October 2016

Annual report of the CFPB Student Loan Ombudsman

Transitioning from default to an income-driven repayment plan

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Executive summary

- Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, this annual report analyzes complaints submitted by consumers between September 1, 2015 and August 31, 2016. During this period, the Bureau handled approximately 5,500 private student loan complaints and 2,300 debt collection complaints related to private and federal student loans. The Bureau also began handling complaints about problems managing or repaying federal student loans and handled 3,900 federal student loan servicing complaints during the final six months of this reporting period.

- Over the past 12 months, consumers with student loans identified a range of payment processing, billing, customer service, borrower communications, and income-driven repayment (IDR) plan enrollment problems. These consumers submitted complaints about nearly 300 companies, including student loan servicers, debt collectors, private student lenders, and companies marketing student loan "debt relief." For five of the largest student loan servicers, borrowers reported a broad range of servicing problems across each company's operations. The Bureau's analysis of these complaints suggests that borrowers assigned to the largest student loan servicers may encounter widespread problems, whether these borrowers are trying to get ahead or struggling to keep up with their student debt.

- This report highlights complaints about the transition from default into an IDR plan, as reported by the most economically distressed consumers. Earlier this year, the Department of Education reported that more than 8 million federal student loan borrowers are in default and that 1.2 million borrowers with Direct Loans defaulted in the past 12 months. The Bureau estimates that more than 1-in-4 student loan borrowers are past-due or in default on a student loan.

- The Bureau estimates that in the last year, more than 650,000 student loan borrowers "rehabilitated" a defaulted federal student loan by making $5 monthly payments for nine months. Over the next 24 months, the Bureau projects that more than 220,000 of these borrowers will default for a second time, unless policymakers and industry take immediate action. Based on this projection, the Bureau estimates that this cohort of borrowers will be charged more than $125 million in unnecessary interest charges over the next two years.

- Borrowers who experience financial hardship and are in default have a right under federal law to cure their default and to enroll in an IDR plan. The majority of borrowers who cure a default and seek to enroll in IDR do so by first rehabilitating their defaulted debt. However, these borrowers describe a range of communication, paperwork processing, and customer service breakdowns at every stage of the default-to-IDR transition. These borrowers identify practices that create barriers to long-term success.

- Inability to secure an IDR plan sets these borrowers up for a payment shock in the near-term, and may drive the most economically distressed borrowers back into default. This report highlights projections by private credit analysts that estimate nearly half (45 percent) of borrowers who rehabilitate a federal student loan will default again shortly after curing their previous default.

- The servicing and collections practices highlighted in this report directly affect the most economically distressed borrowers. Borrowers with very low incomes have a right under federal law to cure a defaulted loan by making a series of $5 payments. Based on the formula used to determine eligibility for a $5 rehabilitation payment, the vast majority of these borrowers will also be entitled to make a $0 monthly IDR "payment" once they have cured their default – protecting them against delinquency and default over the medium-term.

- Although public, market-wide data about the performance of these borrowers is limited, last year, a trade association representing student loan servicers and debt collectors told its members that 1-in-3 borrowers who exit default after making $5 rehabilitation payments are delinquent within 60 days.

- This report observes that legacy requirements in the rehabilitation program place increased burden on borrowers, increase costs for taxpayers, create unnecessary barriers to repayment success, and fail to consider the significant changes that have occurred in higher education finance market in the past decade. The structure of the rehabilitation program was initially designed to work within the bank-based, guaranteed loan program. That same rehabilitation process was applied to Direct Lending when the program was established more than two decades ago. Rehabilitation has not undergone significant reforms since the creation of IDR plans or since the termination of bank-based guaranteed lending in 2010.

- This report offers recommendations to policymakers and market participants, calling for immediate action to improve and strengthen the transition from default to IDR. As Congress seeks to reauthorize the Higher Education Act, lawmakers may wish to consider ways to improve repayment success for previously defaulted borrowers that include immediate access to a stable and long-term IDR plan.

- Policymakers and market participants can take the steps outlined in this report in the near-term to address the challenges identified in consumer complaints by improving borrower communication throughout the default to IDR transition and by streamlining IDR application and enrollment.

- Borrowers and taxpayers both benefit when borrowers successfully complete the default to IDR transition and succeed over the long-term. The current compensation structure for debt collectors reflects this benefit by incentivizing collectors to rehabilitate loans - in some cases, collectors earn nearly $40 in compensation for every $1 in cash recovered through certain rehabilitations. Collectors earn this compensation irrespective of borrower performance over the months or years following a completed rehabilitation, ensuring that collectors have no "skin in the game" when a borrower defaults again. Policymakers may wish to reevaluate the economic incentives in place for debt collectors and student loan servicers to encourage long-term borrower success.

- This report also recommends immediate action to implement the Department of Education's July 2016 recommendation to monitor the repayment behavior of high-risk borrowers through the compilation of public performance metrics on student loan servicing, including data on delinquencies and defaults, as well as data on borrower performance in IDR plans.

1. About this report

The Dodd-Frank Wall Street Reform and Consumer Protection Act established a Student Loan Ombudsman within the Consumer Financial Protection Bureau. Pursuant to the Act, the Ombudsman shall compile and analyze data on student loan complaints and make appropriate recommendations to the Secretary of the Treasury, the Director of the Consumer Financial Protection Bureau, the Secretary of Education, and Congress.

This report analyzes more than 5,500 private student loan complaints and approximately 2,300 debt collection complaints related to student loan debt handled between September 1, 2015, and August 31, 2016. Additionally, this report analyzes approximately 3,900 federal student loan servicing complaints submitted between March 1, 2016 and August 31, 2016. This report also offers analysis and discussion to address issues reported by consumers in the student loan marketplace. The information included in this report represents the Ombudsman's independent judgment and does not necessarily represent the view of the Consumer Financial Protection Bureau.

Seth Frotman
Student Loan Ombudsman
Consumer Financial Protection Bureau

2. Student loan complaint data

From September 1, 2015, through August 31, 2016, the CFPB handled approximately 5,500 private student loan complaints.[1] During this same reporting period, the Bureau handled approximately 2,300 debt collection complaints related to student loans.

On February 25, 2016, the Bureau began handling federal student loan servicing complaints. Between March 1, 2016 and August 31, 2016, the Bureau handled approximately 3,900 federal student loan complaints.

Federal student loan complaint data

This section analyzes a sample of over 1,000 complaints against the top ten companies based on federal student loan complaint volume.[2] This section reports the results of our review.[3]

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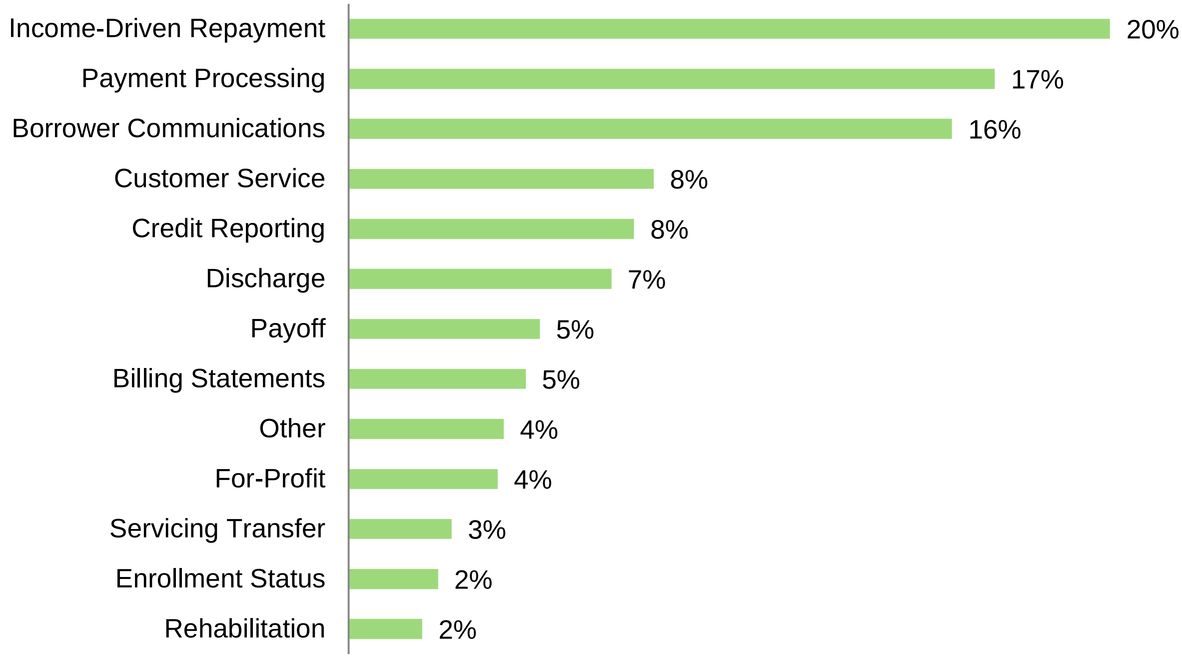
[1] The publication criteria for consumer complaints is available at http://files.consumerfinance.gov/f/201303_cfpb_Final-Policy-Statement-Disclosure-of-Consumer-Complaint-Data.pdf.

[2] When submitting complaints, consumers select the product, sub-product, issue, and sub-issue that best describes their complaint. Consumers' written complaint narratives provide additional details. The Student Loan Ombudsman reviewed the complaint narratives and the company's response to identify specific issues found in the complaints. These concepts were tagged and used to prepare the analysis. For example, complaints in which consumers reported problems related to IDR, including enrollment, recertification, qualified payments, and switching between IDR plans, were tagged "Income-Driven Repayment."

FIGURE 1: IDENTIFIED ISSUE TAGS IN FEDERAL STUDENT LOAN COMPLAINTS AGAINST TOP TEN COMPANIES BY COMPLAINT VOLUME



Note: This chart represents the problems identified in consumer narratives of 1,062 federal student loan servicing complaints submitted between March 1, 2016 and August 31, 3016 against the top 10 companies by federal student loan complaint volume. *See* Appendix B for more information on issue tag definitions. Percentages are rounded and therefore may add up to more than 100 percent.

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[3] In order to identify the problems raised in federal student loan servicing complaints, the Bureau reviewed a sample of 1,062 complaints from the top 10 companies, based on federal student loan servicing complaint volume. Issue tags were assigned based on an independent review by the Bureau. For companies that received the largest numbers of complaints during the reporting period, 200 complaints were randomly sampled for review, with each reviewed complaint weighted by its inverse sampling probability. *See* Appendix A.

Some servicers are selected by the Department of Education to be the sole contractor to perform certain services (*e.g.*, Nelnet is the servicer designated to service accounts of borrowers seeking Total and Permanent Disability discharge), and as such, may have a greater relative amount of complaints about a certain issue than other market participants. For more information on the definitions of the issues identified, *see* Appendix B.

