high-earning occupations such as physicians, who often make a modest income during residency that then increases considerably in the following 5 to 10 years and beyond. If IDR forgiveness were granted 5 or 10 years into repayment, many individuals who will eventually become high earners would receive massive amounts of debt discharged. This approach is neither well-targeted nor equitable. Even providing IDR forgiveness after 15 years instead of 20 would not provide a substantially different outcome for low-income borrowers, yet it would deliver a larger benefit to high-income borrowers who had low payment amounts for a portion of their repayment term before their income increases.

  Another common proposal is to base the time to forgive under IDR on a borrower's balance amount. Because the size of a borrower's balance is not necessarily an indication of their income level, this approach has the same equity and targeting concerns discussed in the previous paragraph. While calibrating the repayment period to the balance size could benefit some low-income, low-balance borrowers, it would do nothing to help low-income borrowers with high balances. Additionally, individuals who see their earnings increase year over year would see debt forgiven that they would have been able to comfortably repay as their income increased.

- **Sub-recommendation 2E: Allow income-driven repayment plan payments made before a borrower consolidates to count toward income-driven repayment forgiveness. Payment counts should not reset regardless of whether the borrower is consolidating Direct Loans or is consolidating Federal Family Education Loans into Direct Loans.**

This recommendation is also put forth by the Center for American Progress and National Consumer Law Center.

Rationale: There is no reason a borrower's IDR forgiveness clock should start over when they consolidate. Borrowers should receive credit on IDR payments made prior to consolidation. This recommendation aligns with our recommendation (Repayment 7C) to allow all FFEL borrowers who consolidate into the Direct Loan program to count previous payments toward PSLF forgiveness. ED's proposal during the Affordability & Student Loans negotiated rulemaking committee included a proposal to count pre-consolidation IDR payments toward forgiveness.

- **Sub-recommendation 2F: Allow all undergraduate and graduate borrowers to access the single income-driven repayment plan. Parent borrowers could access economic hardship deferments but would not be eligible to enroll in income-driven repayment.**

o Graduate students would be eligible to access the same IDR plan outlined above, which provides forgiveness after 20 years of on-time repayment. There would be one single, streamlined IDR plan, which is the same for both undergraduate and graduate borrowers. Borrowers would be able to enroll both their undergraduate and graduate loans in this IDR plan, though the time to forgiveness would be counted on different timelines based on the dates each type of loan enters repayment.

For example, a borrower might take out $10,000 in undergraduate loans, later borrow an additional $20,000 for graduate school, and begin repaying their graduate loans 10 years after they started repaying their undergraduate loans. The borrower's undergraduate and graduate loans would remain separate, and they would first receive IDR forgiveness on the undergraduate loans after 20 years of on-time IDR payments. This would be followed by forgiveness of their graduate loans 10 years after forgiveness of their undergraduate loans because they entered repayment on their graduate loans 10 years later.

o Given Repayment Recommendation #6 to improve the parent PLUS program and protect vulnerable parent borrowers, parent borrowers should not have access to IDR. Parents who struggle with repayment despite these reforms should be able to apply for relief through an economic hardship deferment, which should be reformed to provide additional flexibility as proposed below. See page 27 for more information.

Rationale: Graduate students currently must be in IDR for 25 years before forgiveness, a mechanism intended to guard against moral hazard. However, creating one IDR plan with forgiveness after 20 years for both undergraduate and graduate borrowers is simpler and more straightforward for borrowers trying to understand their repayment options. Rather than basing times to forgiveness on the loan type, servicers will be able to communicate the 20-year repayment term to all borrowers, regardless of whether they have undergraduate or graduate loans.

Although graduate students were not eligible for the new IDR plan proposed by ED in the fall 2021 negotiated rulemaking committee, it is critical to ensure that graduate and professional students have access to an IDR plan. Low-income graduate students who do not see a return on their investment face burdens from their student debt similar to low-income borrowers with undergraduate debt, and as such they should be provided with the same safety net to support them during periods of economic hardship. Extending the same IDR options to graduate students ensures struggling borrowers have equitable access to a safety net, especially when paired with other reforms to graduate borrowing proposed in this paper that should decrease reliance on IDR.

Currently, the only IDR plan available to parent borrowers is the Income-Contingent Repayment (ICR) Plan, which parents can access if they consolidate a parent PLUS Loan into a Direct Consolidation Loan that can then be repaid under the ICR Plan. Although it is undeniable that low-income parent borrowers may struggle greatly to repay their debt, we recommend that parent borrowers not be eligible to enroll in the new streamlined IDR plan proposed in this paper. During the transition of borrowers into one of the three plans proposed in Repayment Recommendation #1, parents who consolidated their loans and are currently enrolled in ICR should be placed in either the standard or extended repayment plan.

Some advocates have proposed allowing parent borrowers to utilize IDR plans. We instead propose more equitable, systemic solutions to better protect current and future parent borrowers. Although an IDR option would not be available to parents moving forward as it currently is, many of the parent borrowers who currently struggle most with repayment — those with unaffordable amounts of debt who received PLUS when their incomes were at or near the poverty level — will have already received forgiveness of the loans for which they should have never been approved in the first place, as proposed in Repayment Recommendation #6. This proposal to cancel the debt of low-income parent borrowers is critical to protecting the parents who have been most adversely impacted by the current parent PLUS Program, and thus are most likely to need a safety net when repaying their loans.

Repayment Recommendation #6 also proposes reforming the structure of the parent PLUS Program to better protect future parent borrowers, particularly those with low incomes, from taking on the lifelong burden of an excessively high loan balance they will likely never be able to repay. Implementing a debt-to-income ratio to more meaningfully assess how much debt a parent can reasonably repay will ensure future parents are not able to overborrow and end up in situations where they would need to rely on IDR to make their monthly payments.

Together, these two recommendations provide immediate relief to low-income parents who are saddled with excessive loan balances and ensure that moving forward parents can only borrow PLUS amounts they can reasonably repay. As such, we do not recommend allowing parent borrowers to access the same IDR plans as students. Beyond proposing recommendations that solve the problems parent access to IDR aims to achieve, there are a number of additional justifications for this decision. First, the logic underlying IDR does not apply to parents, whose ability to repay is not a function of the return on their investment in their child's education. What's more, the rationale for creating the current avenue by which parents may access IDR — repaying a Direct Consolidation Loan through ICR — lacks a clear justification. Finally, although not a primary reason for the recommendation to restrict parents from enrolling in IDR, doing so could prevent parents from strategic and unnecessary borrowing. Allowing parents to access IDR plans could encourage those looking toward retirement to increase their borrowing with the expectation their post-retirement income will be low, resulting in a low monthly IDR payment. This could result in a scenario in which a high-income parent close to retirement age borrows PLUS loans instead of paying out-of-pocket, has a low IDR payment based on their minimal post-retirement income, and ultimately receives IDR forgiveness. Again, this is not a primary rationale for this recommendation, but one that could have an impact in certain cases.

It is important to recognize that even with reforms to limit parent PLUS borrowing and implement measures to protect parents from borrowing excessively, there will still be cases of struggling parent borrowers who need additional support to remain in good standing. Parents who borrowed a reasonable amount based on their income at the time may find themselves unable to make their monthly payment due to job loss or unexpected expenses. Parents in need of relief can apply for an economic hardship deferment. With the flexibilities proposed in the default section of this paper, this program provides a safety net to support struggling parents during periods of financial distress.

- **Sub-recommendation 2G: Mandate that all student loan debt forgiven or discharged under income-driven repayment plans is free from taxation.**

  This recommendation is also put forth by the Center for American Progress and National Consumer Law Center.

  Rationale: Temporarily, due to borrower relief provisions related to the COVID-19 pandemic included in the American Rescue Plan signed into law March 11, 2021, any federal student loan debt discharged through 2025 will be forgiven without any tax implications. However, unless Congress chooses to extend or make permanent this provision, this benefit will expire December 31, 2025. This provision should be made permanent. Taxing borrowers on the amount of forgiveness received is counterintuitive. It provides a disincentive for high-debt borrowers to take advantage of the repayment plans that allow for forgiveness, and it creates a sudden financial hardship for borrowers receiving forgiveness. At the moment borrowers should finally be emerging from their debts, they are abruptly faced with a significant lump-sum cost with few options for easy repayment. It could be argued that in certain cases this is more calamitous to the borrower than simply remaining in repayment.

Repayment Recommendation #3: Explore ways interest could be reformed to better align the federal student loan program with its purpose of expanding postsecondary access.

This recommendation is also put forth by the Higher Education Loan Coalition and NASPA - Student Affairs Administrators in Higher Education.

- **Sub-recommendation 3A: Drastically lower interest rates for all types of Federal Direct Loans (subsidized, unsubsidized, PLUS) to advance the program's primary goal of promoting postsecondary access. One option to do this is by tying federal student loan rates to the rate at which the federal government borrows and lowering the maximum interest rate cap specified in the HEA.[14]**

  Rationale: The purpose of the federal loan programs is to support postsecondary access. However, the current system functions as a vestige of bank-based lending, where the lender is guaranteed a certain profit. While a guaranteed profit may have been required at the beginning of the federal student loan programs to encourage lender participation, interest rates that dramatically exceed either the cost of federal borrowing or administering the program no longer make sense. Promoting postsecondary access should be the primary goal of the federal student loan program, and borrowers should not be burdened with high interest rates. Undergraduate and graduate students should have the same interest rates on Direct Loans. Loans borrowed by parents on behalf of their dependent students should have a slightly higher rate than undergraduate and graduate student loans, though still much lower than current parent PLUS interest rates.

  Although there have been proposals to make all federal student loans interest free, we believe maintaining interest at a lower amount is both more equitable and sustainable. We are concerned about the impact that setting rates to 0% for all borrowers, with no assessment of financial need, might have on the overall volume of the loan program. Rather than heavily subsidizing loans for high-income borrowers, we instead propose maintaining interest at a much lower rate and directing federal funds toward means-tested aid programs such as the Pell Grant.

