May 16, 2017

Update from the CFPB Student Loan Ombudsman

Transitioning from default to an income-driven repayment plan

May 16, 2017

Contemporaneous with the publication of the 2016 Annual Report of the CFPB Student Loan Ombudsman, the Bureau sent a letter seeking information from several student loan servicers. This letter requested a range of qualitative and quantitative information about practices for servicing the student loan accounts of economically vulnerable borrowers as they transition from default into an income-driven repayment plan (the "Default-to-IDR transition").[1]

In response, servicers that collectively handle accounts for approximately half of all student loan borrowers provided information to the Bureau. The following report provides the public with a preliminary update on the information provided, including a closer look at data related to the performance of certain previously defaulted student loan borrowers. Despite the growing scale of our student loan default problem and the high stakes for borrowers and taxpayers, this new data suggests that this process is failing the borrowers who need it most.

Seth Frotman
Student Loan Ombudsman
Consumer Financial Protection Bureau

[1] *See* Consumer Financial Protection Bureau, *2016 Annual Report of the CFPB Student Loan Ombudsman* (Oct. 2016), https://www.consumerfinance.gov/data-research/research-reports/2016-annual-report-cfpb-student-loan-ombudsman/.

A Closer Look at the "Default-to-IDR Transition"

As noted above, the Bureau sent a voluntary request for information to several student loan servicers, seeking information about practices for servicing the student loan accounts of borrowers as they transition from default into an income-driven repayment plan. Servicers collectively handling accounts for more than 20 million student loan borrowers provided a range of qualitative and quantitative information in response to the Bureau's request.[2] This input provides additional support for the observations made in the Bureau's October 2016 report—hundreds of thousands of struggling student loan borrowers will end up back in default over the next two years, paying more than $125 million in unnecessary interest charges on the way. A combination of problematic servicing practices and government programs can prevent the most vulnerable student loan borrowers from accessing affordable repayment plans (i.e. income-drive repayment or IDR)—increasing costs to taxpayers and failing to set up borrowers for success over the long term.[3]

Based on the data submitted in response to our request, the CFPB has made the following preliminary observations. Of borrowers about whom a servicer provided information about loan performance:

- **The vast majority (greater than 90 percent) of borrowers who rehabilitated one or more defaulted loans were not enrolled and making IDR payments within the first nine months after "curing" a default.** As the Bureau's October 2016 report discussed in detail, for most borrowers exiting default, the range of widely-

[2] Responses include qualitative responses from three student loan servicers collectively servicing loans for more than 20 million borrowers with Direct Loans, ED-held FFELP loans, and privately held (commercial) FFELP loans. In addition, two servicers provided quantitative responses to the Bureau, providing summary data about borrower performance for more than 600,000 unique borrowers recently curing at least one previously-defaulted federal student loan.

[3] The following general observations reflect data provided by two servicers collectively servicing borrowers on behalf of the Department of Education and private holders of legacy guaranteed federal loans (FFELP). Information in this section about borrowers with previously-defaulted federal student loans is not based on random sample, the population may not be representative of all borrowers with previously-defaulted federal student loans, and readers should not infer statistical significance or causality, based on this analysis. However, given that this data includes information about four borrower cohorts totaling approximately 600,000 borrowers who cured a default in 2012, 2013, 2014, and 2015 (about one fifth of all federal loan borrowers exiting default over this period, based on the Bureau's estimate), it may offer readers insight into the experience for a typical borrower who is serviced by a large nonbank servicer and might avoid re default by making a successful default-to-IDR transition.

available IDR plans should ensure payments remain affordable and repayment success is possible over the long-term. However, a series of administrative, policy, and procedural hurdles may limit access to or enrollment in IDR for borrowers with previously defaulted federal student loans.[4] Data provided in response to our request reinforces this observation. Of previously defaulted borrowers who recently completed rehabilitation and for whom a servicer provided information about short-term performance, fewer than 1-in-50 (two percent) were enrolled and making payments in IDR in their first billing cycle after rehabilitation. In fact, the vast majority of these borrowers still had not accessed IDR nine months later—fewer than 1-in-10 borrowers in this cohort (less than ten percent) were enrolled and making payments in IDR by the ninth billing cycle after rehabilitation.