FIGURE 2: ISSUE TAGS IDENTIFIED IN COMPLAINTS SUBMITTED AGAINST ACS BETWEEN MARCH 1, 2016 AND AUGUST 31, 2016

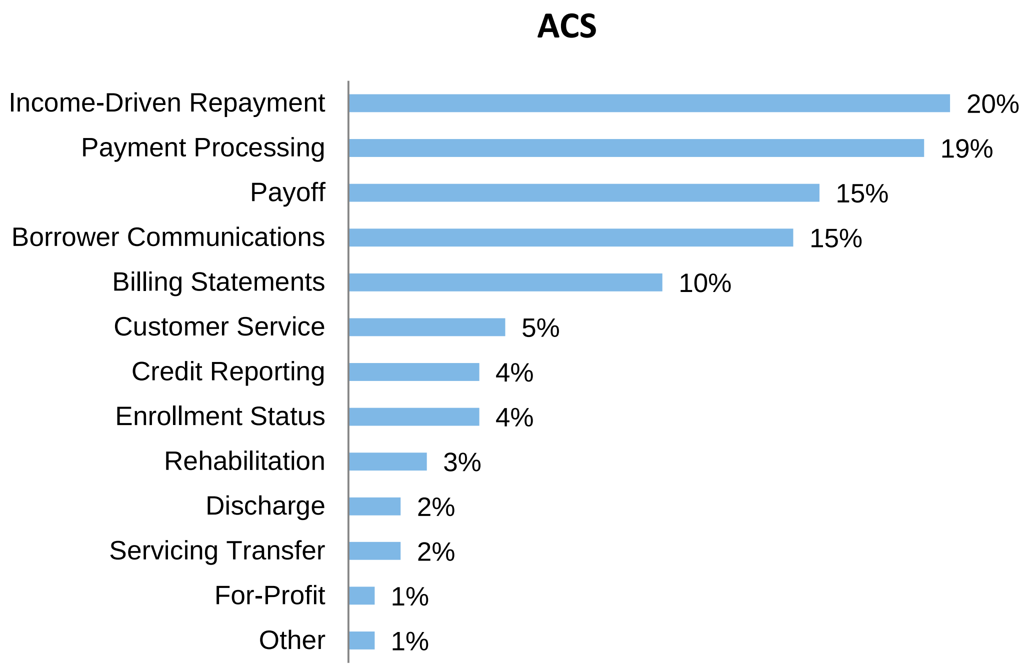


FIGURE 3: ISSUE TAGS IDENTIFIED IN COMPLAINTS SUBMITTED AGAINST AES/PHEAA BETWEEN MARCH 1, 2016 AND AUGUST 31, 2016

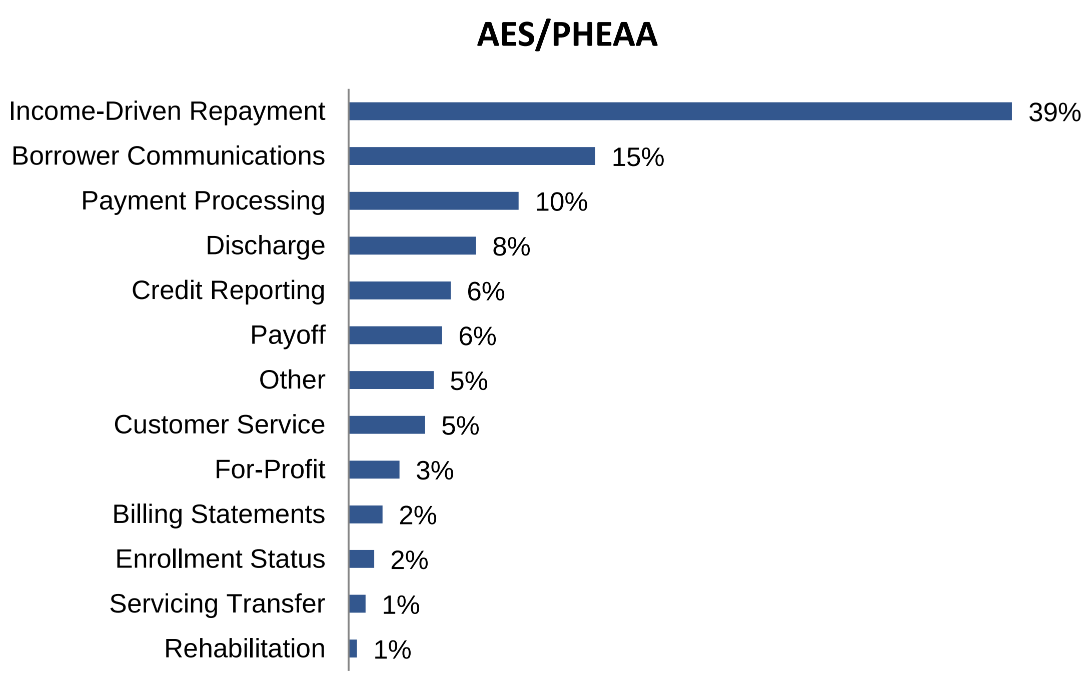


FIGURE 4: ISSUE TAGS IDENTIFIED IN COMPLAINTS SUBMITTED AGAINST GREAT LAKES BETWEEN MARCH 1, 2016 AND AUGUST 31, 2016

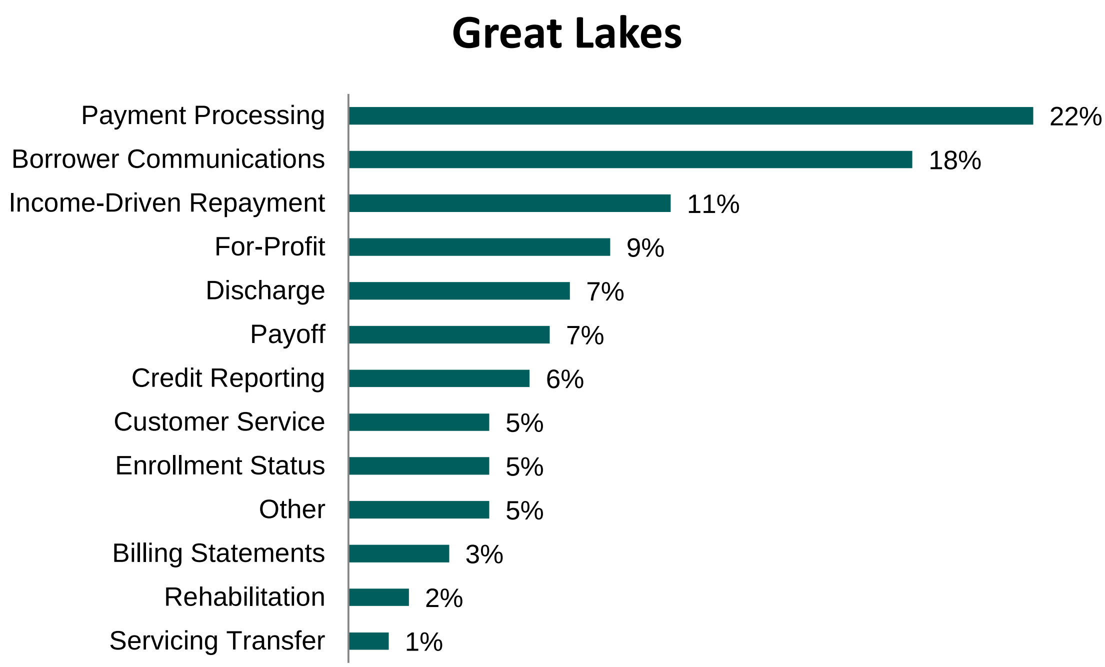


FIGURE 5: ISSUE TAGS IDENTIFIED IN COMPLAINTS SUBMITTED AGAINST NAVIENT BETWEEN MARCH 1, 2016 AND AUGUST 31, 2016

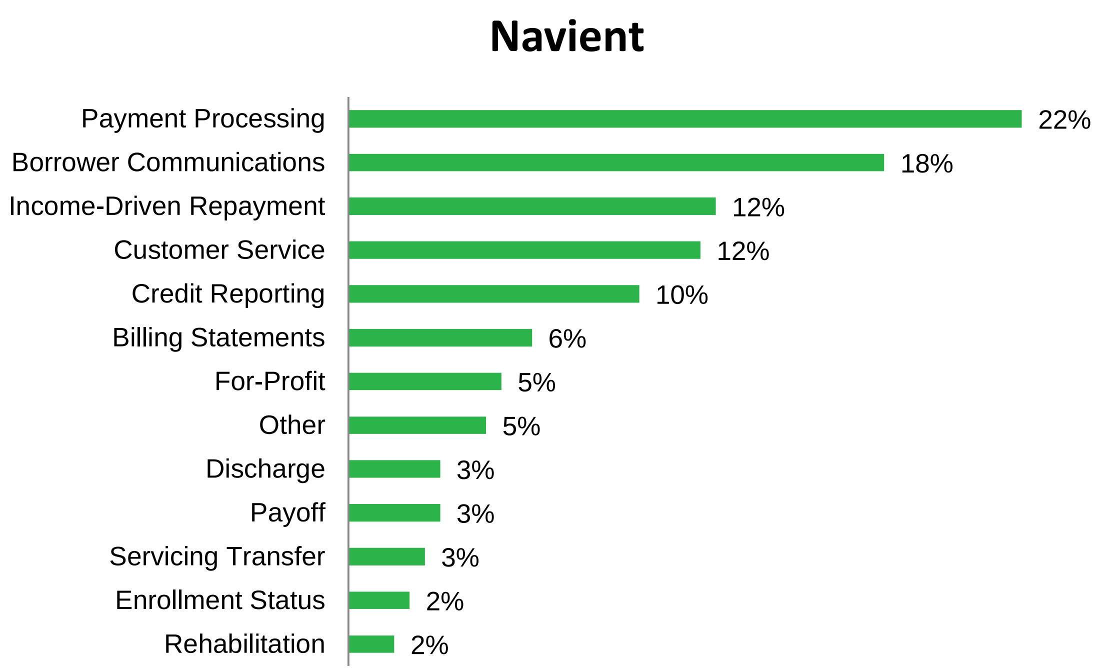
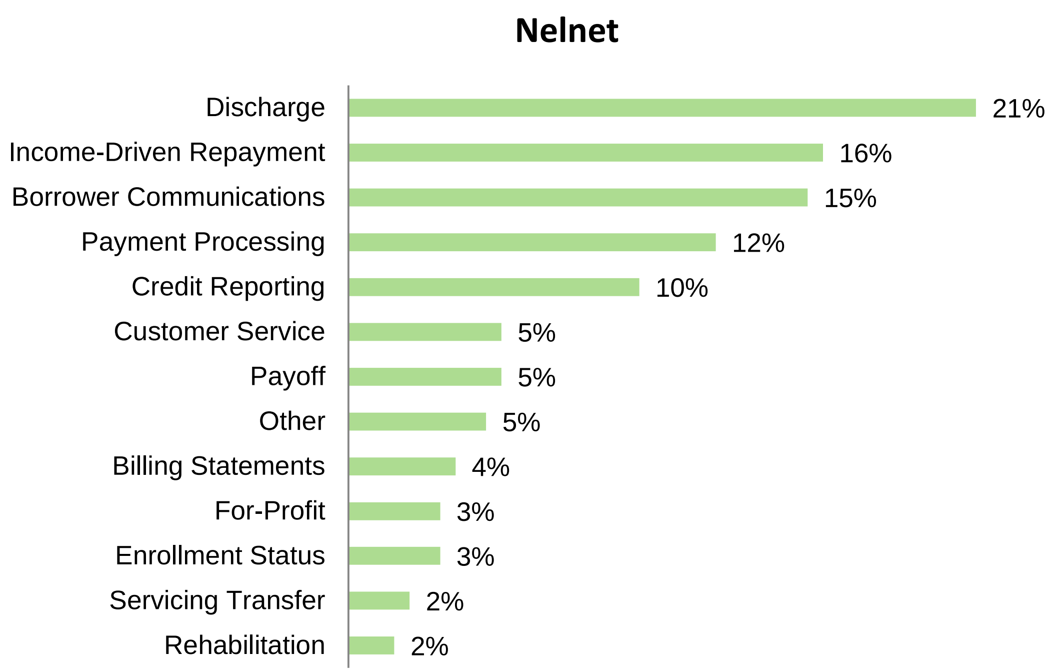


FIGURE 6: ISSUE TAGS IDENTIFIED IN COMPLAINTS SUBMITTED AGAINST NELNET BETWEEN MARCH 1, 2016 AND AUGUST 31, 2016



Update from the Consumer Complaint Database

Information about consumer complaints, including information about student loan and debt collection complaints, is available to the public through the CFPB's Consumer Complaint Database.[4]

The database contains anonymized complaint data provided by consumers, including the type of complaint, the date of submission, the consumer's zip code, and the company that the complaint concerns. The database also includes information about the actions taken by a company in

[4] *See* Consumer Financial Protection Bureau, *Consumer Complaint Database*, *available at* http://www.consumerfinance.gov/complaintdatabase/.

response to a complaint: whether the company's response was timely, how the company responded, and whether the consumer disputed the company's response. The database does not include consumers' personal information. The database includes web-based features such as the ability to filter data based on specific search criteria; to aggregate data in various ways, such as by complaint type, company, location, date, or any combination of available variables; and to download data.

Private student loan complaint data

The following tables are based on complaints handled from September 1, 2015 through August 31, 2016, as exported from the public Consumer Complaint Database as of October 1, 2015.[5] Due to the lack of publicly available data on private student loans, these tables are not indexed for market share.[6]

FIGURE 7: PRIVATE STUDENT LOAN ISSUES REPORTED BY CONSUMERS FROM SEPTEMBER 1, 2015

[5] Not all complaints handled by the Bureau are published in the public Consumer Complaint Database. Complaints are listed in the database after a company responds or after has had the complaint for 15 calendar days, whichever comes first. Complaints that do not meet publication criteria may be removed from the database. The publication criteria are available at http://files.consumerfinance.gov/f/201303_cfpb_Final-Policy-Statement-Disclosure-of-Consumer-Complaint-Data.pdf. Therefore, the number of complaints published in the database may be fewer than the total number of complaints handled by the Bureau.

[6] Compared to other large markets of consumer financial products (such as residential mortgages and credit cards), availability of market data is quite limited, for private student loans, which grew rapidly in the years leading up to the financial crisis. *See* Consumer Financial Protection Bureau and U.S. Department of Education, *Private Student Loans* (2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/.

THROUGH AUGUST 31, 2016

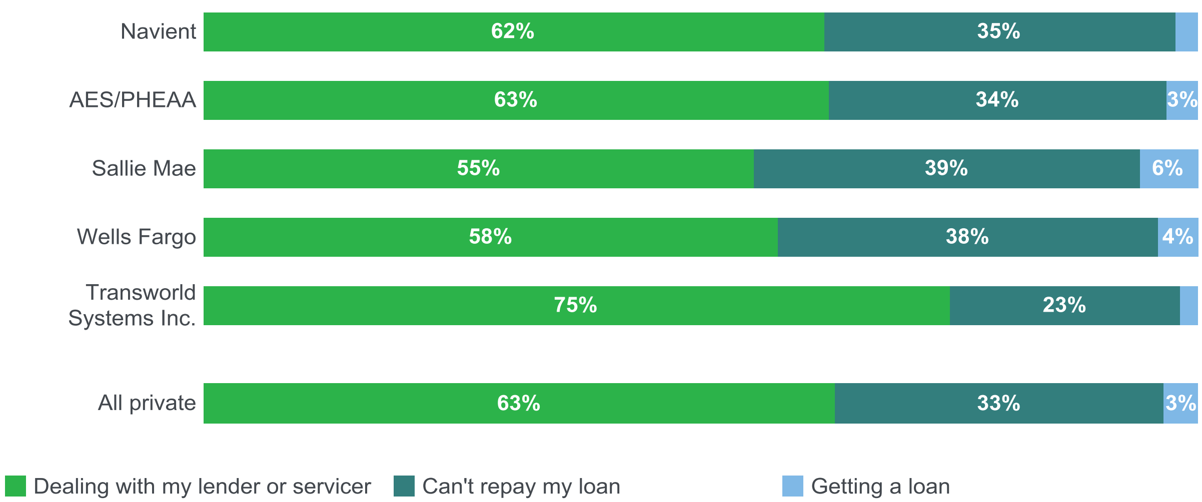
Note: Consumers submitting student loan complaints can select from the following three types of complaint categories: "Getting a loan," "Can't pay my loan," and "Dealing with my lender or servicer." This figure reflects the categories consumers selected when submitting a complaint.

FIGURE 8: COMPANIES WITH THE MOST PRIVATE STUDENT LOAN COMPLAINTS RANKED BY VOLUME

Company	Sept. 2014 – Aug. 2015	Sept. 2015 – Aug. 2016
Navient	1,756	1,613
AES/PHEAA	416	476
Sallie Mae	245	242
Wells Fargo	251	220
Transworld Systems Inc.	121	168

Note: This table reflects complaints where (1) the consumer identified the sub-product as a non-federal student loan and (2) the identified company responded to the complaint, confirming a relationship with the consumer. This table reflects the top companies by complaint volume for the period of September 1, 2015 through August 31, 2016.