[14] Currently, as specified in the HEA, maximum interest rates may not exceed 8.25% for Direct Subsidized/Unsubsidized undergraduate loans, 9.50% for Direct Unsubsidized graduate loans, and 10.50% for Direct parent/graduate PLUS loans. See https://fsapartners.ed.gov/knowledge-center/library/electronic-announcements/2021-05-19/interest-rates-direct-loans-first-disbursed-between-july-1-2021-and-june-30-2022-ea-id-loans-21-06

Additionally, lowering interest rates on federal student loans should not come at the expense of good servicing. Although it may be reasonable for rates to be slightly higher than the rate at which the government borrows to help cover some administrative costs, lowering interest rates for borrowers may require Congress to provide additional resources to support the cost of high-quality servicing and cover other program administration costs.

Additional research is needed to determine the best method to set interest rates each year. One possibility would be to eliminate the current add-on amount and set student loan interest rates equal to the rate on 10-year Treasury Notes.[15] Other options include tying student loan interest rates to the rate of the 3-month Treasury Bill, which is typically lower than the 10-year Treasury Note,[16] or possibly even tying it to the average interest rate of all the securities issued by the U.S. Treasury.

Further investigation is also needed to determine the appropriate level for interest rate caps. When determining how to amend the current caps, one important consideration is setting a limit that is low enough to achieve the goal of providing relative consistency in interest rates for those who borrow at different times. There will, of course, be annual fluctuations that will result in a lower or higher interest rate for different borrowers who take out loans several years apart, but the difference should be nominal. A student who borrows $10,000 should not be expected to repay a substantially higher amount than a student who borrows the same amount 10 years later simply because government borrowing rates happened to be significantly higher when the student enrolled. When evaluating where to set an appropriate limit on interest rates, historical trends in Treasury rates should be considered to ensure the new cap provides meaningful consistency between students who borrow at different times and allows for only reasonable fluctuation year over year. Achieving these goals will help avoid a return to the large disparities in interest rates currently seen between individuals who borrowed federal loans at different points in time, making proposals to allow borrowers to refinance their loans into the future unnecessary.

- **Sub-recommendation 3B: Restore graduate and professional student eligibility for subsidized loans so graduate students with financial need can access loans that do not accrue interest during their enrollment.**

Rationale: The Budget Control Act of 2011 eliminated graduate student eligibility for the in-school interest subsidy as a means of reducing the federal budget deficit. With no access to federal grants, the elimination of the in-school interest subsidy harms low-income students in their pursuit of an advanced degree and leads to increased debt. Benefits for graduate and professional students are often the first targeted in the federal budget process, which leads to higher debt loads and a growing utilization of private loans with inconsistent consumer protections. Restoring the in-school interest subsidy for graduate students will ensure students from low-income backgrounds have the resources necessary to pursue graduate education.

When combined with other proposals in this recommendation, such as eliminating negative amortization, maintaining subsidized and unsubsidized loans and allowing graduate students to access the in-school interest subsidy is a much better targeted and more equitable proposal than alternative proposals such as eliminating unsubsidized loans altogether and offering subsidized loans without assessing financial need. Eliminating in-school interest accrual for all borrowers would disproportionately benefit higher-income families and could lead to an increase in borrowing. For example, parents who would otherwise pay out-of-pocket for their student's education might instead have the student borrow the maximum amount for which they are eligible and pay off the loan in full once they graduate, because the loans are interest free while the student is enrolled.

- **Sub-recommendation 3C: Once the lower interest rates recommended in Sub-recommendation 3A are implemented, automatically adjust all outstanding federal student loans with interest rates higher than the new rate to match the new lower rate.**

This recommendation is also put forth by the National Consumer Law Center.

Rationale: This one-time reset will get all borrowers to the new lower interest rate, and the revised cap on interest rates will reduce or eliminate the need for future refinancing. This adjustment should be made automatically for all borrowers for whom the new rate would be lower, and it should not require action from borrowers. Sub-recommendation 3A would ensure minimal fluctuation in interest rates from year to year, and that any differences in rates based on the date of loan origination are nominal. If substantial year-to-year differences continue despite the revised interest rate cap, borrowers should have the opportunity to refinance their loans when rates decrease by a specified amount.

[15] The Congressional Budget Office's updated budget and economic outlook for 2021 to 2031 (published July 2021) projected the 10-year Treasury Note interest rate would have an annual average of 3.2% between 2024-2025, and 2.4% between 2026-2031. https://www.cbo.gov/system/files/2021-07/57218-Outlook.pdf

[16] ibid.

- **Sub-recommendation 3D: Eliminate negative amortization for all borrowers.**

  This recommendation is also put forth by the Center for American Progress.

  Borrowers whose monthly payment is less than the amount they are charged in interest should have their monthly accrued interest charge reduced to an amount equal to their monthly principal payment.

  Rationale: Eliminating negative amortization is a well-targeted proposal providing a back-end subsidy to the lowest-income borrowers. Low-income borrowers who rely on IDR as a safety net should not experience the detrimental effects of negative amortization or face the demoralizing experience of seeing their principal balance grow despite making their required monthly payments. Eliminating negative amortization will incentivize borrowers to continue engaging with the repayment system rather than becoming disconnected altogether. What's more, it is unlikely that borrowers whose monthly payment amounts are consistently less than their interest will successfully repay their debt before receiving forgiveness, so eliminating negative amortization will likely make little difference on the amount repaid to the federal government.

- **Sub-recommendation 3E: Eliminate interest capitalization for all borrowers.**

  This recommendation is also put forth by the Center for American Progress and National Consumer Law Center.

  Interest may accrue but should never be capitalized into the principal.

  Rationale: Interest capitalization increases the amount borrowers must repay on their loans because it causes interest to accrue on interest. Capitalization is a less common occurrence with other types of consumer loans, such as auto loans and mortgages, than with federal student loans. The experience of seeing their interest capitalize, and in turn watching their balances quickly grow, can be both confusing and frustrating to student loan borrowers. The notion that a borrower will owe more and take longer to repay their loans due to interest capitalization runs contrary to the principle that the federal student loan programs should function primarily as a college access tool, not a way for the federal government to make money. ED should, as it proposed in the negotiated rulemaking committee held in October 2021, eliminate interest capitalization where it has the authority to do so through regulation. Congress should then work to pass legislation that eliminates the capitalization currently required in law and ensure this policy becomes permanent by codifying in statute the elimination of interest capitalization as a facet of the federal student loan system.

Repayment Recommendation #4: Eliminate student loan origination fees.

This recommendation is also put forth by the Higher Education Loan Coalition, NASPA - Student Affairs Administrators in Higher Education, and the Center for American Progress.

Rationale: Deemed the "student loan tax," loan origination fees are a relic of the 1980s, when additional revenue was necessary to offset loan subsidies in the now defunct FFEL Program. Though the FFEL Program no longer exists, origination fees remain. Origination fees withhold a portion of a student's loan proceeds while still requiring repayment with accrued interest on the full loan amount before the deduction of fees, thereby masking the borrower's true loan cost and compounding the confusion surrounding federal student loans. Under mandatory sequestration, loan fees are increased based on an annual adjustment percentage determined by the Office of Management and Budget. Though origination fees serve as a revenue generator for the federal government, the federal budget should not be balanced on the backs of students and families. The average undergraduate borrower in a four-year program pays an estimated $239 in origination fees and associated interest if enrolled in a standard 10-year repayment plan, while the average graduate student in a two-year program pays about $1,334 in fees and interest on those fees if repaying over 10 years.

Repayment Recommendation #5: Maintain a single loan program for graduate/professional students with borrowing limits that allow students to borrow up to the in-state cost of attendance at public institutions. Allow additional borrowing based on earnings data for the student's program of study or a debt-to-income ratio.

- Eliminate the grad PLUS Program, creating a single federal loan program for graduate and professional students. This single program would be the only federal student loan option available for graduate and professional students, but it would remain separate from the program available for undergraduate borrowing.
- Institute a borrowing limit on the loan program that is high enough to cover the public, in-state cost of attendance for the student's program of study in the state in which the institution is located, regardless of a student's state of residence and whether they are charged at the in-state or out-of-state rate. These limits should be determined by ED and should be sufficient to cover the full cost of in-state attendance, including tuition, fees, living expenses, and other non-tuition costs. A student wishing to attend a program at a private institution may borrow up to the average in-state cost of attendance (including the tuition and fee rate for in-state students) for comparable programs at public institutions in that state. These caps would be set by ED and would vary by program and state.

- Allow students to borrow beyond the annual limit if they can demonstrate they will be able to repay. Students may be approved for increased limits by passing one of two assessments:
  - A debt-to-income ratio that determines the amount of additional debt a borrower can responsibly take on based on their current income level; or
  - A review of program earnings data that demonstrates how much the borrower will have the means to repay in excess of the aggregate cap based on their anticipated future earnings. The additional amount allowed beyond the standard cap would increase as expected earnings increase. To take the onus of this review off financial aid administrators, ED could use scorecard data to approve additional borrowing amounts by program.

Rationale: This recommendation proposes a framework for reforming graduate borrowing that allows students to access graduate and professional education while also placing reasonable limitations around the federal government and taxpayers' role in funding graduate education. This framework is reasonable, especially when considering the extensive reforms to the student loan and repayment systems made throughout this paper, which will provide borrowers with more generous loan terms and repayment options. We believe it is reasonable to allow graduate students to borrow up to the amount it will cost them to attend a program at a public, in-state institution, and only borrow above that amount if justified by their debt-to-income ratio or future anticipated earnings.

This paper considers the extent to which the federal student loan programs can solve and balance issues of access, equity, and choice, and proposes a recommendation that sits at the intersection of these three values. Inequality exists in our society that cannot and should not be solved by student loans, and policymakers should aim to ensure the federal student loan programs strike the right balance between advancing postsecondary access, protecting vulnerable populations from taking on excessive and crippling debt, and asking taxpayers to play a reasonable role in supporting access to graduate education.

The goal of this recommendation is not to limit a student's ability to access graduate or professional education altogether, but instead to limit access to programs that do not deliver a return on investment that is large enough to justify their costs. Our current system promotes access to graduate and professional programs by allowing students to borrow up to the full cost of attendance, but that universal access comes at the cost of allowing some of our most vulnerable students to take on far more debt than they will ever be able to repay. Rather than continuing a system that has brought tremendous harm to many vulnerable borrowers, we believe universal access to all programs should not necessarily be the goal. Instead, we propose a system that enables access to graduate and professional programs to a reasonable extent, but does not support access to programs that will not pay off. We believe it is reasonable and necessary for the federal government to ensure students are able to borrow up to the cost of attending an in-state public program. If a student does not want to attend a program in their state of residence and instead wants to enroll in a program offered by a private or out-of-state institution, they will only be able to borrow beyond this cap if their current debt-to-income ratio or anticipated future earnings demonstrate that they will be able to successfully repay their debt.