- **Borrowers who did not enroll in IDR were five times more likely to default for a second time.** A growing body of evidence suggests that borrowers making income-driven payments default at far lower rates than borrowers enrolled in other types of payment arrangements.[5] Data provided in response to this request also demonstrates that IDR is an important default-aversion tool for many of the most vulnerable student loan borrowers. When comparing three-year outcomes for borrowers who rehabilitate a loan, borrowers in our sample who did not enroll in IDR were five times more likely to redefault than those who did enroll in IDR within the first three-to-four years following the successful rehabilitation of their defaulted loans. Data provided in response to our request shows that 45 percent of borrowers who were not enrolled in an IDR plan ended up back in default within three years. Of previously defaulted borrowers who completed rehabilitation and for whom a servicer provided information about three years of repayment history, virtually all borrowers who defaulted for a second time (greater than 95 percent) were not enrolled in an IDR plan at the time of redefault. Of the borrowers in this cohort who enrolled in IDR, fewer than 1-in-10 (less than 10 percent) redefaulted over this period.

---

[4] *See* Consumer Financial Protection Bureau, *2016 Annual Report of the CFPB Student Loan Ombudsman* (Oct. 2016), https://www.consumerfinance.gov/data-research/research-reports/2016-annual-report-cfpb-student-loan-ombudsman/.

[5] *See, e.g.* Consumer Financial Protection Bureau, *Student Loan Servicing* (2015); and U.S. Department of Education, *Servicing Summit Portfolio Overview* (Dec. 2014), http://fsaconferences.ed.gov/conferences/library/2014/servicing/2014ServicingSummitPortfolioOverview.ppt.

- **Nearly one in three borrowers who exited default through rehabilitation defaulted for a second time within 24 months, and over 40 percent of borrowers redefaulted within three years.** In the CFPB's October 2016 report, the Bureau relied on a series of publicly available data sources and estimates by third-party analysts to project that approximately 1-in-3 borrowers who rehabilitate a loan would redefault in the near term. New data provided to the Bureau supports this projection. Of previously defaulted borrowers who completed rehabilitation and for whom a servicer provided information about two years of repayment history, approximately 30 percent had redefaulted within the first 24 months. Evidence suggests that, while a critical mass of defaults is concentrated in the period immediately following rehabilitation, additional borrowers do continue to default over time. Of previously defaulted borrowers who completed rehabilitation and for whom a servicer provided information about three years of repayment history, more than 40 percent had redefaulted within three years.

- **A large majority (over 75 percent) of borrowers who default for a second time did not successfully pay a single bill to their student loan servicer.** All borrowers who cure default through rehabilitation have demonstrated their ability to successfully make timely payments to a debt collector each month (a prerequisite to rehabilitate a student loan).[6] These payments are generally pegged to borrowers' financial circumstances and can be as low as five dollars per month.[7] However, data suggests that this track record of payment success does not translate to continued success once a borrower's rehabilitated loans have been placed with a student loan servicer. Of previously defaulted borrowers for whom a servicer provided information about two years of repayment history and who default for a second time, three-in-four borrowers (over 75 percent) did not successfully satisfy a single bill, including those who used forbearance or deferment for a period of time before defaulting again.[8] As the Bureau's October 2016 report noted, the CFPB estimates that as many as four out of every five borrowers who rehabilitate a student loan could be eligible for a zero dollar

[6] *See* 34 C.F.R. 682.405 (FFELP), 34 C.F.R. 685.211 (Direct Loans).

[7] *Id.*

[8] For the purposes of this data request we asked servicers to define a successful payment as 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. Borrowers with a zero dollar payment in an income-based repayment plan they selected is considered as paid in full for that month. Payments made during rehabilitation, or before the servicer starts billing, do not count as successful payments. Months under a deferment, forbearance, or similar status does not count as a successful payment.

"payment" under an IDR plan, suggesting many of these defaults were preventable, even for the most economically vulnerable consumers.[9]

- **In stark contrast, borrowers who used consolidation to resolve their student loan defaults are more likely to immediately begin to repay their debts successfully.** Unlike the nine-month-long rehabilitation program, the consolidation option allows borrowers to immediately pay off their defaulted loans by refinancing them into a new Federal Direct Consolidation Loan.[10] Except in rare circumstances, borrowers consolidating defaulted loans are required to enroll in an IDR plan, which is easily facilitated by the Federal Direct Consolidation Loan application process.[11] Relatively few borrowers use this mechanism to cure defaulted loans (rehabilitations generally make up 70 percent of federal loan collections while consolidation makes up less than 20 percent).[12] While these borrowers may differ from those choosing rehabilitation, data provided to the Bureau suggests those choosing consolidation have better outcomes. Of previously defaulted borrowers who recently cured default through consolidation and for whom a servicer provided information about short-term performance, nearly all (95 percent) remained in active repayment twelve months later. After two years, 20 percent of these borrowers defaulted for a second time, relative to the approximately 30 percent of borrowers who defaulted for a second time after using rehabilitation.[13]