FIGURE 9: ISSUES IDENTIFIED IN PRIVATE STUDENT LOAN COMPLAINTS BY COMPANY FROM SEPTEMBER 1, 2015 THROUGH AUGUST 31, 2016



Note: This table reflects complaints where (1) the consumer identified the sub-product as a non-federal student loan, (2) the consumer identified the issue, and (3) the identified company responded to the complaint, confirming a relationship with the consumer. This table reflects the top companies by complaint volume.

Debt collection complaint data

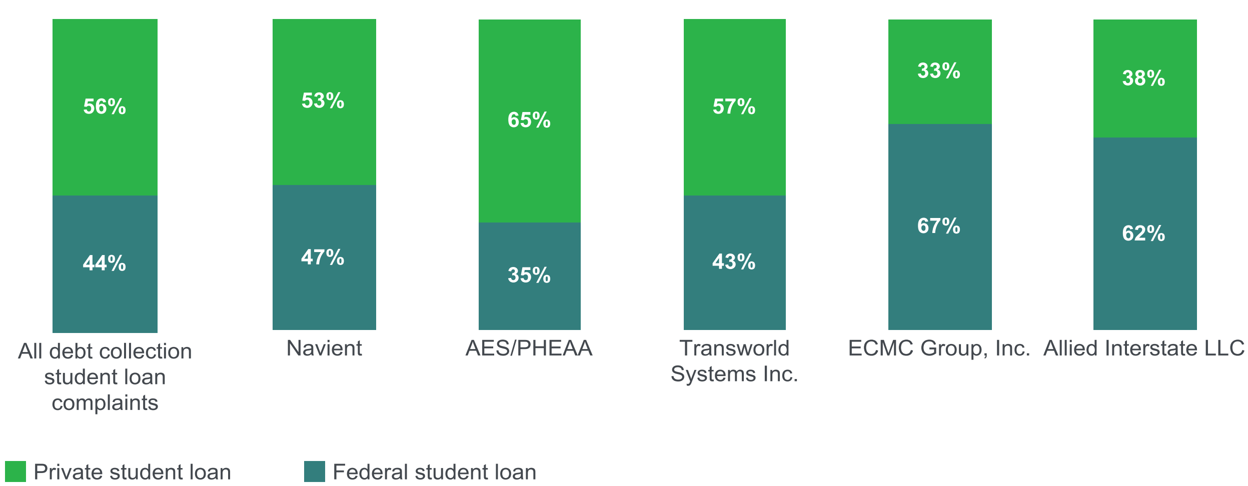
From September 1, 2015, through August 31, 2016, the CFPB handled approximately 2,300 debt collection complaints related to student loans.

FIGURE 10: TOP RECIPIENTS OF STUDENT LOAN DEBT COLLECTION COMPLAINTS FROM SEPTEMBER 1, 2015 THROUGH AUGUST 31, 2016

Federal Student Loans	Number of Complaints	Private Student Loans	Number of Complaints
Navient	146	Navient	166
AES/PHEAA	36	AES/PHEAA	68
Transworld Systems Inc.	32	Transworld Systems Inc.	42
ECMC Group, Inc.	28	URS Holding, LLC	23
Allied Interstate LLC	23	Financial Asset Management Systems, Inc.	20

Note: This table reflects debt collection complaints where (1) the consumer identified the sub-product as a non-federal or a federal student loan, and (2) the identified company responded to the complaint, confirming a relationship with the consumer. This table also reflects aggregated complaints of subsidiary debt collection companies under the parent company.

FIGURE 11: DISTRIBUTION OF LOAN TYPE FOR STUDENT LOAN DEBT COLLECTION COMPLAINTS BY COMPANY FROM SEPTEMBER 1, 2015 THROUGH AUGUST 31, 2016



Note: This table reflects debt collection complaints where (1) the consumer identified the sub-product as a non-federal or a federal student loan and (2) the identified company responded to the complaint, confirming a relationship with the consumer. This table was not adjusted to reflect each company's relative market share. This table reflects the top companies by complaint volume. This table also reflects aggregated complaints of subsidiary debt collection companies under the parent company.

3. Issues faced by borrowers

SOURCES OF INFORMATION

To identify the range of issues faced by student loan borrowers, this report relies on complaints handled by the Bureau. We also reviewed other information, such as comments submitted by the public in response to requests for information, submissions to the "Tell Your Story" feature on the Bureau's website, and input from discussions with consumers, regulators and law enforcement agencies, and market participants.

LIMITATIONS

Readers should note that this report does not suggest the prevalence of the issues described as they relate to the entire student loan market. The information provided by borrowers helps to illustrate where there may be a mismatch between borrower expectations and actual service delivered. Representatives from industry and borrower assistance organizations will likely find the inventory of borrower issues helpful in further understanding the diversity of customer experience in the market.

3.1 Overview of student loan complaints

Over the past 12 months, consumers with student loans identified a range of payment processing, billing, customer service, borrower communications, IDR plan enrollment problems. These consumers submitted complaints about nearly 300 companies, including student loan servicers, debt collectors, private student lenders, and companies marketing student loan "debt relief."

In February 2016, the Bureau began handling complaints from borrowers with federal student loans related to student loan servicing. As the figures in the preceding section illustrate, for five of the largest student loan servicers, borrowers reported a broad range of servicing problems across each company's operations. The Bureau's analysis of these complaints suggests that borrowers assigned to the largest student loan servicers may encounter widespread problems, whether they are trying to get ahead or struggling to keep up with their student debt.

The Bureau continues to receive complaints from borrowers related to a range of servicing problems, including problems enrolling in and recertifying income under IDR plans, problems processing qualified payments for purposes of loan forgiveness, and problems related to communications between colleges and servicers as borrowers transition between school and repayment.

Over this reporting period, federal student loan borrowers submitted complaints when unable to enroll in an IDR plan several months after submitting an application. These borrowers reported processing delays and lost application documents, resulting in unnecessary forbearance and an inability to make qualified payments towards loan forgiveness. Some of these complaints suggest that servicing problems are preventing borrowers from making qualified payments in pursuit of Public Service Loan Forgiveness (PSLF). When borrowers seek to enroll in an eligible repayment plan and contact their lender or servicer to obtain information about PSLF, complaints reveal that some of these borrowers may not be provided with accurate information about how to certify their progress toward forgiveness or may be directed to enroll in a repayment plan that is not eligible for PSLF.

Federal student loan borrowers also submitted complaints noting that their student loans had unexpectedly entered repayment, when their loans status should indicate an "in-school" status, or an "in-school" deferment. These borrowers complain that when servicers receive delayed and inaccurate information about a borrower's enrollment status, it may lead to a loss of grace period benefits, unexpected payments due, and unnecessary capitalized interest.

As the remainder of this report highlights in detail, consumers also report a range of problems related to the "default-to-IDR transition" for borrowers with federal student loans.

In addition to complaints about federal student loans, private student loan borrowers continue to submit complains about co-signer issues, including a lack of information surrounding co-signer release requirements and co-signers' ability to allocate payments to only co-signed loans on borrowers' accounts. Complaints document ongoing challenges borrowers face when servicers place performing loans in default following the death of a co-signer or a bankruptcy filing.[7] Additionally, borrowers continued to submit complaints regarding the ability to obtain flexible repayment options for their private student loans during times of financial distress. Complaints indicate that borrowers may be told there are flexible repayment options available, but when they seek to apply for such options, they are either ineligible or the repayment plan is unavailable.

3.2 Issue highlight: The federal student loan default-to-IDR transition

This report highlights complaints from borrowers who have defaulted on their federal student loans. These borrowers report problems when seeking to cure their default by working with a debt collector to "rehabilitate" the debt, one of the ways federal student loan borrowers are permitted to cure a defaulted student loan and get back on track. Previously defaulted borrowers report similar problems when working with a student loan servicer to stay on track after curing a defaulted loan.

According to a recent estimate by the Department of Education, more than eight million borrowers have federal student loans in default (have not made a payment for more than twelve months) and more than 1.2 million borrowers defaulted within the past 12 months.[8] Borrowers

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[7] Earlier this year, the Bureau announced it had cited one or more student loan servicers for unfair practices relating to this issue. *See* Consumer Financial Protection Bureau, *Supervisory Highlights: Winter 2016* (March 2016), *available at* http://files.consumerfinance.gov/f/201603_cfpb_supervisory-highlights.pdf.

[8] *See* U.S. Department of Education, *Federal Student Loan Portfolio* (accessed Sept. 14, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/portfolio. Readers should note that the Higher Education Act defines "default" as a period of nonpayment lasting 270 days (nine months); however, the Federal Student Aid

who are in default cannot access many of the consumer protections established under federal law, including the right to enroll in an IDR plan.[9]

The Higher Education Act provides these borrowers with two options to cure a default and get back on track. Borrowers can "rehabilitate" their debt by entering into an agreement with a debt collector to make a series of nine on-time monthly payments, set based on their financial circumstances.[10] Alternatively, borrowers can opt to refinance their defaulted debt with a new Direct Consolidation Loan.[11] The Department of Education estimates that borrowers complete greater than 70 percent of cured defaults through rehabilitation.[12]

The servicing and collections practices highlighted in this report directly affect the most economically distressed borrowers.[13] Borrowers with very low income have a right under federal

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data center defines default as a period of nonpayment lasting 360 days (12 months) for the purposes of public reporting on student loan performance.

[9] *See* U.S. Department of Education, *Understanding Default* (accessed Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/default#consequences.

[10] *See* 34 C.F.R. § 682.405; 34 C.F.R. § 685.211(f); *see also* U.S. Department of Education, *Getting out of Default* (accessed on Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/default/get-out.

[11] *See* U.S. Department of Education, *Loan Consolidation* (accessed Sept. 29, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/consolidation.

[12] *See* U.S. Department of Education, *Federal Student Aid Data Center: Default Rates FY15 Q4 – FY16 Q3* (accessed Sept. 16, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/default; U.S. Department of Education, *Federal Student Aid Data Center: FFEL Program Lender and Guaranty Agency Reports July 2015 – June 2016* (accessed Sept. 16, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/lender-guaranty

[13] For further discussion of the impact of student loan servicing on financially vulnerable borrowers, *see* Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* (Oct. 2015), *available at* http://files.consumerfinance.gov/f/201510_cfpb_annual-report-of-the-cfpb-student-loan-ombudsman.pdf ("Borrowers who attend for-profit colleges or two-year colleges make up 70 percent of all borrowers in default, according to one recent analysis. Yet the median debt burden and median wages of these borrowers suggest that the average borrower likely would qualify for a $0.00 or a substantially lower loan payment under an income-driven repayment plan.").

law to rehabilitate a defaulted loan by making a series of $5 payments.[14] Based on the formula used to determine eligibility for a $5 rehabilitation payment, the vast majority of these borrowers will also be entitled to make a $0 monthly IDR "payment" once they have cured their default.[15]

The Bureau estimates that, in the last year, more than 650,000 student loan borrowers rehabilitated a federal student loan by making a $5 monthly payment.[16] The Bureau projects that, over the next 24 months, more than 220,000 of these borrowers will default again without immediate action by policymakers and by industry.[17] Based on this projection, the Bureau estimates that servicers and collectors will charge these borrowers more than $125 million in unnecessary interest charges over the next two years. [18]

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[14] *See* U.S. Department of Education, *Getting out of Default* (accessed on Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/default/get-out.

[15] *See* U.S. Government Accountability Office, GAO-15-663, *Federal Student Loans: Education could do more to help ensure borrowers are aware of repayment and forgiveness options* (Aug. 2015), *available at* http://www.gao.gov/products/GAO-15-663.

[16] As noted elsewhere in this report, publicly available data on performance of defaulted and previously defaulted borrowers is extremely limited. The Bureau developed this estimate based on projections from private credit analysts about the expected performance of FFELP securities backed by rehabilitated FFELP loans, and based on historical data published by the Education Department for both Direct Loans and FFELP loans. The Bureau validated this estimate against publicly-available, historical portfolio snapshot data for the Direct Loan program, published by the Department of Education. These data indicate that 162,000 borrowers with Direct Loans defaulted for a second time between the first quarter of 2015 and the third quarter of 2016. *See* U.S. Department of Education, *Direct Loan and Federal Family Education Loan Portfolio by Loan Status* (accessed Oct. 3, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/default and DBRS, *Rating U.S. Federal Family Education Loan Program Securitizations* (Mar. 2014), *available at* http://dbrs.com/research/265582/rating-u-s-federal-family-education-loan-program-securitizations.pdf.; *see also,* Moody's, *Moody's Proposes to Update Its Approach to Rating Securities Backed by FFELP Student Loans* (Jan. 18, 2012).

[17] *Id.*

[18] The Bureau derived this estimate by comparing two otherwise-identical cohorts of 220,000 previously defaulted FFELP and Direct Loan borrowers with identical loan types and interest rates, and who cured default by making $5

The following sections of this report focus on problems experienced by borrowers who seek to rehabilitate and by borrowers who seek to access an IDR plan following rehabilitation – a process referenced throughout this report as the "default-to-IDR transition."

3.2.1 Curing a default through rehabilitation

The "default-to-IDR transition," as illustrated in Figure 13, occurs in three stages, beginning with a borrower's initial decision to cure defaulted debt through rehabilitation.[19] At the completion of this process, the vast majority of borrowers regain the ability to access IDR plans, including the right to make a $0 monthly "payment" for borrowers experiencing severe financial distress. Borrowers also receive a limited credit benefit – federal law requires the owner of the loan to request that consumer reporting agencies remove any notation of the student loan default appearing on the borrower's credit report.[20]

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rehabilitation payments. Based on these assumptions, the Bureau contrasted the cumulative interest charges assessed to each cohort. One cohort enrolled (or consolidated and enrolled) in the Revised Pay As You Earn (REPAYE) plan immediately following rehabilitation. These borrowers are entitled to a 50 percent interest subsidy for any unpaid interest accrued while enrolled in this plan. The other cohort remained in a standard payment plan and re-defaulted within 24 months of completing rehabilitation, forgoing the associated interest subsidy and other benefits under REPAYE. Readers should note that borrowers with Direct Subsidized Loans or Subsidized Stafford Loans may be entitled to additional interest subsidies over-and-above the benefit considered in this analysis. This estimate is exclusive of any collection costs assessed to borrowers with FFELP loans upon re-default, which can be as high as 16 percent of outstanding principal and interest. *Supra,* note 16.