This proposal will not impact access to programs that result in a reasonable return on investment, as students enrolling in these programs will be able to borrow up to the full cost of attendance based on the program's earnings data, even if they are attending a private institution or a public institution as an out-of-state student. If a program's cost can be justified by the increase in earnings experienced by its graduates, students will be able to borrow extra to pay for that program. Access will only be limited in cases where a student wants to enroll in a program, either at a private institution or at an out-of-state public institution as a non-resident student, where the return on investment is not strong enough to justify additional borrowing. Put simply, if a student must take on significant debt to enroll in a program, the program's outcomes should be worth what it costs them. This is a protection for both students and taxpayers.

This concept of providing aid up to only a certain amount is not unprecedented, with the Post-9/11 GI Bill covering up to the cost of public, in-state tuition and fees, in addition to the cost of living and other non-tuition expenses. Veterans who are charged out-of-state tuition at public institutions outside their state of residence receive GI Bill benefits they are eligible for up to the in-state tuition rate and are responsible for covering any remaining amount. This recommendation proposes a similar system allowing graduate and professional students to borrow at the "in-state" rate. The following examples demonstrate the standard borrowing limits, which a student could exceed if justified by either their debt-to-income ratio or the program's earnings data.

- If an Ohio resident wants to pursue a master's in teaching at a public institution in Ohio, where they would be charged the in-state rate for tuition and fees, they will be able to borrow up to the full cost of attendance to do so.
- If an Ohio resident wants to pursue a master's in teaching at a public institution in Wisconsin, where they would be charged the out-of-state rate for tuition and fees, they will be able to borrow up to the cost of attendance charged to in-state Wisconsin residents and would be responsible for covering any additional costs beyond that limit.
- If an Ohio resident wants to pursue a master's in teaching at a private institution in Ohio, they would be able to borrow up to the average in-state cost of master's in teaching programs at public institutions in Ohio.

It is important to acknowledge that any proposal to limit graduate borrowing could disproportionately impact historically marginalized groups of students, including communities of color and low-income students. These students may feel they need to attend more expensive graduate programs at selective, private institutions to be competitive in the job market compared to their non-marginalized peers. This scenario raises some questions around both moral and market values, some of which are societal and transcend the bounds of higher education. Nonetheless, extensive research and modeling is needed prior to implementation to understand the full impact of this proposal and evaluate how it will affect graduate education access and outcomes for underserved communities. The details and implementation of this framework should be informed by this research to ensure graduate education remains accessible for low-income students and students of color and that existing inequities are not exacerbated. Some topics warranting additional research include:

- The racial and socioeconomic equity implications of this proposal, including how it would impact racial and socioeconomic diversity in graduate and professional programs.
- The potential impacts on graduate enrollment at institutions that serve high numbers of low-income students and students of color, including Historically Black Colleges and Universities (HBCUs), Tribal Colleges and Universities (TCUs), and Minority Serving Institutions (MSIs).
- Whether this proposal might push more borrowers into the private loan market.
- The logistics of determining the exact metrics that should be used to set borrowing limits and determine whether a student is eligible to borrow beyond those limits.
- Whether and how aggregate loan limits might need to be adjusted. Given that annual loan limits would vary between programs and states, and that a students could enroll in programs in multiple states and at multiple degree levels, an appropriate single figure for aggregate limits would need additional research to be determined.

As mentioned in the introduction to this section, increasing front-end investment in the student aid system will go a long way in better supporting low-income students and reducing this population's reliance on student loans. There is also an important role to be played by the accountability system, which should ensure that graduate and professional programs provide students with high-quality education that translates to positive employment outcomes and increased earnings.

In addition to providing borrower protection, instituting a borrowing cap should incentivize schools to closely evaluate when increases in costs are necessary and identify strategies to support worthwhile programs with higher costs. Some institutions may wish to continue offering high-cost programs that result in lower anticipated earnings for reasons related to either the program's societal value or alignment with the school's mission. Although schools set their prices costs based on what it costs them to operate programs, the borrowing caps proposed in this recommendation may incentivize schools to devote more institutional resources to sustaining these types of programs. For example, allocating resources to offset some of what it takes to operate programs, or allocating additional funds to student aid and scholarships, will help keep costs down for students and in turn make it possible for more students to enroll.

Repayment Recommendation #6: Reform the parent PLUS Program by using a debt-to-income ratio to meaningfully assess how much a parent can responsibly borrow, and provide forgiveness of loan debt for parent borrowers who received PLUS when their incomes were at or near the poverty level.

Place reasonable restrictions on parent PLUS borrowing to manage excessive overborrowing and more meaningfully assess whether parents can repay their loans. We do not recommend setting a specific annual limit, but instead propose using a debt-to-income threshold to allow for variable limits based on a parent's income. This ratio should be added to parent PLUS underwriting and should be strong enough to protect parent borrowers while still being more generous than the private student loan market.

Currently, students whose parents are denied a parent PLUS can borrow an additional $4,000 to $5,000 in unsubsidized federal student loans, depending on their academic level. This policy should be maintained to ensure students whose parents are not approved for PLUS have access to additional resources to support their enrollment. In the case that a parent is approved for some, but not all, of the loan amount they requested based on their debt-to-income ratio, their dependent student may borrow an additional amount that is the difference between the independent student maximum and the amount for which the parent was approved. For example, if a parent applied for $10,000 but was only approved for $7,500, their dependent student could borrow an additional $2,500 in unsubsidized student loans. The additional amount a student could borrow if their parent is denied for a parent loan (in part or in full) would be capped at the $4,000-$5,000, depending on their academic level.

In an effort to hold harmless parents who have been adversely impacted by the current Parent PLUS system, FSA should institute a process to review and provide forgiveness of loan debt for borrowers who received PLUS loans when their incomes were at or near the poverty level and should have never been approved for the loans.

Rationale: When the parent PLUS Program was created, it had an annual borrowing limit of $4,000. In 1993, that limit was abolished and replaced with a borrowing limit of the student's cost of attendance minus aid received, with no aggregate limit, creating a program with nearly limitless borrowing. To protect parent borrowers from taking on debt they will never be able to repay, we propose implementing a debt-to-income ratio to determine the amount of PLUS a parent can take on and reasonably repay. Rather than setting an across-the-board annual limit, this ratio would keep parent borrowing at a reasonable level based on the household income and allow parents whose income demonstrates they can afford higher monthly payments to borrow more within the safe confines of federal loans.

As is the case with graduate borrowing, inequality exists in our society that cannot and should not be solved by student loans. Policymakers should aim to ensure the federal student loan programs strike the right balance between advancing postsecondary access while protecting people from borrowing significantly more than they'll ever be able to repay. In recent years, controversy has surrounded the parent PLUS Program as reports show a large percentage of parent PLUS borrowers are unable to pay, are putting off retirement, or are borrowing from their retirement savings to repay their loans. The program once touted as a progressive step toward advanced postsecondary access has become regressive for too many parents who are carrying a lifelong burden of debt they will never have the means to repay. There now exists a necessity to balance predictability of funding for parents with building in protections for borrowers.

While the parent PLUS Program should not exacerbate racial inequity or widen existing disparities in generational wealth, it is also important to acknowledge the potential impact limiting parent borrowing could have on the postsecondary access of low-income students and students of color, who may be forced to turn to higher-cost borrowing, like credit cards or private lenders, if access to parent PLUS is limited. Similar to the recommendations related to graduate and professional student borrowing proposed above, additional analysis is needed to further explore the racial and socioeconomic equity implications of this recommendation. Extensive research and modeling should evaluate how this proposal will impact historically marginalized groups of students. This research should be used to ensure the parent PLUS Program protects parent borrowers without exacerbating existing inequities in college access, and should examine topics including:

- The racial and socioeconomic equity implications of this proposal, including how it will impact the postsecondary access and success of low-income students and students of color.
- The potential impacts on HBCUs, TCUs, and MSIs, including student access and impact on institutional revenues.
- Whether and how this proposal will increase reliance on private student loans.
- How restrictions on borrowing might impact parents who plan to borrow loans for multiple children.

Finally, and perhaps most importantly, as discussed in the background and Repayment Recommendation #5, additional investments in need-based aid are critical to ensuring access for low-income students. This is especially true for students whose parents cannot borrow PLUS because of their debt-to-income ratio.

Repayment Recommendation #7: Reform the Public Service Loan Forgiveness Program

This recommendation is also put forth by the Higher Education Loan Coalition, NASPA - Student Affairs Administrators in Higher Education, and the Center for American Progress.

- **Sub-recommendation 7A: Update the timeline for the Public Service Loan Forgiveness Program to provide rolling forgiveness opportunities, forgiving $5,000 in debt after each two years of time in public service.**

  For borrowers who still have loan debt left after 10 years of working in public service, PSLF would forgive their remaining balance as it does under the current system. The average undergraduate borrower graduates with $28,000 in student loan debt. Under this rolling forgiveness proposal, they would see their loan debt shrink to $9,000 after 10 years of service, giving them reduced payments and less accrued interest during their 10 years of service until their debt is ultimately forgiven.

  Rationale: The PSLF Program was created to encourage students to pursue and commit to vital public service careers without fear that their student loan payments will follow them for decades. While not a fix-all for the debt problems plaguing today's borrowers, the PSLF Program is of high value to both students and society, but it needs to be evaluated and strengthened to ensure it is an efficient, simple, fair program for borrowers working in public service. Some borrowers intend to pursue careers in public service but are unable to do so for various reasons. Borrowers who devote fewer than 10 years to public service (e.g., three, five, or seven years) also deserve some subsidy, given the large subsidy available to others after 10 years. Rolling forgiveness would also provide some compensation to borrowers who enter into a public service job but are let go before 10 years of service for reasons out of their control.