---

[9] As the Bureau's October 2016 report discusses in detail, many of these defaults appear to be preventable. Upon completion of the rehabilitation program with a collector, federal Direct Loan borrowers are permitted to continue making the same payment amount required under their rehabilitation agreement to their new servicer for up to three months. After this three month grace period, borrowers' payments are based on a standard 10-year payment plan. Unless a borrower enrolls in an IDR plan, his or her payments will likely increase, potentially by hundreds of dollars or more each month. *See* Consumer Financial Protection Bureau, *2016 Annual Report of the CFPB Student Loan Ombudsman* (Oct. 2016), https://www.consumerfinance.gov/data-research/research-reports/2016-annual-report-cfpb-student-loan-ombudsman/.

[10] For a further discussion of the relative benefits and costs associated with rehabilitation and consolidation, *see* Consumer Financial Protection Bureau, *2016 Annual Report of the CFPB Student Loan Ombudsman* (Oct. 2016), https://www.consumerfinance.gov/data-research/research-reports/2016-annual-report-cfpb-student-loan-ombudsman/.

[11] *See* 34 C.F.R. 685.220.

[12] *See* Consumer Financial Protection Bureau, *2016 Annual Report of the CFPB Student Loan Ombudsman* (Oct. 2016), https://www.consumerfinance.gov/data-research/research-reports/2016-annual-report-cfpb-student-loan-ombudsman/.

[13] The cumulative default rate for this cohort of borrowers nearly quadruples in the second year following IDR consolidation. In contrast, rehabilitated borrowers largely redefault within the first year following rehabilitation. Readers should note that redefault among consolidation borrowers in this cohort follows the first IDR 'recertification' obligation, after which many borrowers fail to maintain payment levels reflective of their income. Further study is necessary to determine whether strengthened servicing practices related to IDR recertification could improve the longer-term outcomes for these borrowers. For further discussion of student loan servicing and IDR recertification

Taken together, data provided by servicers reinforces the Bureau's concern that hundreds of thousands of borrowers who recently cured their default through rehabilitation are unable to successfully access a stable and affordable repayment plan and soon end up back in default. Borrowers who cure default through consolidation appear to fare much better, particularly in the first months after exiting default.

The data outlined in this Update offers further support for the policy recommendations included in the 2016 Annual Report of the CFPB Student Loan Ombudsman. In October 2016, the Bureau called for immediate action to improve and strengthen the transition from default-to-IDR.

As reauthorization of the Higher Education Act is considered, the data presented in this Update can inform proposals to improve repayment success for previously defaulted borrowers through immediate access to a stable and long-term IDR plan and to strengthen servicing practices to ensure borrowers avoid default in the first place. 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 and whether current financial incentives for these companies are in the best interests of taxpayers and consumers. [14] In addition, policymakers and market participants can take the steps in the near-term, as outlined in the Bureau's October 2016 report, 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.

---

see, Consumer Financial Protection Bureau, *When you make student loan payments on an income-driven plan, you might be in for a payment shock* (Aug. 2015), https://www.consumerfinance.gov/about-us/blog/when-you-make-student-loan-payments-on-an-income-driven-plan-you-might-be-in-for-a-payment-shock/.

[14] The Bureau noted that policymakers may wish to reevaluate the economic incentives in place for debt collectors and student loan servicers to encourage long-term success for the most vulnerable borrowers. In 2016, the Department of Education changed the way new student loan accounts are allocated to student loan servicers. Under the new metrics, the Department of Education penalizes student loan servicers when accounts they manage go delinquent and default. However, the metrics now explicitly exclude the performance of rehabilitated loans for new account allocations. *See* U.S. Department of Education, *Servicer Performance Metrics and Allocations*, https://studentaid.ed.gov/sa/about/data-center/business-info/contracts/loan-servicing/servicer-performance.