[19] *See* 34 C.F.R. § 682.405; 34 C.F.R. § 685.211(f); *see also* U.S. Department of Education, *Getting out of Default* (accessed on Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/default/get-out.

[20] *See* 34 C.F.R. § 682.405(b)(3)(i)(B); 34 C.F.R. § 685.211(f)(8). For Direct Loans and ED-held FFELP loans, the Secretary performs this function. Loan holders (or the Secretary) do not typically remove information related to past history of missed payments, limiting any potential positive credit effects associated with the removal of any notation of default.

FIGURE 12: FEDERAL STUDENT LOAN DEFAULT-TO-IDR TRANSITION

Note: Consumers have a right to cure default either by rehabilitating a defaulted loan or by refinancing the defaulted debt by taking out a new Direct Consolidation Loan. The Department of Education estimates that more than 70 percent of cured defaults are completed through rehabilitation. As used throughout this report, the "default-to-IDR transition" occurs in three stages, beginning with a borrower's initial decision to cure defaulted debt through rehabilitation.

Rehabilitation requires a borrower to make a series of nine on-time monthly payments over a ten month period, driven by the borrower's income and family size, rather than the borrower's loan balance.[21] Borrowers who are experiencing severe financial hardship may complete an income-driven rehabilitation by paying a total of $45 (nine on-time payments of $5, over a period of ten months), at which point they are likely to be eligible for a $0 monthly "payment" under any of the IDR plans available to borrowers with performing federal loans.[22] Market participants report that nearly 80 percent of borrowers who seek to rehabilitate make payments of five dollars.[23] Borrowers can generally only rehabilitate a defaulted student loan once.[24]

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[21] *See* 34 C.F.R. § 682.405; 34 C.F.R. § 685.211(f).

[22] *See* U.S. Department of Education, *Income-Driven Repayment Plans for Federal Students Loans* (Feb. 2016), *available at* https://studentaid.ed.gov/sa/sites/default/files/income-driven-repayment.pdf.

[23] Timothy Fitzgibbon, Senior Vice President, National Council of Higher Education Resources (NCHER), Panel discussion at the NCHER 2015 Knowledge Symposium, *Loan Rehabilitation And Related Collection Cost Issues* (Nov. 5, 2015) *available at* http://slideplayer.com/slide/9364958.

[24] *See* 34 C.F.R. § 682.405(a)(4); 34 C.F.R. § 685.211(f)(12); The 2008 reauthorization of the Higher Education Act imposed a one-time limit on rehabilitation for newly-defaulted borrowers. Borrowers who initially defaulted prior to

Borrowers' monthly income-driven rehabilitation payments can be calculated in one of two ways:

- *Fifteen percent of discretionary income*. Using a formula similar to the one used to calculate payments under the Income-Based Repayment (IBR) program, a borrower's monthly rehabilitation payments are capped at 15 percent of the borrower's discretionary income.[25] Borrowers with no income or very low wages will have the lowest payments under this method, which can be as low as $5 per month. Borrowers who complete a rehabilitation using this method will generally have a corresponding entitlement to a similar monthly payment once they transition out of default.[26]

- *"Reasonable and affordable" payments*. Alternatively, collectors may recalculate payments to be "reasonable and affordable" for borrowers who cannot afford monthly payments based on their income.[27] Collectors can consider certain borrower expenses when calculating a monthly payment under this method.[28] Borrowers with high expenses relative to their income will have the lowest payments under this method. Because IDR

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the enactment of this provision are permitted to rehabilitate for a second time. In addition, the use of consolidation to cure a defaulted federal student loan may restore a borrower's access to rehabilitation upon a subsequent default.

[25] *See* 34 C.F.R. § 682.405(b)(1); 34 C.F.R. § 685.211(f)(1).

[26] Borrowers with federal student loans are entitled to enroll in an IDR plan upon successfully completing a rehabilitation agreement. IDR plans cap monthly payments at 10 or 15 percent of a borrower's discretionary income. *See* U.S. Department of Education, *Income-Driven Plans* (accessed Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/understand/plans/income-driven.

[27] Readers should note that the Higher Education Act provides a right to make a "reasonable and affordable" payment to borrowers seeking to rehabilitate, authorizing the Department of Education to promulgate regulations further defining this process. These regulations provide for the two channels discussed in this section, only one of which is informally referred to by the Department of Education and the debt collection industry as "reasonable and affordable." *See* 34 C.F.R. § 682.405(b)(vii) (1); 34 C.F.R. § 685.211(f)(1).

[28] *See* 34 C.F.R. § 682.405(b)(1)(vii)(C); 34 C.F.R. § 685.211(f)(3).

plans do not consider borrowers' expenses when calculating monthly payments, borrowers who complete a rehabilitation using this method may not have a corresponding low monthly payment once they transition out of default.[29]

Successful rehabilitation can be borrowers' first step on the path to a stable, long-term payment arrangement under an IDR plan.[30] However, borrowers report that collection practices and servicing problems can lead to dead ends and do-overs resulting in months of additional payments before borrowers can cure their default. These delays postpone access to the post-default borrower protections that an IDR plan provides. In addition, borrowers report that some delays leave borrowers in a prolonged "default status," causing additional negative consequences, including the unnecessary offset of tax returns, garnishment of wages or certain social security benefits, and prolonged ineligibility for federal student aid.

The following section of this report highlights a broad range of challenges identified by student loan borrowers related to each stage of the default-to-IDR transition.

3.2.2 Delays and dead ends during income-driven rehabilitation

A borrower in default on a federal student loan has the right under federal law to work with a collector to rehabilitate their debt.[31] A debt collector facilitates this process by collecting

[29] *See* 20 U.S.C. § 1078-6; 34 C.F.R. § 682.405; 34 C.F.R. § 685.211.

[30] It is important to note that Congress and the Department of Education set the terms and conditions of the rehabilitation program for both Direct Loans and FFELP. *See* 20 U.S.C. § 1078-6; 34 C.F.R. § 682.405; 34 C.F.R. § 685.211. From a consumer's perspective, the requirements to rehabilitate a loan in default under both programs are substantively similar. However, there may be differences in the way Guaranty Agencies and Private Collections Agencies oversee and administer certain aspects of each respective program.

[31] *See* U.S. Department of Education, *Getting out of Default* (accessed on Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/default/get-out. Any borrowers that previously rehabilitated their loan after August 14, 2008 will not be eligible to rehabilitate again; *See* 682.405(a)(4); 34 C.F.R. § 685.211(f)(12).

information from the borrower necessary to set a monthly rehabilitation payment amount. Borrowers report obstacles when attempting to set payment levels and make qualifying payments.

FIGURE 13: FIRST STAGE OF FEDERAL STUDENT LOAN DEFAULT-TO-IDR TRANSITION

Borrowers complain about delays, do-overs, and dead ends when making rehabilitation payments. When rehabilitating a defaulted loan, collectors may calculate the payment based on information provided orally by the borrower and provide the borrower with a rehabilitation agreement using that amount.[32] The collector must request documentation from the borrower to confirm the borrower's AGI and family size.[33] If the borrower does not provide the collector with documentation requested by the collector to calculate or confirm the reasonable and affordable payment amount within a reasonable time deadline set by the collector, the rehabilitation agreement provided is null and void.[34] Borrowers report roadblocks when working with their collector to establish and verify the income-driven payment. Specifically, borrowers complain about communications and paperwork processing breakdowns throughout the rehabilitation payment-setting process.

Borrowers who are making income-driven rehabilitation payments under a verbal agreement, generally by enrolling in automatic payments, complain that they are knocked off track, often

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[32] *See* 34 C.F.R. § 682.405(b)(1)(iv); 34 C.F.R. § 685.211(f)(1).

[33] *Id.*

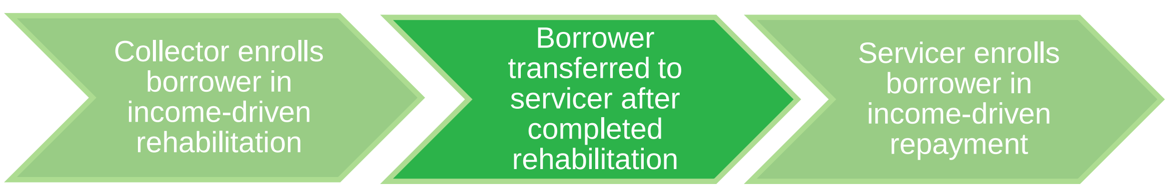
[34] *Id.*

after several months of payments, when their collector invalidates these payments retroactively. Collectors invalidate borrowers' payments when the monthly payment set by the collector is less than what is required based on income documentation subsequently provided by the borrower.[35] Borrowers complain that collectors continue to automatically withdraw incorrect payments from their account each month, despite having determined that the payment amount was invalid. Some borrowers report not learning that all of their payments were invalid until they proactively contact their collector after making all nine required payments.

3.2.3 Problems transferring from a debt collector to a student loan servicer

After a borrower completes rehabilitation, their loans transfer to a new company – a student loan servicer – and the borrower is required to begin making regular payments. Once this transfer is complete, these borrowers are able to exercise their right under federal law to enroll in an IDR plan, potentially qualifying for interest subsidies and making progress toward loan forgiveness. However, borrowers report this transfer process takes several months or more, during which borrowers are required to continue to make payments to their debt collector – a period during which many of the benefits and protections of IDR are unavailable.

FIGURE 14: SECOND STAGE OF FEDERAL STUDENT LOAN DEFAULT-TO-IDR TRANSITION



[35] *See* 34 C.F.R. § 682.405(b)(1)(iv); C.F.R. § 685.211(f)(1), *see also* U.S. Department of Education, *Loan Servicing and Collection – Frequently Asked Questions*, LR-Q2 (accessed Aug. 3, 2016), *available at* https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html#LR-Q2.

Borrowers report disruptions and communication gaps when transferring between a debt collector and student loan servicer. Borrowers report that they experience interruptions after completing their required rehabilitation payments. During this transitional period, borrowers describe how they believe they have satisfied their obligation to their debt collector under their rehabilitation agreement, but that their loans remain in limbo, noting that they are uncertain when their loan will transfer to a student loan servicer. [36]

Despite this uncertainty, borrowers seeking to cure their default must continue making payments.[37] Borrowers tell us that, during this period, they do not receive clear communications about where they should send payments, what amount to pay, and how those payments apply to their loan balance. This repayment limbo can last weeks or months until a servicer contacts the borrower to provide payment instructions.[38] Additionally, some borrowers report that their student loan servicer sets their due date for their first regular payment before they receive any introductory communication from their servicer.

Borrowers complain that collectors do not help facilitate IDR enrollment after curing default. Financially distressed borrowers may wish to avoid payment shocks by beginning the IDR plan enrollment process before their rehabilitated loan is placed with their new student loan servicer.[39] Borrowers report that collectors and servicers do not effectively

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[36] After a borrower makes the required nine on-time payments, a collector transfers a borrower's defaulted loans to a servicer. Private Collection Agencies collecting on behalf of the Department of Education transfer loans to the Department's Default Management System for assignment and transfer to a Department of Education-contracted student loan servicer. Guaranty Agencies rehabilitating commercially held FFELP loans must first attempt to sell the loan to an investor, who then assigns the loan to a servicer. A Guaranty Agency may assign a loan to the Department of Education if the Guaranty Agency is unable to find a private-sector buyer. *See* 34 C.F.R. § 682.405(b)(2)(ii).

[37] *See* 34 C.F.R. § 682.405(b)(2)(ii).

[38] *See supra* note 35.

[39] Readers should note that the Higher Education Act prevents borrowers from enrolling in IDR prior to the completion of rehabilitation; however, readers should also note that consumers complain about obstacles when seeking to take incremental steps toward IDR enrollment not explicitly prohibited under federal law, including

communicate with each other regarding borrowers' accounts during the hand off, causing borrowers to receive conflicting information from their servicer and collector. Borrowers note that this conflicting information leads to confusion over whether they are on track to quickly transition to an IDR plan.

3.2.4 Servicing problems after entering repayment

When a borrower completes the transition from a debt collector to a student loan servicer, servicers assume responsibility for managing borrowers' accounts and facilitating enrollment for borrowers seeking alternative repayment plans, including IDR. For borrowers who cured a default through an income-driven rehabilitation, enrollment in IDR is the next step necessary to ensure continuity in their monthly payment level, setting them up for successful repayment over the long-term.

FIGURE 15: THIRD STAGE OF FEDERAL STUDENT LOAN DEFAULT-TO-IDR TRANSITION

Borrower complaints suggest that student loan servicers are not providing clear, accurate, and actionable information on how to continue making income-driven payments after rehabilitation is complete. Once borrowers' loans are placed with a servicer after rehabilitation, borrowers may

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barriers to obtaining information about their expected monthly payment following rehabilitation and obstacles when seeking to obtain or populate required paperwork in advance.

find it difficult and confusing to transition their income-driven payments in rehabilitation to full enrollment in an IDR plan.[40]

When seeking to make post-default payments, borrowers report servicing problems that can contribute to default. As noted above, available data suggest that the vast majority of borrowers curing default through an income-driven rehabilitation make $5 payments, and, consequently, should have a right to make $0 payments under an IDR plan.[41] However, borrowers report that servicers do not proactively take the steps necessary to help them understand how to access IDR and quickly enroll. Borrowers report that these communication and processing problems may lead to subsequent delinquency and re-default.

One borrower who rehabilitated his loan complains that he was facing immediate delinquency when he could not afford to make payments under his standard payment plan after rehabilitation. The borrower complains that after curing his default, his loan was transferred to a servicer where his payment jumped to $1000, which was more than he could afford to pay. He expressed frustration that he was placed in this position because the debt collector was aware of his financial circumstances, but failed to provide this information to his new servicer.

Borrowers complain that poor customer service creates barriers to enrollment in IDR plans, even when they proactively request payment relief. Borrowers report that servicers direct them to temporary forbearance and deferment options, instead of providing information on and facilitating enrollment in an IDR plan. Borrowers who are experiencing continuing financial distress describe how they can quickly fall behind when a short-term cessation of payment expires.