  Rolling forgiveness, rather than one-time forgiveness at the end of the 10-year period, will also give borrowers more certainty that they are on the right path to receive forgiveness, and avoid situations where borrowers believe they are working toward PSLF Program forgiveness only to find out after 10 years that they have not been on the correct track to have their debt discharged. Forgiving an amount of debt after each two years of public service will also boost public confidence in the program, likely enticing more borrowers to enter public service with a renewed trust that their service will lead to forgiveness.

  The recent Affordability and Student Loans negotiated rulemaking committee featured robust discussions around what should be considered eligible employment under PSLF. Although some negotiators proposed PSLF eligibility for all borrowers with public service job functions, regardless of whether they work for a 501(c)(3) nonprofit or a for-profit organization, ED emphasized this would not be possible based on available data. For this reason, this paper does not include a recommendation around this topic.

- **Sub-recommendation 7B: Ensure all borrowers who are eligible to benefit from the current Public Service Loan Forgiveness waiver are able to do so before the flexibilities are ended.**

  The flexibilities granted by ED's PSLF waiver, introduced in fall 2021, aim to correct bureaucratic errors which may have prevented some borrowers from qualifying for forgiveness. To ensure borrowers are held harmless for errors that weren't their own or for misunderstanding the program's confusing and previously poorly communicated requirements, ED and Congress should ensure all borrowers who could benefit from the waiver are able to do so before the flexibilities are ended.

  Rationale: Some have called to make the provisions included in the PSLF waiver permanent. However, indefinitely extending the waiver should not be necessary once ED has conducted a review of all borrowers to determine whether they will benefit from the flexibilities and be credited additional payments as appropriate. Ensuring as many borrowers as possible are able to benefit from the waiver will help those who have been harmed by previous administrative errors and poor communication surrounding the program, and the improvements to the PSLF Program proposed in this recommendation will ensure future borrowers can better understand and more easily navigate PSLF. Additionally, the reforms to simplify the overall repayment system proposed in Repayment Recommendation #1, including reducing existing repayment options to just three plans, should make it easier for servicers to communicate which plans are eligible for PSLF and send targeted outreach to borrowers if they select a repayment plan that is not eligible for PSLF. The goal of the waiver is to clean up the mess made by more than a decade of poor communication and administration. Rather than accepting bad outcomes, this recommendation aims to both hold borrowers harmless from past mistakes and fix the program going forward so past wrongs are not continued and similar waivers are not needed in the future.

- **Sub-recommendation 7C: Allow all Federal Family Education Loan borrowers who consolidate into the Direct Loan Program to count previous payments toward forgiveness under the Public Service Loan Forgiveness Program.**

  This recommendation is also put forth by the National Consumer Law Center.

  Rationale: Allowing borrowers with FFEL to count payments made prior to consolidation towards PSLF is one element of the current waivers that should be retained indefinitely. Currently, in order to participate in PSLF, borrowers with FFEL Program loans must consolidate into the Direct Loan Program, and any payments made prior to the consolidation do not count towards PSLF. PSLF was initially restricted to Direct Loans to encourage schools to participate in the Direct Loan Program, an incentive that is no longer necessary. From a servicing perspective, it is most practicable for FFEL borrowers to consolidate into the Direct Loan Program in order to participate in PSLF, but these borrowers should be held harmless and be able to count their previous payments toward forgiveness. This will allow FFEL borrowers who do not consolidate into the Direct Loan Program prior to the end of the waiver period to receive credit for payments they've already made. Doing so will require statutory changes from Congress, as ED does not have the authority to count previously made FFEL payments toward PSLF outside of the current emergency waiver.

- **Sub-recommendation 7D: Take steps to minimize borrower confusion and bolster public confidence in the Public Service Loan Forgiveness Program.**

  ED should:

  - o Strongly encourage the submission of annual employment certification forms, increase outreach to borrowers about the program, and ensure borrowers receive effective messaging that informs them if they are on a plan that is not eligible for PSLF.
  - o To the greatest extent possible, use administrative data to automate the PSLF enrollment process, including maintaining a database of eligible employers. The Department indicated in the Affordability and Student Loans negotiated rulemaking committee that it was committed to doing this.
  - o Increase outreach to eligible employers, in addition to increasing borrower communication. This should be relatively easy for ED given that it now has a database of eligible employers.
  - o Provide more publicly available data about the PSLF Program's cost, effectiveness, and integrity.

  Rationale: Efforts to rectify the program's previous errors and mishaps, such as by ensuring all eligible borrowers benefit from ED's fall 2021 PSLF waiver, encouraging annual submission of employment certification forms, and increasing and improving outreach to borrowers and eligible employers, will also go a long way in delivering on the program's original promise to support borrowers who devote their careers to public service. Ensuring that current borrowers who have been wrongfully denied PSLF receive the forgiveness they are entitled to will boost confidence in the program, paving the way for future students and borrowers to enter public service trusting that they will eventually see the benefits from a reliable PSLF Program.

Student Loan Default

Background

More than seven million Americans are in default on their student loans, representing roughly one in six of the nearly 43 million Americans holding federally managed student debt and one in five of those with loans who have entered repayment.[17] In the year prior to the COVID-19 pandemic, more than one million Direct Loan borrowers defaulted and, although many do exit default, in FY2017, more than 100,000 borrowers defaulted for at least a second time.[18] The challenges surrounding student loan default are extensive and emblematic of "deep structural inequities, discrimination, and racism not only in our system of higher education but also in the foundation of how families access capital and build wealth."[19] But it is also a problem that we know relatively little about, in part due to a lack of quantitative and qualitative data about borrowers' experiences in default and in part because of the complexity of the system itself.

This section provides an overview of what it means to default on a federal student loan, an exploration of existing research on which borrowers are most likely to default, and an examination of opportunities and recommendations for policy-related reform. Although additional issues exist with the older (and now defunct) FFEL Program, this section primarily addresses processes and solutions related to Direct Loans.

What Does It Mean to Default on a Student Loan?

When borrowers enter repayment, their loans are managed by federal contractors called student loan servicers. They are able to choose from among a host of repayment plans, including a suite of income-driven plans (IDRs) that tie payments to borrowers' incomes and family sizes and result in lower monthly payments and rates of default for many. Borrowers also have the ability to pause payments using deferments and forbearances if they experience financial hardship or return to school, among many other reasons. (During the pandemic, the government has paused student loan interest, payments, and collection efforts for most borrowers through at least the end of April 2022. After expanding these protections to all borrowers in default, no loans have entered default since March 2020.)

Typically, when borrowers miss 270 days of required payments, they default on their loans and eventually enter an entirely different system managed by a different set of federal contractors. The pre-default student loan repayment system is already complex and confusing for borrowers, and the post-default system, often including multiple hand-offs, is equally, if not more, opaque.

Day 270-360

- While borrowers are technically in default when they have missed 270 days of payments, they remain with their pre-default servicers for approximately 90 days.
- During this time, the pre-default servicer can still attempt to help borrowers bring their loans out of default by making payments or using deferments or forbearances.

Day 360-425

- After 360 days of missed payments, the pre-default servicer transfers the loan to the Department of Education (ED) Debt Management and Collections System (DMCS). The Default Resolution Group (DRG) manages collections for ED-held loans that are in default. DMCS and the call centers operated by DRG are both managed by Maximus, the federally contracted loan servicer for borrowers in default. (Maximus also recently took over Navient's pre-default federal student loan portfolio.)
- At this point, borrowers lose eligibility to use income-driven repayment plans, deferments, and forbearances.
- According to ED, "during this period, the borrower is sent a due process notice and provided an opportunity [for approximately 60-65 days] to enter voluntary repayment or prove the debt should not be in collections"(p. 30). If borrowers do so, their loans are not sent to a private collection agency (PCA) and they are not assessed collection fees. (Recently, ED ended its contracts with PCAs, and it is still unclear what this means for the future of the default system.)
- Importantly, default-related notices are sent to borrowers' last known addresses, and they are otherwise contacted using the most recent contact info on file. If a borrower has moved or ED/federal contractors do not have the most recent contact information, borrowers may not receive this information.

[17] Thirty-five million borrowers with federally managed loans are not in "in-school" or "grace period" statuses.

[18] This is the latest time period for which data are available.

[19] https://www.barrons.com/articles/a-path-forward-for-the-one-in-five-student-loan-borrowers-in-default-51636123063

Day 425+

- The default is reported to national credit bureaus.
- Previously, loans would have been assigned to a PCA.
- The processes for initiating Treasury offset of tax refunds and certain federal benefits and garnishing borrowers' wages may begin.
- Borrowers are charged collection fees.
- ED may initiate litigation.

If borrowers exit default, they experience yet another hand off as their loans are transferred back to a pre-default servicer, which may be a different servicer than their previous pre-default servicer.

Who Is Most Likely to Default?

Research over the last few decades, but especially recently as more data have become available, has highlighted a host of groups that are more likely to default than their peers. Many of these borrowers come from traditionally underserved communities which often have multiple risk factors and have been disproportionately bearing the brunt of the pandemic. As a result, default can exacerbate existing financial insecurity and economic disparities.

Several papers have highlighted that 17% of first-time students (and 29% of first-time students who borrowed) who began school in the early 2000s defaulted on their loans within 12 years. And borrowers continue to default beyond this period; one analysis suggests that close to 40% of these borrowers may ultimately default on their loans.

However, default is not a terminal status: The median length of time to default once borrowers enter repayment is between two and three years, and the typical defaulter remains in that status for almost three years. Importantly, many borrowers default more than once. A recent study found that, within five years of defaulting, 25% of borrowers re-default.