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[40] Borrowers with Parent PLUS loans who complete rehabilitation are not eligible for a repayment plan based on their income. However, borrowers who first consolidate their Parent PLUS loans can enroll in the Income-Contingent Repayment plan. *See* U.S. Department of Education, *Loan Servicing and Collection – Frequently Asked Questions*, LR-Q4 (accessed Sept. 28, 2016), *available at* https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html.

[41] *See* NCHER, s*upra* note 23; GAO, *supra* note 15.

4. Ombudsman's discussion

Based on the preceding analysis of complaints and other market trends, additional discussion is offered below. This discussion represents the Ombudsman's independent judgment and does not necessarily represent the view of the Consumer Financial Protection Bureau.

4.1 Rehabilitation may not be setting up borrowers for success

The preceding section of this report focuses on problems reported by borrowers related to the "default-to-IDR transition" for borrowers who elect to rehabilitate a defaulted federal student loan.

Collectors, in some cases, may earn nearly $40 for every dollar in cash recovered through rehabilitation, suggesting that the desired outcome – curing default – offers taxpayers a long-term economic value beyond the immediate recovery of cash.[42] The Department of Education

[42] Consider a borrower who qualifies for a $5 monthly payment under an income-driven rehabilitation. Collectors will recover a total of $45 over a period of nine months for borrowers who make consecutive repayments. In exchange for completing this rehabilitation, the Department of Education may pay collectors up to $1,710 – nearly 40 times the amount of the cash recovery. *See* U.S. Department of Education, Solicitation ED-FSA-13-R-0006 (Sept. 30, 2014), *available at* https://www.fbo.gov/?s=opportunity&mode=form&id=6b7574995ffcb7209e3b0f5de846f331; and *U*.S.

estimates that more than 70 percent of cured defaults are completed through rehabilitation.[43] In contrast to a student loan servicer, which is generally paid a fixed monthly fee irrespective of a borrower's repayment arrangement, many collectors, including the Department of Education's private collection agencies (PCAs), receive supplemental incentive-based compensation driven by short-term borrower outcomes.[44] However, recent analyses produced by a broad range of stakeholders – including government agencies, student loan market analysts, credit rating agencies, and guaranty agencies – highlight poor repayment outcomes over the medium and long term. These poor outcomes are driven, in part, by the problems identified by consumers in the previous section of this report, suggesting that servicing and collections practices may create obstacles for a broad segment of student loan borrowers pursuing rehabilitation.[45] As these analyses show, many borrowers face significant headwinds when attempting to successfully exit rehabilitation, enter repayment, and succeed over the long term – indicating that the borrowers experiencing the most severe financial hardship are the most likely to re-default.

Department of Education, Solicitation ED-FSA-16-R-0009 (Jan. 22, 2016), *available at* https://www.fbo.gov/utils/view?id=738a6d94d03048187f5fc89b70e98b2e.

[43] *See* U.S. Department of Education, *Federal Student Aid Data Center: Default Rates FY15 Q4 – FY16 Q3* (accessed Sept. 16, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/default; U.S. Department of Education, *Federal Student Aid Data Center: FFEL Program Lender and Guaranty Agency Reports July 2015 – June 2016* (accessed Sept. 16, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/lender-guaranty.

[44] *See* GAO, *supra* note 15.

[45] *See, e.g.*, U.S. Department of the Treasury, Report on Initial Observations from the Fiscal-Federal Student Aid Pilot for Servicing Defaulted Student Loan Debt (Jul. 2016), *available at* https://www.treasury.gov/connect/blog/Documents/student-loan-pilot-report-july-2016.pdf; DBRS, *Rating U.S. Federal Family Education Loan Program Securitizations* (Mar. 2014), *available at* http://dbrs.com/research/265582/rating-u-s-federal-family-education-loan-program-securitizations.pdf; Moody's, *Moody's Proposes to Update Its Approach to Rating Securities Backed by FFELP Student Loans* (Jan. 18, 2012), *available at* http://www.nhhefa.com/documents/MoodysProposestoUpdateItsApproachtoRatingSecuritiesBackedbyFFELPStudentLoans.pdf.

Although public data related to the performance of previously defaulted borrowers is very limited, available data offers insight into the precarious position of many of the most vulnerable borrowers with federal student loans.

The stakes are higher for previously defaulted borrowers. Borrowers are restricted to a single rehabilitation over the life of their loan, meaning that a subsequent defaulted loan cannot be rehabilitated.[46] For a borrower who has previously rehabilitated a loan and is not eligible for consolidation, a subsequent default may be a permanent barrier to critical borrower protections. For example, borrowers in default cannot access the many benefits of IDR, including short-term payment relief, immediate access to interest subsidies, and potential loan forgiveness. Consequently, for previously defaulted borrowers seeking to succeed over the long term, the stakes are higher and the consequences of default are more severe when compared to the borrower population at large.

The volume of defaults cured through rehabilitation is growing. Over the past decade, the volume of defaulted federal student loans cured through rehabilitation has grown precipitously, from less than $6.2 billion in 2012 to more than $12.5 billion over the past year.[47] According to the Department of Education, rehabilitation of defaulted loans accounts for almost 70 percent of the $17.5 billion dollars in federal student loans collected by PCAs and Guaranty

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[46] The 2008 Higher Education Opportunity Act (HEOA) imposed a one-time use limitation on rehabilitations. Prior to 2008, borrowers had a right to rehabilitate defaulted federal student loan debt irrespective of whether they had previously taken advantage of this protection. *See* 20 USC §1078-6 (FFELP) and 20 USC §1087a et. seq. (Direct Loans). Readers should also note that taking out a Direct Consolidation Loan to refinance a previously rehabilitated loan can restore eligibility for rehabilitation if a borrower subsequently defaults on their new Consolidation Loan.

[47] *See* Vigna, Dwight, U.S. Department of Education, *Panel discussion at the NCHER 2014 Knowledge Symposium* (Nov. 3, 2014) *available at* https://c.ymcdn.com/sites/www.ncher.us/resource/collection/D9B3BBF9-0F3A-4E76-BCF5-B82C06A5711C/MON1045ED_Update_-_G3.pptx; U.S. Department of Education, *Federal Student Aid Data Center: Default Rates FY15 Q4 – FY16 Q3* (accessed Oct. 3, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/default; U.S. Department of Education, *Federal Student Aid Data Center: FFEL Program Lender and Guaranty Agency Reports August 2015 – July 2016* (accessed Oct. 3, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/lender-guaranty.

Agencies (GAs) in the last year.[48] Despite the primacy of rehabilitation in the student loan collections market, current policies and practices underpinning the rehabilitation process may be inadequate to set borrowers up for repayment success over the long term.

Nearly half of rehabilitated borrowers will re-default. Recent projections by industry analysts estimate that approximately 45 percent of FFELP borrowers rehabilitating their loans will default again.[49] Of those who default, three quarters will default within the first two years following rehabilitation.[50] This is particularly troubling, given the extended duration of delinquency afforded to federal student loan borrowers under the Higher Education Act, which requires that a borrower miss a minimum of nine monthly payments prior to default.[51] Another private-sector estimate of the performance of previously defaulted FFELP loans notes that re-defaults could climb as high as 60 percent to 75 percent over the lifetime of a loan.[52]

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[48] *See* U.S. Department of Education, *Federal Student Aid Data Center: Default Rates FY15 Q4 – FY16 Q3* (accessed Sept. 16, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/default; U.S. Department of Education, *Federal Student Aid Data Center: FFEL Program Lender and Guaranty Agency Reports July 2015 – June 2016* (accessed Sept. 16, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/lender-guaranty.

[49] *See* DBRS, *Rating U.S. Federal Family Education Loan Program Securitizations* (Mar. 2014), *available at* http://dbrs.com/research/265582/rating-u-s-federal-family-education-loan-program-securitizations.pdf.

[50] *Id.*

[51] *See* 34 C.F.R. §682.200(b)(1); 34 C.F.R. §685.102(b). Due to the elongated period of pre-default delinquency required under federal law, re-default is technically impossible for the first 9 months following the completion of rehabilitation. For borrowers entitled to 12 months of $0 payments under an IDR plan, inability to pay should not be a barrier to remaining current on their obligation. However, this analysis suggests that a substantial share of borrowers who re-default never enroll in an IDR plan with a $0 payment and never make another standard payment after completing a successful rehabilitation – quickly transitioning from default to a delinquency back into default.

[52] *See* Moody's, *Moody's Proposes to Update Its Approach to Rating Securities Backed by FFELP Student Loans* (Jan. 18, 2012), *available at* http://www.nhhefa.com/documents/MoodysProposestoUpdateItsApproachtoRatingSecuritiesBackedbyFFELPStudentLoans.pdf.

One-third of borrowers making $5 rehabilitation payments struggle financially immediately after entering repayment. In a recent presentation to its members, an industry trade association representing student loan servicers and debt collectors estimated that nearly 80 percent of borrowers who seek to rehabilitate their loan make payments of $5.[53] Based on the formula used to determine eligibility for a $5 monthly rehabilitation payment, a majority of these borrowers should expect an IDR payment of $0 per month following a successful rehabilitation – effectively making short-term distress impossible. However, one market participant reports that one-third of borrowers who made the minimum $5 monthly rehabilitation payment became delinquent after 60 days in repayment.[54] In contrast, borrowers making monthly rehabilitation payments of greater than $200 were delinquent at half the rate of borrowers making $5 payments.[55]

This data suggests that the most financially vulnerable borrowers are served poorly, both in the short-term and over the long-term, by the current policies and practices that underpin the default-to-IDR transition.[56] These servicing and collection practices may also pose additional challenges for certain borrower populations, particularly borrowers of color, who face disproportionately greater economic barriers when paying for college and are more likely to experience delinquency and default.[57] Available evidence raises important questions about

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[53] *See* NCHER, *supra* note 23.

[54] *Id.*

[55] *Id.*

[56] Contemporaneously with the publication of this report, the Bureau sent an information request to several of the largest student loan servicers calling for new information about the performance of this important segment of student loan borrowers. *See* Appendix C.

[57] For further discussion*, see* Consumer Financial Protection Bureau, *The significant impact of student debt on communities of color* (Sept. 15, 2016), available at http://www.consumerfinance.gov/about-us/blog/significant-impact-student-debt-communities-color/ ("Despite the increased number of repayment options available to federal student loan borrowers, one-in-four borrowers are delinquent or in default on their federal student loans. This is particularly common for students who leave school before completing their degree or attend for-profit colleges. These

whether the economic incentives that drive collector and servicer practices throughout the default-to-IDR transition are properly aligned and, as discussed below, whether rehabilitation delivers the intended benefits to consumers, industry, and taxpayers when the program was created more than two decades ago.

4.2 Rehabilitation was designed as a feature of the legacy bank-based guaranteed loan program

The basic structure of the rehabilitation program – including the requirement that borrowers make a series of payments to a debt collector prior to exiting default – has not been revised in more than two decades. This process does not reflect two major changes to the federal student loan program in the intervening years – the termination of bank-based guaranteed lending and the establishment of a near-universal right for borrowers to make income-driven student loan payments. As the preceding section of this report indicates, today, consumers encounter significant problems with the debt collection and servicing practices put in place to execute certain required program functions, forcing vulnerable borrowers to work with multiple private companies to complete seemingly duplicative processes to set affordable student loan payments.

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troubling statistics raise concerns that millions of borrowers may not be getting information about repayment options or may encounter breakdowns when attempting to enroll in these plans. For borrowers of color, who are more likely to attend for-profit colleges and face unique obstacles while completing a degree, these breakdowns may be even more troubling. Some research suggests higher rates of student loan defaults and delinquencies in ZIP codes populated primarily by minorities with higher income levels," *citing* Washington Center for Equitable Growth, *Geography of Student Debt* (2016), *available* at http://equitablegrowth.org/research-analysis/an-introduction-to-the-geography-of-student-debt/).

Banks once made the vast majority of federal student loans and rehabilitation was designed as a feature of this program. Prior to the authorization of the Direct Loan program in 1993, banks and other private lenders made all new federal student loans, other than those made by colleges and universities.[58] Prior to 2010, FFELP loans were the dominant source of new student lending, comprising more than 75 percent of all outstanding federal student loans as of the end of fiscal year 2009.[59] These loans are guaranteed by guarantors and reinsured by the federal government.[60] Secondary markets and private investors who purchased FFELP loans (or bonds backed by FFELP loans) provided liquidity under this federally guaranteed lending model.[61] Although Congress halted new originations under FFELP in 2010, nearly $245 billion in commercial FFELP loans remain outstanding.[62]

[58] Readers should note that the 1992 Higher Education Act Amendments created a pilot Direct Loan program, which made a limited number of student loans prior to the authorization of the Direct Loan program in 1993. *See* P.L. 102-325. The Student Loan Reform Act of 1993, a part of the Omnibus Budget Reconciliation Act of 1993, authorized the program in its present form, requiring that the program be implemented on a phased-in basis, reaching scale during the 1998-1999 academic year. *See* Pub. L. 103-66. For further discussion of the structure of the student lending market, *see* Consumer Financial Protection Bureau, *Student Loan Servicing* (2015), *available at* files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf.

[59] *See* U.S. Department of Education, *Federal Student Aid Data Center: Portfolio Summary* (accessed Sept. 12, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/portfolio.

[60] To learn more about the structure of the FFEL Program, *see* 34 C.F.R. § 682.404.

[61] *See* Consumer Financial Protection Bureau, *Testimony of Rohit Chopra Before the Senate Committee on Banking, Housing, and Urban Affairs* (June 24, 2013), *available at* http://www.consumerfinance.gov/about-us/newsroom/the-cfpb-before-the-senate-committee-on-banking-housing-and-urban-affairs/.

[62] *See* U.S. Department of Education, *Federal Student Aid Data Center: Portfolio Summary* (accessed Sept. 12, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/portfolio; U.S. Department of Education, *Federal Student Aid Data Center: ED-Held FFEL Portfolio by Loan Status* (accessed Sept. 12, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/portfolio.

When a borrower with a FFELP loan defaults on his or her obligation, the guarantor repays the private investor that owns the loan and assumes ownership of the loan.[63] However, the guarantor must still attempt to recover the defaulted amount from the borrower, either by serving as a first-party debt collector or by contracting with a third-party debt collector. Federal law also permits collectors to recover "reasonable collection costs" from a borrower by assessing a fee of up to 16 percent of the unpaid principal and accrued interest.[64] Guaranty Agencies turn over recovered funds and the net of collection costs to the federal government.

Guarantors are not permitted to sell defaulted federal student loan debt to private debt buyers – under most circumstances, they must continue to pursue collection of all defaulted debt on their balance sheet until a borrower cures their default or satisfies his or her obligation.[65]

Federal law provides for a series of extraordinary tools to collect on this type of defaulted federal student loan debt (*e.g.* administrative wage garnishment, the offset of tax refunds and other

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[63] Under certain circumstances, the federal government then reimburses the guarantor.

[64] 20 U.S.C. § 1078–6(a)(1). Prior to July 1, 2014, federal law permitted collection costs up to a maximum of 18.5 percent. The Department of Education has ceased imposing collection costs for borrowers with loans on its balance sheet who cure default through rehabilitation; however, this practice continues for borrowers who cure default on a privately held FFELP loan. The U.S. Department of Education has attempted to halt the imposition of collections costs by Guaranty Agencies when a borrower has initiated rehabilitation within 60 days of default. For further discussion, *see* U.S. Department of Education, *Dear Colleague Letter GEN-14-15* (July 10, 2015), *available at* https://www.ifap.ed.gov/dpcletters/attachments/GEN1514.pdf; and *see Bible v. USA Funds Inc.*, 799 F.3d 633 (7th Cir. 2015).

[65] *See* 34 C.F.R. § 682.405. Readers should note that under certain circumstances Guaranty Agencies are also permitted to assign defaulted student loans to the Department of Education after performing "due diligence" to collect on the defaulted debt.

government benefits).[66] Congress subsequently established the rehabilitation program to provide consumers with a path to cure default and return to good standing.[67]

As described in detail in the preceding section, borrowers are required to make nine timely payments over a period of ten months in order to rehabilitate a defaulted loan.[68] Borrowers with FFELP loans depend on their loan guarantor to take an additional step in order to complete rehabilitation – the guarantor must find a lender or other loan holder to "repurchase" the defaulted loan.[69] Establishing a history of timely payments, and requiring additional

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[66] *See, e.g.,* 20 U.S.C. § 1095a (Administrative Wage Garnishment); and 31 U.S.C. § 3720A (Tax Offset Program); *see, generally* 34 C.F.R. § 682. For further discussion, *see* InsideARM, *The Evolution of Student Loan Collections (*2014)*, available at* www.insidearm.com/opinion/evolution-of-student-loan-collections/.

[67] *See* 20 U.S.C. § 1078-6 (FFELP) and 20 U.S.C. § 1087a et. seq . (Direct Loans). For further discussion, see Higher Education Act Amendments of 1992, *Conference Report,* Conf. Rept. 102-630 (June 29, 1992), available at http://files.eric.ed.gov/fulltext/ED351985.pdf. ("The conferees intend that the new loan rehabilitation provisions are to provide a second chance, particularly to low-income borrowers many of whom were defrauded by unscrupulous schools and never received promised jobs or training and who now have ruined credit or even judgements against them because of defaulted loans.")

[68] *See* 20 USC § 1078-6 (FFELP) and 20 USC § 1087a et. seq. (Direct Loans).

[69] Regulations for the FFELP program explicitly prescribe the relationship between the rehabilitation process and the future sale of this debt. *See* 34 C.F.R. § 682.405(a). ("A guaranty agency that has a basic program agreement must enter into a loan rehabilitation agreement with the Secretary. The guaranty agency must establish a loan rehabilitation program for all borrowers with an enforceable promissory note for the purpose of rehabilitating defaulted loans…so that the loan may be purchased, if practicable, by an eligible lender and removed from default status"). Readers should note, however, that as the outstanding volume of commercial FFELP loans continues to decline and remaining privately held FFELP student loans show signs of elevated distress when compared to other asset classes, guarantors may encounter obstacles when seeking to sell rehabilitated loans to investors. As a result, in 2015, the Department of Education created a new conduit to purchase rehabilitated loans from guarantors, in the event that a guarantor is unable to find a private-sector buyer. *See also* 34 C.F.R. § 682.405(a)(2)(ii).

documentation and information from the borrower (*e.g.*, references and a signed rehabilitation agreement) can help guarantors market rehabilitated loans to investors as performing assets.[70]

The rehabilitation program was designed to offer "reasonable and affordable" payments to defaulted borrowers before Congress created a widespread entitlement to an income-driven repayment plan. In 1992, Congress instructed Guaranty Agencies to permit borrowers to rehabilitate defaulted loans by making a series of monthly payments that were "reasonable and affordable" based on a borrower's financial circumstances.[71] For more than two decades, program requirements permitted collectors to negotiate reasonable and affordable payment levels with individual consumers as part of a rehabilitation agreement. This individualized process persisted despite the near-universal right to Income-Based Repayment for non-defaulted borrowers beginning in 2009.[72] In 2014, the Education Department implemented regulations further defining "reasonable and affordable" to

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[70] *See* 34 C.F.R. § 682.405; *See, also* Consumer Bankers Association *et. al.*, *Comment Letter in response to Education Department NPRM defining "Reasonable and Affordable" payments, Docket ID ED-2013-OPE-0063* (2013), *available at* http://consumerbankers.com/sites/default/files/082813_CBA%20Joint%20Comment%20Letter%20to%20Department%20of%20Education%20Regarding%20Federal%20Loan%20Programs.pdf ("Guaranty agencies may also currently require a borrower to provide updated references and contact information to facilitate the rehabilitation process . . . This enhances a guaranty agency's ability to sell the borrower's rehabilitation-eligible loans."); Douglas Lederman, *Left Out by the Bailout* (Inside Higher Education, November 26, 2008), *available at* https://www.insidehighered.com/news/2008/11/26/rehab ("In normal times, guarantee agencies have sold bunches of such loans to banks or other investors that see them as a worthy asset, and "under normal market conditions, these loans were actively sought out," because the borrowers have shown their willingness and ability to overcome the odds and pay them off, says Fitzgibbons of the council of loan programs."); and Deanne Loonin, *Memorandum to National Council of Higher Education Resources* (December 2008), *available at* http://otrans.3cdn.net/a0379eab4e8e4e7482_gam6bnhw0.pdf ("We have heard many different views about the criteria for selling rehabilitated loans. Some GA staff people have told us that a certain minimum monthly payment is required in order to successfully sell the loan. Others say that the loans can be sold regardless of the borrower's payment plan. We understand that the market is volatile and that currently there is little or no market at all for rehabilitated loans.")

[71] 20 USC 1078-6

[72] 20 USC 1098e (FFELP) and 20 USC 1087e (Direct Loans)

align with IBR, attempting to ensure both programs offer consistent payment levels to borrowers experiencing financial hardship.[73] These changes did not alter the structure of the rehabilitation process.

Despite recent changes, the structure and cadence of rehabilitation remains rooted in a design created to work within a bank-based, guaranteed lending model. Despite the substantial changes outlined above, the structure and cadence designed primarily for the legacy FFEL Program endure in both the FFELP and DL markets. This includes requirements that consumers make nine on-time monthly payments before their loans can be restored to a non-default status. The current process also continues to mire rehabilitated loans in an extended transition between collections and loan servicing, delaying borrowers' access to certain consumer protections available to non-defaulted borrowers, especially IDR.

Congress provided Direct Loan borrowers in default with the same consumer protections afforded to FFELP loan borrowers, including the ability to rehabilitate defaulted loans.[74] However, in contrast to FFELP loans, the Department of Education retains ownership of all Direct Loans for the lifetime of the obligation. Beginning in 2015, the Education Department permits FFELP guarantors to transfer successfully rehabilitated FFELP loans immediately to the Department of Education, rather than selling these loans to a new private-sector buyer.[75] Consequently, policymakers may have an opportunity to further streamline the structure for rehabilitation, given that there is no need to accommodate a secondary market.

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[73] *See* 34 CFR 685.211 (Direct Loans), 34 CFR 682.405 (FFELP)

[74] *See* Pub.L. 103-66. When creating the Direct Loan program, Congress also provided the Department of Education with the same extraordinary collection tools provided to guarantors of FFELP loans, such as Administrative Wage Garnishment and tax refund offset. Policymakers envisioned rehabilitation as an important countervailing protection for consumers, providing borrowers with a path to avoid compulsory collections. *See also* 20 U.S.C. § 1087a et seq.

[75] 34 C.F.R. § 682.405(a)(2)(ii).

Market participants, trade associations representing the student loan servicing and collections industries, consumer advocates, and policymakers have called for simplification of the student loan repayment process for borrowers with performing loans.[76] As the preceding discussion demonstrates, the Higher Education Act also forces defaulted borrowers to navigate a complex and complicated process driven by program rules designed for a bank-based, guaranteed lending model. The legacy requirements that underpin the default-to-IDR transition place an increased burden on borrowers, increase costs for taxpayers, create unnecessary barriers to repayment success, and fail to consider the significant changes that have occurred in the higher education finance market in the past decade.

4.3 Consolidation may provide a faster route to IDR for some borrowers

As discussed in the preceding section, eligible borrowers seeking to cure a defaulted federal student loan can choose between rehabilitating this debt and refinancing their defaulted loan with a new Direct Consolidation Loan. Part three of this report focuses extensively on rehabilitation and the range of problems reported by consumers seeking to exercise their right to cure default through this channel. Alternatively, eligible borrowers can choose to cure defaulted federal student loans by refinancing this debt with a new Direct Consolidation Loan. Borrowers can consolidate their loans with the assistance of a collector or initiate the process directly through the Department of Education's website. As part of this process, borrowers may

[76] *See, e.g.*, Comment from Student Loan Servicing Alliance, CFPB-2016-0018-0670 (June 2016), *available at* https://www.regulations.gov/document?D=CFPB-2016-0018-0670; Comment from National Council of Higher Education Resources, CFPB-2016-0018-0674 (June 2016), *available at* https://www.regulations.gov/document?D=CFPB-2016-0018-0674; Jack Remondi, Editorial, *Navient chief: There are 56 options for repaying federal student loans. It's time to simplify.*, Wash. Post (Aug. 26, 2016), *available at* https://www.washingtonpost.com/news/grade-point/wp/2016/08/26/navient-chief-there-are-56-options-for-repaying-federal-student-loans-its-time-to-simplify/#comments.

apply to enroll in IDR at the time of the application for consolidation. Both rehabilitation and consolidation offer similar and different (mutually exclusive) benefits for consumers. The following discussion seeks to explore the differences in structure and cadence associated with each option, which may be instructive as policymakers assess opportunities to reform the "default-to-IDR transition."

Borrowers who cure default through consolidation can immediately regain access to borrower protections and benefits provided under the Higher Education Act, making it a faster and potentially lower-cost solution for borrowers seeking long-term payment relief under IDR, or those seeking to restore eligibility for federal student aid.[77] Additionally, borrowers with Parent PLUS loans are required to refinance their debt with a new Direct Consolidation Loan in order to access a repayment plan based on their income.[78]

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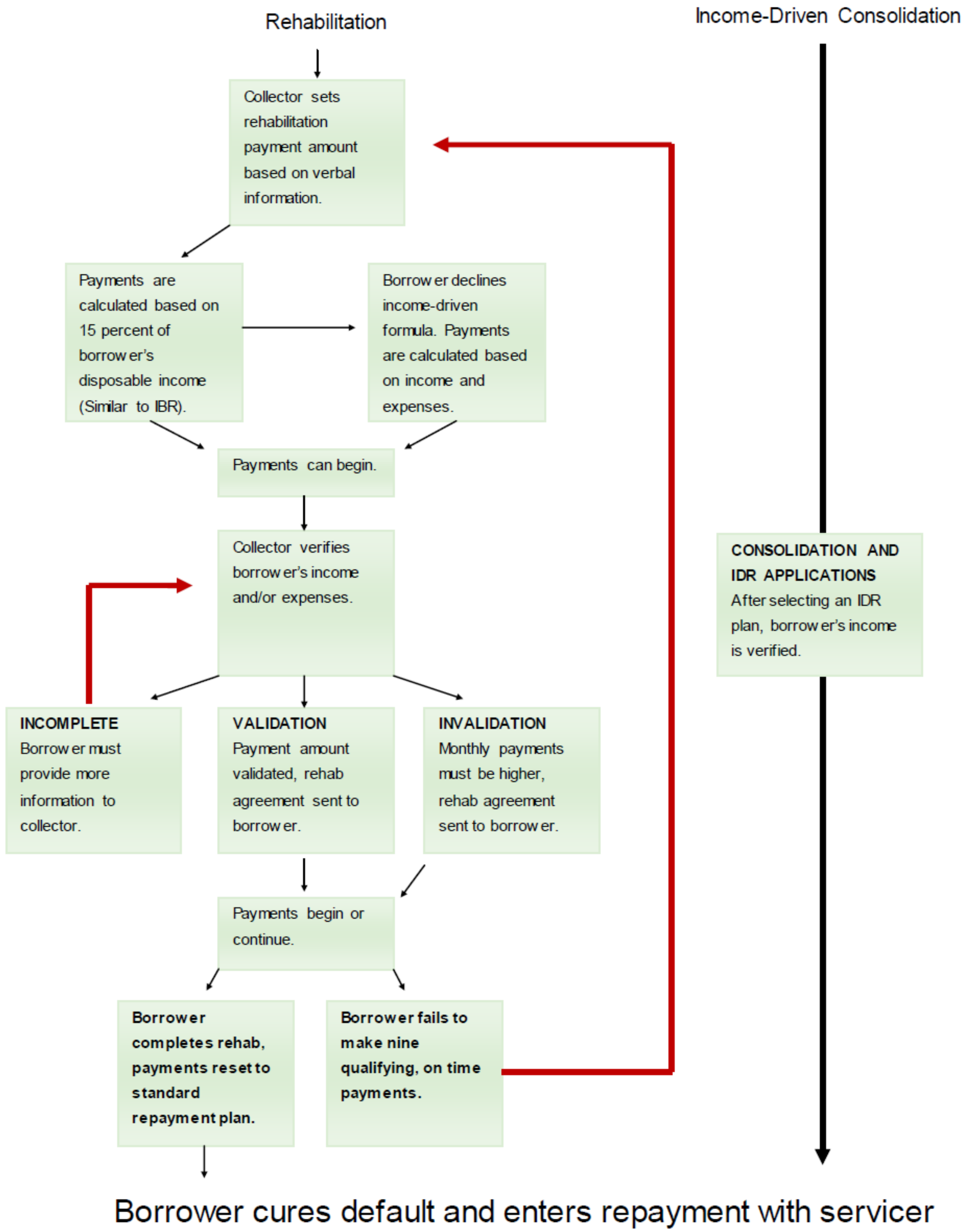
[77] Over time, the assessment of collection costs by debt collectors has varied. Historically, many consumers pursued rehabilitation because debt collectors offered (or were required by the Department of Education to offer) a waiver of collection costs, generally 16 percent of outstanding principal and interest. Under current practice, Direct Loan borrowers may also qualify for a waiver of collection costs when consolidating to cure a default; however, FFELP borrowers are generally assessed these costs, which are capitalized (added to the outstanding principal balance) as part of the refinancing process.