Populations most likely to default:

- **Borrowers of color, particularly Black borrowers:** Using the same dataset described above, researchers found that 12 years after entering college approximately half (49%) of Black borrowers defaulted compared to 21% of white and 36% of Hispanic or Latino borrowers (whose rates of default are also above the national average of 29%). In fact, this disparity exists even among those who complete a bachelor's degree. According to one study, Black graduates default at higher rates than white borrowers who do not complete a degree or credential. These trends have continued over time and the gap in rates of default by race remains significant even when researchers control for a host of demographic and background factors like income, wealth, and college completion. In addition, American Indian or Alaska Native students also default at disproportionately high (41%) rates.
- **Noncompleters:** Students who borrow for but do not complete a degree or credential default at higher rates than their peers who do, although students who complete a certificate also have high rates of default. One study found that, among the group of students who started school in the early 2000s (as described above), those who dropped or stopped out "are more than twice as likely to have defaulted within 12 years as those who completed a credential within six years... (23% vs. 11%) [and that] this trend is true across all school types and student characteristics."
- **Low-balance borrowers:** Relatedly, those with less than $10,000 in debt have the highest default rates, often because they spend short amounts of time in school and do not complete a degree or credential. The typical nondefaulter borrows approximately twice as much.
- **Nontraditional, older, and independent borrowers:** One analysis indicates independent students default at high rates regardless of the amount borrowed and another underscores that borrowers over age 65, who might have decreased or fixed incomes in retirement, are also disproportionately struggling to repay.
- **Low-income, low-wealth, and low-resource students:** Borrowers with low incomes and fewer family resources are more likely to default no matter how much they borrow. Relatedly, Pell Grant recipients both borrow more and default at higher rates than those who don't use Pell. Defaulters also often experience other forms of financial insecurity, including unemployment or volatile incomes, use public benefits, or have other forms of debt in collections.
- **For-profit college attendees:** Default trends among those who attend for-profit colleges are also cause for concern. Those who enroll at for-profits have higher default rates than those who attend public colleges (both 2- and 4-year) and private, nonprofit schools, often by several orders of magnitude. These trends persist even after controlling for demographic and other background characteristics.
- **Other populations:** Student parents, veterans, first-generation college students, and students with disabilities all also have above-average rates of default. Relatedly, those most likely to default often experience multiple risk factors and are also more likely to borrow. For example, Pell recipients are more likely to be first-generation students and independent students. And while Black students and for-profit students each have high rates of default, one analysis highlights that 75% of Black students who drop out of proprietary institutions default.

A host of in-repayment behaviors, actions, and activities are correlated with default. For example, borrowers using IDR plans have lower rates of default than their peers enrolled in the standard plan. Entering an IDR plan often lowers borrowers' monthly payments, which directly contributes to lower levels of default. But those who are less likely to default may also be likely to seek out and use these programs.

As previously mentioned, there are also a host of in-repayment behaviors, actions, and activities correlated with default. For example, borrowers using IDR plans have lower rates of default than their peers enrolled in the standard plan. Entering an IDR plan often lowers borrowers' monthly payments, which directly contributes to lower levels of default. But those who are less likely to default may also be likely to seek out and use these programs.

Evidence is mixed on how often and when defaulters use deferments and forbearances, indicating there are likely different repayment patterns among defaulters. Some do not make payments or use pauses and thus default quickly after entering repayment, signaling high levels of financial distress and/or difficulties using, lack of awareness of, or the insufficiency of the tools available to help them avoid default. Others default several years or more after entering repayment, potentially signaling they are experiencing the same issues that arose for quick-defaulters but were able to make some payments or used tools to postpone default. A recent GAO study also flagged that when borrowers are encouraged (and choose) to use forbearances early in repayment, the cohort default rate (CDR) becomes a less effective accountability tool.

While rates of default differ significantly across some population subgroups, what is predictive of entering default is not always predictive of exiting default. For example, completers and noncompleters exit default at similar rates, according to one study. And Black and white defaulters bring their loans back into good standing at similar speeds. Low-balance borrowers tend to exit default more quickly than those with higher balances, largely because they have less to repay and the government has extraordinary powers of collection.

How Can Borrowers Exit Default?

Once in default, borrowers can exit by making voluntary payments (described in this section) or having funds involuntarily withheld (described in the next section).

- **Full loan payoff:** Borrowers can exit default by paying their full outstanding principal, interest, and any related collection fees. Such a large outlay of funds is likely to be a challenge for many.
- **Rehabilitation:** Borrowers can exit default by making nine payments within a 10-month period by entering a rehabilitation agreement. Once a borrower rehabilitates a loan, the default is removed from their credit report, though records of pre-default delinquent payments are not removed. Borrowers may only rehabilitate a loan one time.

  Payments can be as low as $5 per month and are based on:

  - An income-based repayment plan formula of 15% of the borrower's discretionary income, defined as "the amount of your adjusted gross income (from your most recent federal income tax return) that exceeds 150 percent of the poverty guideline amount for your state and family size."
  - Borrowers can instead request to make payments based on their incomes and expenses. This process typically lowers payments while a borrower is working to exit default, but it can also mean payments jump significantly when borrowers reenter repayment, since no repayment plans take expenses into account.

  A few additional, important notes about rehabilitation:

  - For borrowers in default, each month of the current pandemic-related payment pause counts as a loan rehabilitation "payment" if the borrowers are in rehabilitation agreements, meaning borrowers eligible for a rehabilitation can currently bring their loans back into good standing without making any payments.
  - Borrowers in default are ineligible for federal student aid, but they can regain eligibility after making six months of rehabilitation payments, (although they will not exit default until completing all rehabilitation payments).
  - Borrowers in default who are having their wages garnished are eligible (one time) to have the garnishment lifted after making five months of rehabilitation payments (which must be made in addition to the existing wage garnishments). However, Treasury offsets will continue until the borrower has completed all rehabilitation payments.
- **Consolidation:** Consolidating existing loans into a new loan by making three on-time payments or enrolling in an income-driven repayment (IDR) plan is another option available to defaulted borrowers. This approach allows borrowers to exit default because their new consolidated loan is not defaulted. Similar to rehabilitation, certain loans are not eligible for consolidation and borrowers are usually only able to consolidate one time. Unlike with rehabilitation, borrowers who exit default through consolidation do not have the default removed from their credit history. When a borrower consolidates, any months previously counted as qualifying payments toward IDR or PSLF are typically lost because the consolidated loan is considered a new loan. Despite this drawback, borrowers with FFEL Program loans may benefit from access to IDR plans, PSLF, and other loan discharge options that become available through consolidation. ED is currently considering changes through an ongoing negotiated rulemaking process that would address this issue of pre-consolidation payments counting toward IDR and forgiveness under PSLF, and the issue is also being addressed through a temporary PSLF waiver.

Borrowers are not permitted to consolidate defaulted loans that are being collected via wage garnishment or "in accordance with a court order after a judgment was obtained" against them until those statuses have been lifted.

- **Settlement agreements:** According to ED, "settlements and compromises are only available to defaulted borrowers and are intended as a last resort after other repayment options have been exhausted. Specific guidance related to settlements and compromises is confidential, given that publicizing this information is not in the best interest of the government as it could enable borrowers to reduce their repayments below the amount they can legitimately afford." However, recent research indicates settlements typically allow borrowers to pay slightly less than the total amount they owe.

- **Discharge or cancelation:** Borrowers in default may be eligible for existing loan cancelation programs, including for total and permanent disability (TPD) or borrower defense to repayment, among others.

What Are the Consequences of Default?

Borrowers face a host of severe consequences when they default, and if they do not enter into an arrangement to voluntarily repay their defaulted loans, the government has vast powers of collection to compel payment (i.e., "involuntary" payments). While a handful of largely insufficient protections are built into this process — and borrowers can request hearings, account reviews, and exemptions or reductions for financial hardship — there is no time limit for collection on federal student loans and borrowers can have higher monthly payment amounts and shorter repayment periods while in default than when their loans are in the pre-default repayment system.

- **Debt, including both principal and interest, immediately becomes due in full.** This is called "acceleration," and it allows the full value of the borrower's debt to be collected simultaneously through multiple mechanisms.

- **Borrowers lose access to benefits, protections, and federal aid.** When borrowers default, they can no longer use IDR plans or access the related forgiveness, deferments, or forbearances. In addition, they become ineligible for other federal student aid under Title IV of the HEA and other federal aid programs, such as some that help with homeownership.

- **Borrowers' wages can be withheld via Administrative Wage Garnishment (AWG).** This is a process through which up to 15% of a borrower's disposable income can be collected from their paychecks until a loan is paid off, they exit default, or the wage garnishment is lifted (such as via rehabilitation). Borrowers are permitted to keep, garnishment-free, $217.50 per week, which is the equivalent of working 30 hours per week at the federal minimum wage of $7.25 per hour. However, policymakers and researchers have long indicated that the minimum wage is not a livable wage for families.

- **Through the Treasury Offset Program (TOP), federal tax refunds, benefits, and refundable tax credits can be withheld.** These resources are a lifeline for low-income families. Similar to AWG, these funds can continue to be withheld until a loan is repaid in full or a borrower otherwise exits default. Among other federal payments, benefits and tax credits can include the Child Tax Credit; the Earned Income Tax Credit; and Social Security payments including retirement, survivor, and disability benefits. In general, the government cannot take more than 15% of benefits and no amounts below $9,000 per year ($750 per month).

- **Borrowers face negative credit bureau reporting.** When borrowers miss 90 days of payments, servicers report the delinquencies to the national credit bureaus. Defaults are also reported and can stay on a credit record for up to seven years.

- **In addition:**
  - Borrowers can be charged collection fees as high as 24% of their loan balances,
  - The government may pursue litigation, and
  - Interest continues to accrue while a borrower is in default.

Considerations for Improving Student Loan Default

The following section includes recommendations to improve the default system to be more borrower-friendly. These recommendations are grounded in three principles reflective of the objectives outlined in the Executive Summary.

1. Guardrails should be in place to help struggling borrowers avoid entering default altogether and make it easier for those who do default to return to good standing.
2. Default should be less punitive and should both minimize additional hardship and maximize support for struggling borrowers.
3. Borrowers who are able to meet their obligations should be incentivized to make monthly payments.

Though a primary goal of the recommendations offered is to help borrowers avoid entering default, there will always be individuals who don't make their monthly payments and, under the current system, will eventually default on their loans. There have been proposals to eliminate default entirely as a facet of the federal student loan system. While these proposals are justified in questioning the punitive nature of the existing default system, having a mechanism in place to ensure borrowers who are able to make monthly payments are incentivized to do so is critical. As such, we propose maintaining default as a status, with reforms to make default more borrower-friendly, less punitive, and easier to exit.

When proposing improvements to student loan default, it is important to recognize there are diverse types of borrowers who experience default. Many borrowers enter default because they are experiencing economic distress and are unable to make payments due to unique financial circumstances, even under an IDR plan. Others may be financially comfortable and simply choose to ignore their repayment obligation. While the latter of these groups is likely small, an effective default system is one that can incentivize high-earning borrowers to continue making their payments without placing overly punitive consequences on borrowers who are genuinely struggling, and target resources and support toward borrowers who need additional assistance.