[78] *See* U.S. Department of Education, *Loan Servicing and Collection – Frequently Asked Questions*, LR-Q4 (accessed Sept. 28, 2016), *available at* https://ifap.ed.gov/LoanServicingandCollectionInfo/LSCFAQ.html.

Default-to-IDR: Two potential paths



For some borrowers, consolidation offers a faster track into IDR. In contrast to the months-long rehabilitation process, borrowers may take out a new Direct Consolidation Loan and repay their defaulted debt, irrespective of whether they defaulted on a FFELP loan or a Direct Loan, but not, as noted above, a Direct Consolidation Loan.[79] This process effectively refinances a defaulted loan and extends a new credit obligation to the borrower through the Direct Loan program. Borrowers experiencing financial hardship can immediately cure default without making any payments to a debt collector by completing the required paperwork to enroll their new Direct Consolidation Loan in an IDR plan.[80] After submitting income documentation, the lowest income borrowers can access a $0 "payment."[81] This process can also more-quickly contribute to strengthened household balance sheets by freeing up cash for savings or other expenses. Borrowers enrolled in IDR may also begin to reverse the damage done to their credit by their initial loan default as new information is furnished indicating a successful history of monthly payments under IDR.[82]

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[79] *See* U.S. Department of Education, *Loan Consolidation* (accessed Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/consolidation. Note that borrowers under Administrative Wage Garnishment are not eligible for consolidation.

[80] *See* U.S. Department of Education, *Loan Consolidation* (accessed Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/consolidation. Borrowers generally can only consolidate once. Borrowers can consolidate more than once if the new Direct Consolidation Loan includes an additional Direct Loan or FFELP loan; borrowers can also reconsolidate their loans without an additional loan in certain circumstances, such as FFELP borrowers expressing interest in pursuing the Public Service Loan Forgiveness program.

[81] Alternatively, borrowers can consolidate their defaulted loan and repay the new loan under any repayment plan after making three consecutive, voluntary, on-time, full monthly payments to a debt collector. *See* U.S. Department of Education, *Getting out of Default* (accessed on Sept. 19, 2016), *available at* https://studentaid.ed.gov/sa/repay-loans/default/get-out.

[82] Readers should note that the limited credit benefit offered by the Rehabilitation program is not afforded to previously defaulted borrowers who use consolidation to exit default.

For borrowers who are entitled to access this consumer protection and seek to quickly enroll in IDR, a Direct Consolidation Loan may offer a faster alternative to rehabilitation.[83] However, many of the concerns identified in the preceding section of this report suggest that this option may not be widely advertised by debt collectors or well understood by borrowers in default.

As policymakers consider steps to streamline the "default-to-IDR transition," the simplified IDR enrollment structure available to borrowers who are currently entitled to cure default through consolidation may offer important context.

4.4 Recommendations

Policymakers and market participants may wish to consider the following recommendations to address the specific problems identified in this report.

Streamlining access to IDR for all federal student loan borrowers

The most recent reauthorization of the Higher Education Act took place in in 2008.[84] Since this legislation was last reauthorized, the market for higher education finance shifted and, as noted above, many of the legacy policies and programs established to underpin a bank-based guaranteed loan scheme are now applied to the Direct Loan program, without significant revision to account for the single-creditor structure of this program or a near-universal entitlement to IDR.

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[83] For further discussion, *see* National Consumer Law Center, *Pounding Student Loan Borrowers* (Sept. 2014), *available at* https://www.nclc.org/images/pdf/pr-reports/report-sl-debt-collectors.pdf.

[84] *See* Pub. L. 110-135.

In light of these recent shifts, as reauthorization of HEA is considered, consumers and taxpayers would benefit from a reassessment of the treatment of borrowers with severely delinquent and defaulted loans.

Simplify and streamline access to an income-driven repayment for all borrowers, irrespective of default status. The most economically distressed borrowers are affected directly by the servicing and collections practices highlighted in this report. Regulatory changes made subsequent to the 2008 reauthorization of HEA provide an expanded universe of borrowers with access to an income-driven student loan payment, irrespective of whether their loan is performing or in default. The issues discussed in this report suggest that the "default-to-IDR transition" is failing to achieve its intended purpose – setting borrowers up for repayment success over the long-term.

This raises questions about whether many of the legacy features and economic incentives of the bank-based guaranteed loan program are still relevant in the current single creditor environment. In particular, as policymakers evaluate the efficacy of the default-to-IDR transition, they may wish to examine whether an extended period of income-driven rehabilitation payments and a complicated collector-to-servicer transition are necessary, where a servicer will then be required to enroll a borrower in a new arrangement, but with a similar income-driven structure. As policymakers consider steps to simplify the process of repaying a student loan, they may wish streamline, simplify or enhance the current consumer protections in place for borrowers with defaulted and previously defaulted loans to ensure that the protections are in the best interest of consumers and taxpayers.

In addition to the policy changes recommended above, policymakers and market participants may also wish to consider incremental changes in the immediate term, in order to address the problems described in this report.

Strengthening borrower communications during the rehabilitation-to-IDR transition

As previously discussed, borrowers report a range of operational and communications challenges that may push long-term financial stability beyond reach. In 2015, the Department of Education sought to further "eas[e] the transition of borrowers from rehabilitation to servicing" by providing both collectors and servicers with an additional set of tools to improve this process.[85] All collectors are now required to inform borrowers about the availability of income-driven repayment plans and the process for enrolling, an industry practice in place under the Direct Loan program prior to this rule change.[86] However, evidence suggests that these reforms may be insufficient to assist a substantial share of borrowers navigating the default-to-IDR transition.[87]

In July, the Education Department issued new policy direction to Federal Student Aid (FSA), directing FSA to implement robust servicing standards as part of the Education Department's new vision for servicing student loan borrowers. This guidance directs a process that will include the creation of a new student loan servicing platform for borrowers with Direct Loans and enhanced servicing standards to assist "at risk" borrowers, including borrowers with

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[85] See U.S. Department of Education, Student Assistance General Provisions, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program (Final Rule), 80 Fed. Reg. 67204 (Oct. 30, 2015), available at https://www.gpo.gov/fdsys/pkg/FR-2015-10-30/pdf/2015-27143.pdf.

[86] *See* 34 C.F.R. § 682.405 and 34 CFR § 685.211

[87] Readers should note that the Education Department made incremental changes to enhance the communications required for student loan servicers and private collection agencies under the Direct Loan program, prior to this rule change. In addition, the Education Department required procedural changes to ensure Direct Loan borrowers could continue making payments at the level set in their rehabilitation agreement for three months following the completion of a rehabilitation. Recent Education Department data suggests that the volume of borrowers defaulting for a second time has remained steady over the preceding seven quarters. *See* U.S. Department of Education, *Federal Student Aid Data Center: Default Rates* (Accessed on October 10, 2016), *available at* https://studentaid.ed.gov/sa/about/data-center/student/default./ *See also* Masten, Nancy, *Loan Rehabilitation Counter Proposal* (Submitted to Negotiated Rulemaking Session 2 on March 30, 2015), available at http://www2.ed.gov/policy/highered/reg/hearulemaking/2015/paye2-loanrehab-counterprop.doc ("We understand that Direct Loan servicers currently permit these borrowers to continue making the monthly payment amount established under the loan rehabilitation agreement for the first three monthly payments after rehabilitation is complete, to provide ample time for the borrowers to select a repayment plan and submit any required documentation.").

previously-defaulted loans.[88] Policymakers and market participants should consider immediate action to improve borrower communication throughout the transition from rehabilitation into an IDR plan.

Policymakers and market participants should consider methods for PCAs and Guaranty Agencies to facilitate the application for IDR plans. As described above, PCAs and guaranty agencies work with borrowers to document and verify income and family size – the prerequisites for enrollment in both income-driven rehabilitation and IDR plans. Collectors have strong economic incentives to complete rehabilitations successfully, as short-term borrower outcomes drive collectors' compensation. This is in sharp contrast to a student loan servicer, which generally is paid a fixed monthly fee irrespective of a borrower's repayment arrangement. Given existing economic incentives, the demonstrated capacity for collectors to process income and family size documentation, and the growing body of evidence suggesting that IDR plans drive better borrower outcomes over the long-term,[89] collectors should be required to initiate and assist borrowers seeking to complete applications for IDR plans during the final months of the rehabilitation process.[90] Collectors should also be required to hand-off these documents to student loan servicers for processing. This change in practice would ensure

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[88] *See* U.S. Department of Education, *Education Department to Implement Improved Customer Service and Enhanced Protections for Student Loan Borrowers* (July 2015), *available at* http://www.ed.gov/news/press-releases/education-department-implement-improved-customer-service-and-enhanced-protections-student-loan-borrowers.

[89] *See* Consumer Financial Protection Bureau, *Student Loan Servicing* (2015), *available at* http://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf.

[90] As noted before, Department of Education regulations only require Guaranty Agencies collecting on FFELP loans to provide borrowers pursuing rehabilitation with information on repayment plans available to the borrower after rehabilitating the defaulted loan; explain to the borrower how to select a repayment plan; and provide financial and economic education materials to borrowers who successfully complete loan rehabilitation. In the Direct Loan Program, borrowers who rehabilitate a defaulted Direct Loan are placed initially in an alternative repayment plan, allowing the borrower to continue making the same payments as in rehabilitation for three months while the their student loan servicer provides information to the borrower about the availability of other repayment plans. *See* 34 C.F.R. § 682.405; 34 C.F.R. § 685.211.

that borrowers avoid surprise payment shocks and benefit from the promised continuity between rehabilitation and IDR envisioned by policymakers.

Policymakers and market participants may wish to consider steps to ensure student loan servicers "reach back" to borrowers during the rehabilitation process in order to establish early communication during the transition out of default. As noted in prior reports, accurate and actionable information is critical to facilitate successful enrollment in IDR plans.[91] This is particularly true for borrowers with characteristics that are associated with or predictive of future financial distress. In the July 2016 policy direction noted above, the Department of Education identified previously defaulted borrowers as one cohort of "at risk" borrowers.[92] Policymakers and market participants should consider further enhancing servicer communications for borrowers transitioning out of default, including communications related to IDR enrollment that are personalized to reflect the financial circumstances of these borrowers. These communications can be timed to reach borrowers when these communications can be most effective – during the final stages of the rehabilitation process.[93]

Policymakers may wish to strengthen protections to ensure taxpayer investment in loan servicing and collections is consistent with the intent of these programs. As discussed above, activity in the market for post-default collection of federal student debt

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[91] *See* Consumer Financial Protection Bureau, *Midyear Update on Student Loan Complaints: Income-Driven Repayment Plan Application Issues* (August 2016), *available at* http://files.consumerfinance.gov/f/documents/201608_cfpb_StudentLoanOmbudsmanMidYearReport.pdf.

[92] *See* U.S. Department of Education, Memorandum from U.S. Department of Education Under Secretary Ted Mitchell on Policy Direction on Federal Student Loan Servicing (July 20, 2016), *available at* http://www2.ed.gov/documents/press-releases/loan-servicing-policy-memo.pdf.

[93] In April, the Bureau joined with the Department of Education to release several prototype "payback playbooks" focused on different borrower segments and personalized to reflect borrowers' individual financial circumstances. Market participants may wish to consider adoption of personalized disclosures for borrowers' completing rehabilitation. *See* Consumer Financial Protection Bureau, *Payback Playbook* (Apr. 2016), *available at* http://www.consumerfinance.gov/payback-playbook/.

transitioned rapidly to focus on the rehabilitation of these loans. Economic incentives heavily compensate debt collectors for the completion of a rehabilitation at levels greatly in excess of any cash recovered.[94] Available data suggests that a substantial share of these borrowers subsequently default, raising questions about who benefits from an incentive structure that succeeds at assisting borrowers in curing default, but fails to provide support over the long-term.[95]

Policymakers should consider whether a compensation structure contingent upon a borrower's long-term repayment success better serves borrowers and taxpayers. Reassessing the economic incentives in place for debt collectors and student loan servicers responsible for administering this process can help ensure that companies do not receive an unnecessary windfall for rehabilitating borrowers who experience immediate financial hardship following default.

In light of the issues identified by consumers at every stage of the default-to-IDR transition, policymakers may want to consider incentive compensation contingent upon completion of this entire process – linking debt collector and servicer pay to the completion of a rehabilitation, enrollment in IDR and successful recertification of income after the first year of IDR enrollment.

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[94] *See* U.S. Department of Education, Solicitation ED-FSA-13-R-0006 (September 30, 2014), *available at* https://www.fbo.gov/?s=opportunity&mode=form&id=6b7574995ffcb7209e3b0f5de846f331; and *U*.S. Department of Education, Solicitation ED-FSA-16-R-0009 (Jan. 22, 2016), *available at* https://www.fbo.gov/utils/view?id=738a6d94d03048187f5fc89b70e98b2e.