A final group that is important to acknowledge are those borrowers who, despite persistent outreach from ED and servicers, are fully disengaged from the repayment system. These are borrowers who either never began making payments once they entered repayment or have not made a monthly payment over multiple months and years, and they are unresponsive to all communications from ED and their servicer. Although it is important to continue efforts to reengage these borrowers in the repayment system, there are limited policy levers available to help struggling borrowers who cannot be reached. The recommendations that follow aim to provide ample opportunities for borrowers to avoid entering default and, for those who still default, to minimize the punitive consequences that can be life-altering for vulnerable individuals.

Recommendations

These servicing recommendations are put forth by NASFAA, the American Association of Community Colleges, the National Association of College and University Business Officers, Higher Education Loan Coalition, and NASPA - Student Affairs Administrators in Higher Education. Additional supporters of individual recommendations are listed below each recommendation.

Recommendations to Help Borrowers Avoid Default

Student Loan Default Recommendation #1: Bring all borrowers currently in default into good standing as part of the resumption of student loan repayment following the COVID-related suspension of monthly payments.

This recommendation is also put forth by the National Consumer Law Center, the Center for American Progress, and New America Higher Education Program.

ED should use its authority under the Higher Education Relief Opportunities for Students Act (HEROES Act) of 2003 to provide flexibilities that will help defaulted borrowers exit default through rehabilitation during the COVID-19 emergency.

- ED should allow defaulted borrowers to retroactively count each month of suspended payments, dating back to March 2020 when the national emergency began, as a qualifying rehabilitation payment. Borrowers should be automatically transferred out of default through this retroactive rehabilitation process by waiving the requirement that borrowers proactively elect to enter a rehabilitation agreement. Borrowers should be provided with the option to opt-out of retroactively rehabilitating their loans.
- Waive the one-time limit on rehabilitation to ensure borrowers who have already used rehabilitation to exit default are able to do so again, and borrowers who have never used rehabilitation will be able to access rehabilitation in the future.
- Minimize barriers and provide easier access to IDR enrollment for borrowers exiting default.
  - o Through the HEROES Act, temporarily allow borrowers, including those exiting default, to self-certify their income and family size for IDR enrollment.
  - o Allow borrowers whose loans were retroactively rehabilitated to count the months of paused payments following what would have been their 9- to 10-month rehabilitation period toward forgiveness retroactively.

- o Employ a robust and targeted outreach campaign aimed at ensuring borrowers removed from default at the end of the repayment pause do not re-default and experience additional punitive consequences. This should include repeated communications offering borrowers the opportunity to provide consent for ED to access their tax information and automatically enroll them in IDR.

Rationale: Some borrowers who were in default at the onset of the COVID-19 pandemic have since returned to good standing thanks to ED counting each month of the repayment pause as a qualifying rehabilitation payment. While this has helped borrowers to exit default if they were already in rehabilitation at the onset of the pandemic or began the rehabilitation process early in the national emergency, other defaulted borrowers who did not elect to or were not eligible to rehabilitate their loans during the payment suspension have not benefited from this flexibility.

The upcoming return to repayment offers an unprecedented opportunity for ED to help give borrowers experiencing the punitive consequences of default a fresh start. Taking steps to place all borrowers who are currently in default back into good standing is both good for borrowers and good for the federal student loan system because it reengages many individuals who have not interacted with the repayment system in years. To maximize benefits and give borrowers the best possible chance of success once in good standing, it is essential that ED allow these borrowers to exit default without seeing their interest capitalize. The one-time limit on rehabilitation should be waived to allow borrowers who have previously rehabilitated their loans to be able to do so again, and this automatic, retroactive rehabilitation should not count toward the one-time limit for those who have not previously used rehabilitation.

Enrolling in an IDR plan after defaulting has been shown to drastically reduce the likelihood that a borrower re-defaults, with those who enrolled in IDR five times less likely to default again. As such, ED should use its HEROES Act authority to make it easier for borrowers to enroll in IDR following this automatic/retroactive rehabilitation by temporarily allowing for self-certification of income and family size. While ED is planning to allow this for borrowers as they enter repayment after the current pause ends, it is essential to ensure this option is available for those exiting default.

Directing borrowers exiting default into IDR will also ensure the additional months of paused payments following the completion of their rehabilitation are counted toward IDR forgiveness. ED could also consider allowing borrowers whose loans were retroactively rehabilitated to retroactively count the months of paused payments following what would have been their 9- to 10-month rehabilitation period toward forgiveness, as if they had begun their rehabilitation at the beginning of the payment pause.

Though worthwhile, it is important to note that these recommendations would have significant financial implications for the Department and its contractors. Most notably, the loans of over 7 million people would have to be reassigned to a different servicer in order to automatically bring defaulted borrowers into good standing. This would require ED to pay servicers to manage these loans and ensure adequate oversight and resources to help these borrowers remain in good standing and avoid defaulting again once repayment resumes.

Student Loan Default Recommendation #2: Whenever possible, automatically enroll delinquent borrowers in income-driven repayment before they enter default.

- We have previously proposed providing borrowers with three repayment plans to choose from: a single IDR plan, a standard 10-year plan, and an extended 25-year plan (borrowers with graduate debt only). The automatic option is the IDR plan.
- For borrowers enrolled in a standard or extended plan who become delinquent, ED should begin the process of automatically enrolling the borrower in the IDR plan.
  - o When a borrower is 60 days delinquent, ED uses their income information on file at the IRS to send a personalized notice informing the borrower that:
    - ◆ They have lower monthly payments available to them under IDR.
    - ◆ They may apply for an economic hardship deferment, which would also pause their interest.
    - ◆ Their credit will be negatively impacted after 90 days of delinquency, at which time their loan servicer will report the delinquency to the three major national credit bureaus.
    - ◆ They have 60 days to either enroll in an IDR plan or make payments on their current plan. If they don't take any action by day 120 of delinquency (60 days after receiving the notice), they will be automatically enrolled in IDR.
  - o If the borrower has not acted on this information and is continuing to progress toward default by the time they are 120 days delinquent, they are automatically placed in an IDR plan.
  - o Once enrolled in IDR, if the borrower has a payment amount greater than $0, they will be given 60 days to make a payment on their new IDR plan. If they have not made a payment in the first 60 days that they are enrolled in IDR (by day 180 of delinquency), they will be sent another notification about the opportunity to apply for an economic hardship deferment. If they still have not taken action by day 240, they will receive a final notification that they will enter default on day 270. If there is no action by then, the borrower will enter default after day 270.

- For borrowers enrolled in the IDR plan who become delinquent, ED will begin sending notices no less often than every 60 days reminding the borrower about the opportunity to apply for an economic hardship deferment. If there is no action on the borrower's part by day 270, they enter default. These notifications sent to delinquent borrowers by ED should be in addition to outreach sent by student loan servicers. To the extent possible, loan servicers should be enabled to access borrower contact information (such as the borrower's address) from the IRS to facilitate successful borrower contact.

Rationale: Research suggests potential benefits to automatically enrolling borrowers in IDR, particularly for the borrowers most likely to struggle in repayment. As previously mentioned, borrowers who do not enroll in an IDR plan upon exiting default are five times more likely to re-default. Because borrowers enrolled in IDR have a greater chance of success after exiting default than their peers enrolled in a standard plan, automatically enrolling delinquent borrowers in IDR will help many vulnerable borrowers remain in good standing and avoid the punitive consequences of default altogether. Once enrolled in IDR, the lowest-income borrowers — those with monthly payments of $0 under an IDR plan — will continue to remain in good status and avoid default without having to pay anything each month. Many other borrowers with an IDR payment greater than $0 will be able to comfortably make monthly payments of an affordable amount.

The process of enrolling borrowers in IDR should be as automatic as possible, minimize what is required of borrowers to the greatest extent possible, and rely heavily on the data-sharing provisions included in the FUTURE Act. The Department's proposal offered during the fall 2021 Affordability & Student Loans negotiated rulemaking committee would allow ED to automatically enroll borrowers who have not made a payment in 80 days in whichever IDR plan would result in the lowest monthly payment, if the data needed to calculate the borrower's payment can be accessed. Under this plan, ED could automatically place borrowers in IDR, without the borrower submitting an application, so long as the borrower has already consented to the disclosure of their applicable tax information. Allowing for automatic IDR enrollment for any borrower who has already consented for their tax returns to be shared will provide struggling borrowers with quick and seamless access to a safety net and will give them a chance to return to good standing before they default.

Although allowing ED to access tax information without borrowers first needing to opt into the data-sharing would be the most effective way of automatically enrolling borrowers in IDR, the FUTURE Act includes privacy provisions that require borrowers to give active consent for their tax data to be shared between the IRS and ED for the purpose of IDR enrollment. As a result, a consent process that is fast, easy, and straightforward is the linchpin to ensuring auto-IDR is a useful tool in assisting struggling borrowers.

ED's negotiated rulemaking proposal would require borrowers to consent to the disclosure of applicable tax information needed for automatic IDR recertification as part of completing a Master Promissory Note (MPN) when taking out a Direct Loan or applying for Direct Loan Consolidation. Requiring this consent as part of the MPN will ensure all borrowers taking out Direct Loans in the future have already provided the consent needed to be seamlessly enrolled in IDR. However, ED will still need to get consent from borrowers who are already in repayment in order to enroll those borrowers in IDR.

For borrowers already in repayment who have not yet given consent to having their tax information disclosed, ED has proposed requiring them to do so as part of their application to enroll in an IDR plan. Building consent into existing steps in the loan and repayment system will make the process of enrolling in IDR as automatic as possible for borrowers. ED will be able to automatically retrieve the tax returns of individuals who give consent as part of either signing an MPN or submitting an IDR application, meaning unmarried borrowers and married borrowers who filed jointly with their spouse will not be required to provide additional consent or take additional action in order to be automatically enrolled in IDR. However, because borrowers cannot be automatically enrolled in IDR without consenting to the disclosure of their tax information, individuals who have not provided consent on either an MPN or IDR application will need to take action to do so.

Two groups of borrowers should receive additional targeted outreach from ED to obtain the consent necessary for auto-IDR enrollment. The first is struggling borrowers who are already in repayment (i.e., they will not give consent through a new MPN) and do not apply to enroll in IDR on their own (i.e., they have not given consent through an IDR application). The second is married borrowers who filed their tax returns separately from their spouse rather than jointly. In these cases, even if ED has consent to access the borrower's individual tax information from either the MPN or IDR application, their IDR enrollment cannot be completed unless the spouse also gives consent for ED to access their tax information. While this requires additional action on the part of the borrower and is not as automatic as the enrollment of single and married borrowers who file jointly, this process is more streamlined than it is currently, and it strikes the important balance of ensuring individuals consent to disclosure of their tax information.

To help delinquent borrowers before the default, it is imperative that ED conduct proactive outreach to get consent from those who have not yet provided it and to notify borrowers if they need their spouse's consent to enroll in IDR. This outreach should include relevant links and instructions to make it as easy as possible for borrowers and spouses to provide necessary consent. Information on providing consent should be incorporated into the communications ED and servicers send to delinquent borrowers, including the notices sent to borrowers after 60 days of missed payments.

Student Loan Default Recommendation #3: Develop additional safety nets for struggling borrowers who are still at risk of default despite being enrolled in income-driven repayment.

ED should increase the flexibility of IDR and the economic hardship deferment to ensure they are available to assist struggling borrowers in unique circumstances who are not able to make their monthly payments but either do not qualify for a $0 payment through the standard IDR formula or are not eligible for IDR (i.e., parent borrowers). The increased flexibility should help prevent default by borrowers who have legitimate reasons for being unable to make payments, but still include enough guardrails to prevent fraud and abuse.

ED should:

- Create a process for IDR borrowers struggling to make monthly payments to request an adjustment in their monthly payment amount due to unique circumstances. Although there is an existing process for IDR borrowers with reductions in income to request a change in their monthly payment amount, ED should expand this process to allow for consideration of costs for necessary expenses that can be prohibitively high, such as medical bills or child/elder care, and allow a borrower's IDR payment to be adjusted to an amount that is reasonable based on their circumstances, including as low as $0. The economic hardship deferment should also be modified to allow for consideration of expenses that impact a borrower's ability to make their monthly payments.

- Improve outreach and communication to delinquent borrowers and relevant state entities that assist struggling borrowers to ensure borrowers are made aware of and able to easily request a special circumstances IDR review or an economic hardship deferment.

- Ensure borrowers whose circumstances justify an economic hardship deferment continue to receive credit toward IDR forgiveness for each month they are in the deferment. This is currently happening, as specified in regulation, and should continue in a simplified, streamlined IDR system.

- Interest should not accrue for the duration of an economic hardship deferment. This should be the case for all loans, regardless of the type of loan and whether or not it is subsidized.

- Borrowers in an economic hardship deferment should be reevaluated annually to determine whether their circumstances justify remaining in deferment status.

Rationale: While automatic IDR enrollment as proposed above will act as an effective safety net to protect many struggling borrowers from slipping into default, there will likely be a small group of borrowers for whom even an IDR payment is unaffordable, putting them at risk of defaulting on their loans. Many of these borrowers are struggling to make their IDR payments as a result of unique circumstances, such as overwhelming medical bills or expensive child or elder care. Providing a process to evaluate these circumstances and make appropriate adjustments to a borrower's monthly payment amount will provide a lifeline to borrowers who are genuinely unable to make their payments, protecting them from the worst impacts of default and keeping them engaged with the repayment system until they're either back on solid financial footing or their circumstances allow them to return to a normal IDR payment amount. Modifying the economic hardship deferment to allow for similar consideration of expenses will provide struggling parent borrowers, who are not able to access IDR, with a safety net to get them through financial hardship.

This concept of accounting for unique circumstances is not unprecedented in the federal student aid landscape. When students have unusual situations impacting their federal student aid eligibility, financial aid administrators have the authority to use their professional judgment to evaluate those circumstances and, on a case-by-case basis and with appropriate documentation, adjust the student's FAFSA to more accurately assess their financial situation. The above proposal is essentially a "professional judgment" on the repayment end of the financial aid lifecycle, giving appropriate consideration to unique circumstances that impact a borrower's ability to make their monthly payments.

Designing and implementing a system to review and appropriately adjust payment amounts based on unique circumstances will require a careful and strategic process, and additional research is needed to inform the development and implementation of such a system. It is also worth noting that implementing these flexibilities would require ample resources and guidance for servicers, who would be responsible for conducting these reviews and determining when adjustments to a borrower's payment amount is appropriate, but the potential impact makes this investment worthwhile. ED would need to develop criteria and guidance to help servicers make determinations, achieving an appropriate balance between giving servicers the flexibility to address the unique needs of individual borrowers while also ensuring borrowers requesting adjustments receive similar treatment across servicers.

Recommendations to Make It Easier for Borrowers to Exit Default

Student Loan Default Recommendation #4: Allow defaulted borrowers who enroll and make a payment in an income-driven repayment plan to immediately exit default.

Borrowers in default, who currently do not have access to IDR, should be able to enroll in IDR plans. We propose a new path for exiting default that allows defaulted borrowers to enroll in IDR. Under this plan, a defaulted borrower may enroll in an IDR plan and will be automatically removed from default status as soon as they make their first required payment. Once the borrower exits default, their Title IV eligibility will be restored and any use of Administrative Wage Garnishment or Treasury Offset Program will cease. The borrower must make nine monthly payments in their first 10 months in the IDR program to have their default record and default-related negative credit reporting removed from their credit history. Borrowers evaluated to have a $0 IDR payment should automatically have the default and other default-related negative credit reporting immediately removed from their credit history because they will not be expected to pay any amount during their first 10 months. Providing this pathway out of default for borrowers who make a required IDR payment minimizes barriers that could be especially challenging for borrowers with limited resources.

Borrowers who do not successfully make nine payments within the 10-month period (i.e., miss more than one monthly payment), will return to default status, although they will not have a new default appear on their credit history. The original default will remain on their credit history, and it will appear as if the borrower never exited default at all, similar to borrowers who begin but do not successfully complete loan rehabilitation.

We propose that this new pathway, which allows borrowers to exit default immediately by enrolling in and making a payment through an IDR plan, be available to borrowers only once. If a borrower does not make nine payments within the first 10 months and returns to default, or defaults again in the future, they will have other pathways to exit default, such as rehabilitation and consolidation.

Rationale: Allowing borrowers to enroll in IDR plans while in default is a common-sense proposal that will provide many of the repayment system's most vulnerable borrowers with a reasonable chance to return to good standing. Defaulted borrowers include many low-income individuals who were unable to make monthly payments due to loss of income or other financial hardship. These borrowers, many of whom likely would have avoided default in the first place had they been able to enroll in an IDR plan, have limited financial resources and will struggle to navigate existing pathways out of default. If allowed to enroll in IDR, some defaulted borrowers will have a $0 monthly payment, and those whose monthly payment is greater than $0 will find their payment amount affordable. It is counterintuitive to deny many of the system's most vulnerable borrowers access to the very tool that has been proven to increase the likelihood of successful repayment outcomes.

Rather than forcing defaulted borrowers who enroll in IDR to go through nine months of rehabilitation before exiting default, this proposal provides a simple, direct pathway out of default that can be easily communicated and prevents borrowers from having to navigate the complexities of rehabilitation or consolidation. This approach eliminates barriers inherent in the complex and lengthy rehabilitation process, which decrease the chances a borrower will take action and increase the likelihood that they remain in default. This is especially true for those with limited resources.

Keeping in mind the importance of eliminating the overly punitive nature of our current default system, our recommendation to allow borrowers to access this pathway only once is motivated by a belief that there must be some consequence to entering default in order to motivate borrowers who are able to make their required payments and remain in good standing. This proposal provides borrowers with a chance to exit default quickly and easily after just one payment and, after nine monthly payments, no longer have their credit impacted by the default. This more streamlined pathway out of default will be especially effective for low-income borrowers, including those who have a $0 payment. We believe it is reasonable to extend this "free pass" to all borrowers once, but we are concerned that allowing borrowers to utilize this pathway indefinitely will do little to incentivize high earners, who can afford to make their payments, to remain in good standing in order to avoid the consequence of default.

Removing the default from a borrower's credit history immediately after they make just one payment would create a system through which high-income borrowers would face no consequence for entering default. Delaying the removal of the default from the borrower's credit history is an important mechanism to incentivize high-earning borrowers, who are more likely to rely on credit than low-income borrowers. This is a worthwhile tradeoff because low-income borrowers will experience minimal harm from this delay as the record of the default will be completely removed from their credit history once they make nine IDR payments. An additional benefit of this proposal is that it will direct a much higher volume of defaulted borrowers into IDR, which has been shown to reduce the likelihood that a borrower defaults again and ensures borrowers' payments immediately start counting toward IDR forgiveness.

Student Loan Default Recommendation #5: Remove the one-time limit on rehabilitation of defaulted loans.

This recommendation is also put forth by the National Consumer Law Center.

Borrowers should be allowed to rehabilitate their loans more than once, without fees or with minimal, standardized fees.

Rationale: Rehabilitation will remain a pathway out of default for those borrowers who first use the new IDR pathway proposed in Student Loan Default Recommendation #4 but do not make nine payments within the first 10 months and return to default, or those who do not wish to enroll in IDR to exit default. The one-time limit on rehabilitation was not introduced until the 2008 reauthorization of the HEA, which also included a new provision to allow removal of defaults from a borrower's credit history after rehabilitation. Before this time, borrowers were not limited in the number of times they could rehabilitate a loan. If maintaining borrower engagement is a primary goal of the repayment system, borrowers deserve more than one opportunity to exit default through rehabilitation.

Recommendations to Make the Default System More Borrower-friendly

Student Loan Default Recommendation #6: Eliminate acceleration of loan balances and use collections mechanisms only in extreme circumstances.

This recommendation is also put forth by the National Consumer Law Center.

As proposed in Default Recommendation #4, borrowers should be allowed to enroll in IDR and those who do not should pay no more under default than they do in an IDR plan. To achieve this goal, TOP should be used only in extreme circumstances, and borrowers with student loans in default should never experience a reduction or elimination of tax refunds intended to support low-income families and low-income workers, including the Child Tax Credit and Earned Income Tax Credit. The use of Administrative Wage Garnishment (AWG) should be limited, ensuring funds are only taken once borrowers have received a living wage.