[95] For further discussion of the potential disincentives in place in student loan servicing and the effect of this economic structure on IDR enrollment, see Consumer Financial Protection Bureau, *Annual Report of the CFPB Student Loan Ombudsman* (2015)*, available at* http://files.consumerfinance.gov/f/201510_cfpb_annual-report-of-the-cfpb-student-loan-ombudsman.pdf.

Strengthening transparency through improved access to data about the performance of previously defaulted loans

As discussed in this report and in past publications, public data on student loan performance is limited when compared to available data on origination and performance of other consumer financial products, particularly mortgages.[96] This is particularly concerning, given mounting evidence that current servicing practices are inadequate to prevent default for a substantial share of "at risk" borrowers, including borrowers previously in default.[97]

As part of the Department of Education's July 2016 policy guidance, the Department of Education directed Federal Student Aid to implement a series of servicer-level public "dashboards."[98] The "Previously Defaulted Borrower Dashboard" included in the policy directive can serve as a potential framework for policymakers considering action to improve transparency.[99]

Borrowers, market participants, and regulators would all benefit from the periodic publication of identifiable, servicer-level data related to the performance of previously defaulted borrowers:

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[96] *See, e.g.*, Consumer Financial Protection Bureau, *2015 Annual Report of the CFPB Student Loan Ombudsman* (October 2015), *available at* http://files.consumerfinance.gov/f/201510_cfpb_annual-report-of-the-cfpb-student-loan-ombudsman.pdf.

[97] *See* U.S. Department of Education, Memorandum from U.S. Department of Education Under Secretary Ted Mitchell on Policy Direction on Federal Student Loan Servicing (July 20, 2016), *available at* http://www2.ed.gov/documents/press-releases/loan-servicing-policy-memo.pdf.

[98] *See* U.S. Department of Education, Memorandum from U.S. Department of Education Under Secretary Ted Mitchell on Policy Direction on Federal Student Loan Servicing (July 20, 2016), *available at* http://www2.ed.gov/documents/press-releases/loan-servicing-policy-memo.pdf.

[99] *Id.*

- Servicer-level data on loan performance for previously defaulted borrowers, including loan status, delinquency status, lifetime re-default rate, school sector and type, and repayment cohort;
- Servicer-level data on repayment plan selection by previously defaulted borrowers, including metrics on IDR plan enrollment, recertification, utilization of forbearance, and the share of previously defaulted borrowers making partial financial hardship payments; and
- Servicer-level data tracking a series of new "cohort re-default rates," documenting loan performance of previously defaulted borrowers over 12-, 24- and 36-month periods following the transition from default to repayment.

In recent months, policymakers and market participants have placed renewed emphasis on expanding IDR utilization amid continued reports of challenges for borrowers seeking to enroll or recertify. Publication of robust performance metrics can better position policymakers and market participants to target resources to assist consumers and can inform future initiatives to establish industrywide standards for the servicing of student loans.

5. Contact information

To reach the CFPB's Student Loan Ombudsman:

By email students@cfpb.gov

By mail Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

To submit a complaint:

Online consumerfinance.gov/complaint

By phone 180+ languages, M-F 8am-8pm EST
Toll-Free: (855) 411-CFPB (2372)
TTY/TDD: (855) 729-CFPB (2372)

By mail Consumer Financial Protection Bureau
PO Box 4503
Iowa City, Iowa 52244

By fax (855) 237-2392

Press and media requests

By email press@consumerfinance.gov

Congressional inquiries

By phone (202) 435-7960

Additional resources to assist student loan borrowers

Repay Student Debt web tool
http://www.consumerfinance.gov/paying-for-college/repay-student-debt

Paying for College suite of tools
www.consumerfinance.gov/paying-for-college/

Ask CFPB
http://www.consumerfinance.gov/askcfpb/

APPENDIX A: FEDERAL STUDENT LOAN COMPLAINT SAMPLE

Company	Total complaints handled March 1, 2016 – August 31, 2016	Total complaints reviewed in sample set
Navient Solutions, Inc.*	812	200
AES/PHEAA*	580	200
Nelnet*	259	200
Great Lakes	152	152
ACS Education Services	117	117
ECMC Group, Inc.	48	48
MOHELA	47	47
Utah System of Higher Education	39	39
Heartland Payment Systems	37	37
EdFinancial Services	21	21

*For companies with over 200 complaints handled during the reporting period, a random sample of 200 complaints was reviewed.

APPENDIX B: TAGGING DEFINITIONS

Issue Tag	Definition
Billing Statements	Consumer complained about information related to a billing statement, including timely receipt of a bill, method of receipt (paperless inbox, paper mail, etc.), or ability to review previous payments made.
Borrower Repayment Communications	Consumer complained of student loan debt and is seeking general payment relief, but does not identify specific issues related to IDR plans. Issue tag also includes problems related to extended and graduated repayment plans.
Credit Reporting	Consumer complained of either (1) individual loans are reported as trade lines, when they are grouped for billing or account purposes; or (2) deferment and/or forbearance not reported as “paid as agreed.”
Customer Service	Consumer complained of problems related to a company’s customer service representative, including receiving conflicting or incorrect information, excessive calls, and debt collection tactics.
Discharge	Consumer complained of problems related to student loan discharge, including discharge for total and permanent disability, closed school, defense to repayment, and teacher loan forgiveness programs.
Enrollment Status	Consumer complained of problems relating to or resulting from the consumer’s enrollment status with his or her institution.
For-Profit	Consumer complained of problems related to attending a for-profit institution.
Income-Driven Repayment	Consumer complained of problems related to income-driven repayment, including enrollment, recertification, qualified payments, and switching between IDR plans.
Other	Consumer complained of a problem not captured by other tags, including debt relief scams.
Payment Processing	Consumer complained of problems related to payment allocation, default allocation methodology, autopay, or submission of payments.
Payoff	Consumer complained of problems related to paying off a student loan, including loan consolidation and refinance.
Rehabilitation	Consumer complained of problems related to federal student loan rehabilitation, enrolling in or exiting rehabilitation, making payments during rehabilitation; also includes problems related to defaulted borrowers seeking to make payments but have not yet entered a rehabilitation

	program.
Servicing Transfer	Consumer complained of problems relating to or resulting from the transfer of a loan or account to a new servicer. Issue tag may include changes to auto pay or interest reductions.

APPENDIX C: VOLUNTARY DATA REQUEST

DATE, 2016

Name
Company
Address Line 1
Address Line 2

Dear [Name]:

We have heard from consumers who have encountered problems related to the transition out of default and into repayment under an income-driven repayment (IDR) plan, following the rehabilitation or consolidation of their defaulted federal student loans. The Bureau estimates that more than 220,000 previously defaulted student loan borrowers who are potentially eligible to make zero dollar payments under an IDR plan will end up back in default over the next 24 months. Over this period, these borrowers will incur more than $125 million in unnecessary interest charges - a direct consequence of these borrowers' inability to secure an income-driven payment. The purpose of this letter is to request additional information about the policies and procedures in place at your company related to the service you provide to your previously defaulted customers.

Performance of rehabilitated loans and loans consolidated from default

If you hold or service commercial FFELP loans, ED-held FFELP loans, or federal Direct Loans that have been rehabilitated or consolidated from default, it would be helpful to understand the extent to which borrowers of these loans select specific repayment plans, continue to maintain a current payment status, and ultimately remain in good standing.

Information on policies and procedures related to the servicing of rehabilitated student loans and loans consolidated from default. Please describe your company's practices, policies, and procedures when servicing newly rehabilitated loans and loans consolidated from default. Please include any relevant information related to initial communication, payment plan selection, and any special assistance provided to borrowers.

Please note any specific efforts related to assisting these borrowers in enrolling in an IDR plan and the extent to which your company has specially trained staff who proactively work with these "at risk" borrowers. Additionally, please include the point, if at all, in the rehabilitation or consolidation process in which your company first initiates contact with a borrower before their loan is placed with your company.

Information about repayment plans for newly rehabilitated loans. For rehabilitated loans from accounts with only undergraduate loans (Subsidized and Unsubsidized Stafford) received by your company in calendar year 2015, accounts that include rehabilitated graduate and professional loans (*e.g.,* Subsidized Stafford, Unsubsidized Stafford, and PLUS loans borrowed by graduate and professional students) that you received in 2015, and accounts with rehabilitated Parent PLUS[100] loans that you received in 2015, separated by federal loan program (Commercial FFEL, ED-held FFEL, and Direct Loans), please describe:

a. The breakdown between number of accounts that were in an IDR plan and those not in an IDR plan on borrowers' first, second, third, fourth, sixth, and ninth billing due dates.[101]

b. The number of accounts, number of rehabilitated loans, and dollar amount of rehabilitated loans for those accounts in each repayment category for each billing cycle described in (a).

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[100] All loans for accounts with both undergraduate and graduate loans should only be counted in the graduate and professional account type. Similarly, all loans for accounts with any Parent PLUS loans should only be counted in the Parent PLUS account type.

[101] IDR plans include Income-Based Repayment, Income-Contingent Repayment, Pay as You Earn, and Revised Pay as You Earn. For the purposes of this data request, all loans from accounts with both Direct Loans and FFELP loans should be categorized in the analysis based on the highest outstanding balance between programs.

To determine what portion of accounts received by your company were rehabilitated, please also indicate the total number of accounts, number of loans, and dollar amount of loans received by your company during the same timeframe.

Information about repayment plans for newly consolidated loans comprised of previously defaulted loans. For loans consolidated from default within accounts containing consolidated undergraduate loans (Subsidized and Unsubsidized Stafford) received by your company in calendar year 2015, accounts that include consolidated graduate and professional loans (*e.g.,* Subsidized Stafford, Unsubsidized Stafford, and PLUS loans borrowed by graduate and professional students) that you received in 2015, and accounts with consolidated Parent PLUS[102] loans that you received in 2015, separated by federal loan program (Commercial FFEL, ED-held FFEL, and Direct Loans), please describe:

a. The breakdown between number of accounts that were in an IDR plan and those not in an IDR plan on a borrowers' first, second, third, fourth, sixth, and ninth billing due dates.[103]

b. The number of accounts, number of consolidation loans, and dollar amount of consolidation loans for those accounts in each repayment category for each billing cycle described in (a).

Information on successful repayment for rehabilitated loans. For rehabilitated loans serviced by your company, please describe the following, separated by federal loan program (Commercial FFEL, ED-held FFEL, and Direct Loans), account type (accounts with

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[102] *See* note 100.

[103] *See* note 101.

undergraduate loans, accounts with graduate and professional loans, and accounts with Parent PLUS) and by repayment plan (an IDR plan or non-IDR plan):

a. The total number of accounts with rehabilitated loans, number of rehabilitated loans, and dollar amount of rehabilitated loans for those accounts;

b. Number of accounts, average number of loans, and average dollar amount placed with ED or purchased by a Guarantee Agency on or before December 31st, 2015;

c. The average number of billing cycles an account identified in subsection (a) is in repayment before placement with ED or purchased by a Guarantee Agency; and

d. The percentage of accounts identified in subsection (a) that are placed with ED or purchased by a Guarantee Agency without making a single successful payment.[104]

Please provide this information separately for account cohorts that were received by your company in each of the calendar years 2012, 2013, and 2014.

Information on repayment success for consolidated loans. For loans consolidated from default and received by your company, please describe the following, separated by federal loan program (Commercial FFEL, ED-held FFEL, and Direct Loans), account type (accounts with undergraduate loans, accounts with graduate and professional loans, and accounts with Parent PLUS) and by repayment plan (an IDR plan or non-IDR plan):

a. The total number of accounts with consolidation loans, number of consolidation loans, and dollar amount of consolidation loans for those accounts;

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[104] For the purposes of this data request, a successful payment is one that meets or exceeds the amount due in a monthly billing statement made under a standard payment plan or a repayment plan selected by the borrower. A loan with a zero dollar payment in a borrower selected IDR plan should be considered as paid in full for that month. Payments made during rehabilitation, or before you start billing, do not count as successful payments. Months under a deferment, forbearance, or similar status does not count as a successful payment.

b. Number of accounts, average number of loans, and average dollar amount placed with ED or purchased by a Guarantee Agency on or before December 31st, 2015;

c. The average number of billing cycles an account identified in subsection (a) is in repayment before placement with ED or purchased by a Guarantee Agency; and

d. The percentage of accounts identified in subsection (a) that are placed with ED or purchased by a Guarantee Agency without making a single successful payment.[105]

Please provide this information separately for account cohorts that were received by your company in each of the calendar years 2012, 2013, and 2014. To determine what portion of loans consolidated from default and serviced by your company are placed with ED or purchased by a Guarantee Agency; please also indicate the total number of consolidated loan accounts you received for servicing during each of these calendar years.

Information about payment history for rehabilitated loans. Please describe how your company processes payments from a borrower made after making his or her ninth successful rehabilitation payment with his or her collector. After a borrower has made nine successful payments, please describe how your company applies any additional borrower payments made to his or her collector before his or her loan is received by your company for regular servicing.

This is not a request for confidential supervisory information and your response is voluntary. Information provided in response to this request will support the Bureau's ongoing consumer education and market analysis functions and will be treated in accordance with the Bureau's confidentiality regulations, 12 C.F.R. Part 1070. We may make public certain information we gather in response to this request, but we will not identify any specific market participants when doing so. Information provided may be subject to public disclosure to the extent required by law.

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[105] *See* previous note.

If you choose to respond, the information that you provide must not include any personally identifiable information that directly identifies any consumer, such as a consumer's name, address, telephone number, social security number, or account number. Data and other submissions should be provided to the CFPB via a secure method appropriate to the sensitivity of the information. (For example, you can use a Secure File Transfer Protocol (sFTP) server).

If you have any questions about this request, please do not hesitate to let us know. Please respond by XXXX, 2016. We hope to share aggregate results from responses by various market participants. Thank you in advance for your participation.

Sincerely,

Seth Frotman
Assistant Director and Student Loan Ombudsman
Consumer Financial Protection Bureau