Rationale: Currently, when a borrower defaults, their debt (both principal and interest) immediately becomes due in full. This process, called "acceleration," allows the full value of the borrower's debt to be collected simultaneously through multiple mechanisms, including withholding borrowers' wages via AWG and withholding federal benefits through TOP. The rationale behind acceleration is flawed and counterproductive to the goal of helping borrowers return to good standing and establish consistent repayment behaviors.

The current denial of access to other federal benefits is unnecessarily punitive and counterproductive, pushing struggling borrowers into worse financial circumstances. Low-income borrowers already struggling to make ends meet should not be burdened with additional financial stress caused by TOP and AWG, which can currently withhold federal means-tested benefits, tax credits, and wages that serve as lifelines for financially distressed families. TOP and AWG should only be used in extreme cases where a borrower who has the means to repay their loans is actively refusing to do so, and should not withhold funds from borrowers who are genuinely struggling or earning below a living wage. Additional research is needed to establish the best method of determining whether a borrower is truly unable to make payments or is simply unwilling to despite having the means to do so. However, with reliable income data and research-informed evaluation criteria, it should be possible for ED to develop a system to assess a borrower's ability to repay and define the "extreme circumstances" that justify use of TOP and AWG.

Student Loan Default Recommendation #7: Eliminate interest capitalization for borrowers exiting default.

This recommendation is also put forth by the National Consumer Law Center and the Center for American Progress.

Congress should ensure that entering or exiting default does not count as an interest capitalizing event. As recommended in the previous section, interest capitalization should be eliminated altogether for all borrowers, including borrowers in default as well as those moving between default and repayment. The Department does not currently capitalize interest when borrowers default or exit default on Direct and ED-held FFEL Program loans (except when borrowers exit through consolidation). Although ED proposed regulatory language during the Affordability & Student Loans negotiated rulemaking committee to more permanently eliminate these default-related actions as capitalizing events, Congress should pass legislation that eliminates all interest capitalization, including for borrowers in default, to ensure this policy remains permanent.

Rationale: This paper previously recommended that interest capitalization be eliminated entirely, as capitalization unnecessarily increases the amount that borrowers must repay on their loans and runs contrary to the purpose of the federal student loan programs. The rationale that informed that recommendation holds true here; it is essential to ensure that borrowers in default, as well as those exiting default, also do not experience interest capitalization.

Student Loan Recommendation #8: Delay credit reporting of default status to provide borrowers with additional time to return to good standing.

Currently, a borrower's default status is typically reported to national credit bureaus after Day 425. This credit reporting should be delayed for an additional 305 days, so the default is not reported until two years (730 days) after the borrower's loan becomes delinquent.

Rationale: In addition to the proposals in this section that aim to help borrowers avoid default altogether, this recommendation provides a further opportunity for borrowers to get in good standing before experiencing default-related consequences. With this delay, two years will pass between the time a borrower first becomes delinquent and when the default is noted on their credit report. This additional 305 days (roughly 10 months) will provide borrowers with a final chance to exit default and return to good standing — through the new IDR pathway proposed above (including sufficient time to make nine payments within the first 10 months), rehabilitation, or consolidation — before having a default appear on their credit history. This recommendation would only delay reporting of the default, and would not impact the credit reporting of missed payments leading up to the default, which begins at day 90.

Although the default itself would not appear on a borrower's credit report for an additional 10 months, lenders would be able to see recent delinquencies on a defaulted borrower's credit report. While some borrowers may eventually have the record of these pre-default delinquencies removed after exiting default (see Recommendation #9 below), continuing to report missed payments despite delaying the reporting of the default will ensure defaulted borrowers are not able to dig themselves into a deeper credit hole. Maintaining credit reporting as an eventual part of default is a mechanism to ensure borrowers who can afford to make their payments but choose not to, who are more likely to rely on credit than struggling low-income borrowers, are incentivized to make their payments.

Student Loan Default Recommendation #9: Remove default from the credit history of any borrower who exits default, and remove all default-related negative credit reporting the first time a borrower completes rehabilitation on a defaulted loan or exits default through the IDR pathway proposed in Recommendation #4.

- Borrowers who exit default through the IDR pathway proposed in Recommendation #4 should have the default and default-related negative credit reporting removed from their credit history if they make nine monthly payments within the first 10 months. Borrowers opting for this path who are determined to have a $0 IDR payment should automatically have the default and other default-related negative credit reporting removed from their credit history immediately after enrolling in the IDR plan.
- Default should be removed immediately from the credit histories of all other borrowers once they exit default, whether through rehabilitation, consolidation, or fully paying off their balance.
- Borrowers should have other default-related negative credit reporting, such as delinquencies, removed from their credit history after the first time they rehabilitate their loans.

Rationale: Currently, a borrower can only have a default removed from their credit history if they rehabilitated their loans to exit default. Record of default remains on the credit histories of borrowers who exited default through consolidation or by paying off the balance of their defaulted loan in full. There is no clear rationale for this variability, and ED should remove default from the credit histories of all borrowers who exit default, regardless of the method used to do so.

Removing other negative reporting from the credit history of borrowers who exit default by completing rehabilitation will ensure payments previously missed on the loans they have now rehabilitated do not continue to harm their ability to purchase a car or rent an apartment. There have been proposals to remove all negative credit history, including delinquencies, once a borrower exits default, regardless of which path they use to do so. Removing all negative credit history for all borrowers would create inequity between the credit history provisions for those borrowers who resolve defaults versus those who are delinquent but do not default. For that reason, we recommend that the removal of all negative credit history only be extended on the first occasion that a borrower rehabilitates and to those who successfully exit default through the new IDR pathway.

Student Loan Default Recommendation #10: Streamline, standardize, and reduce collection fees.

This recommendation is also put forth by the National Consumer Law Center.

Rationale: When borrowers default, they can be charged collection fees as high as 24% of their loan balances. ED should, at a minimum, ensure collections fees are lowered and streamlined to be less punitive toward borrowers. ED could also consider replacing the existing variety of penalties with a flat fee consistent across all borrowers, or consider eliminating collection fees entirely.

Recommendations to Prevent Re-default

Student Loan Default Recommendation #11: Automatically enroll borrowers exiting default through consolidation into income-driven repayment before they return to repayment.

This recommendation is also put forth by the National Consumer Law Center.

Similar to borrowers entering repayment for the first time, borrowers who are exiting default and returning to repayment through consolidation should be automatically placed into an IDR plan unless they opt-out of IDR and select a different plan.

Rationale: Enrolling in an IDR plan after defaulting has been shown to drastically reduce the likelihood that a borrower re-defaults, with those who enrolled in IDR five times less likely to default again. Borrowers who exit default through the new IDR pathway proposed in this paper will already be enrolled in IDR, and those who exit through rehabilitation will have successfully made at least nine monthly payments on the repayment plan they have selected. For borrowers who exit default through another pathway, such as consolidation, automatic enrollment into IDR will ensure they are put into a plan with manageable monthly payments. Borrowers exiting default through consolidation should not have to go through the hassle of opting into an IDR plan

Student Loan Default Recommendation #12: Provide consistent, high-quality servicing to simplify and streamline transitions from default to repayment.

Borrowers should not be moved to a different servicer simply because they enter default status. They should remain with the same servicer throughout their entire time in repayment, including periods when they are in default or rehabilitation, unless the servicer is not adequately supporting the borrower. Additionally, as proposed in Loan Servicing Recommendation #2, Federal Student Aid should implement a single brand for all loan servicing operations and interactions with student loan borrowers using a single servicing system.

Even with a single servicing platform, ED should also ensure defaulted borrowers receive high-quality servicing and effective support by:

- Developing specific ways to monitor and measure the ability of servicers to work with and assist defaulted borrowers, paying special attention to re-default rates and IDR reenrollment rates for previously defaulted borrowers.
- Providing consistent direction, such as a common manual, for serving this population of borrowers.
- Having a mechanism to remove borrowers from servicers who do not show the ability to assist defaulted borrowers consistently and effectively.

Rationale: The Loan Servicing section of this report includes recommendations to ensure the quality of practices and treatment of borrowers does not vary from servicer to servicer. While these recommendations will go a long way toward ensuring high-quality servicing through the repayment lifecycle for all borrowers, the way servicers manage borrowers in default warrants additional scrutiny. Transferring a borrower from one servicer to another causes confusion and only exacerbates the unfavorable outcomes already experienced by struggling borrowers. Having the same servicer continue servicing the borrower throughout their entire time in repayment, including during periods where the borrower is in default or rehabilitation, will both provide consistency for borrowers and serve as a mechanism to incentivize high-quality servicing.

While defaulted loans should not be transferred between servicers frequently, transfers are occasionally necessary or in the best interest of the borrower. If a servicer ends its contract with ED, all loan accounts in their portfolio must be transferred. There may also be instances where borrowers should be transferred away from servicers that have not proven successful in effectively assisting defaulted borrowers. Given the reality that loan transfers will always be necessary to some extent, having a single, uniform servicing platform will make these transfers more seamless for borrowers, mitigating the confusion and the resulting harm. Implementing a single brand for all loan servicing operations and all interactions with student loan borrowers using a single servicing system would be especially critical for borrowers who default.

Even with limited instances of loan transfers and a streamlined servicing platform, ED must put in place mechanisms to ensure defaulted borrowers receive high-quality servicing and get the right kind of help. This is particularly important when a borrower's original servicer wasn't successful at keeping them out of default in the first place.

Conclusion

Over the past year, NASFAA and the coalition have worked to develop thoughtful, systemic, and targeted policy solutions to address some of the flaws in the current student loan system. We have accomplished work of extensive breadth and depth to address the shortcomings of the current student loan repayment and servicing systems that lead borrowers into financial hardship. While there is still more work to be done, we hope the 31 recommendations put forth in this report advance the conversation on student loan repayment. NASFAA looks forward to working with lawmakers and the higher education community to further explore and strengthen these proposals as we work towards achieving an improved student loan system for all borrowers.

The National Association of Student Financial Aid Administrators (NASFAA) provides professional development for financial aid administrators; advocates for public policies that increase student access and success; serves as a forum on student financial aid issues; and is committed to diversity throughout all activities.

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