

Memorandum

To: U.S. Department of Education; Negotiated Rulemaking Committee

From: Persis Yu and Joshua Rovenger, Negotiators for Legal Assistance Organizations that Represent Students and/or Borrowers; Bethany Lilly and John Whitelaw, Negotiators for Individuals with Disabilities or Groups Representing them

Date: October 4, 2021

Re: Additional Topics to add to Rulemaking: Protections for Defaulted Borrowers

Introduction

Roughly 9 million borrowers are in default on their federal loans.¹ Defaulted borrowers experience extraordinarily punitive collection tactics, such as wage garnishment, social security offset, and tax refund offset—including seizure of the Child Tax Credit and Earned Income Tax Credit, that undermine the social safety net and siphon funds away from life’s necessities like food, rent, childcare, and medication.

As one borrower shared with the National Consumer Law Center, “I am a single mother of 2 children and struggling to not be homeless. I fell behind on student loans after the death of my husband due to the fact that now my household had become a single income. I was counting on my return this year to get back on track and save some money to help with those unforeseen bumps in life. Now I’m left in the middle of an ocean with no life support, the U.S department of education has taken all of my federal and state income tax. My loans are in a rehabilitation program, but not knowing about this program before filling taxes this year, it was too late to stop the offset. I don’t believe it is right for them to take everything.”²

The government can engage in these tactics all without a court order. These harsh realities are overwhelmingly more likely to be felt by families of color. Because of decades of structural inequities and discrimination, student loans have burdened Black and Latinx borrowers more than other groups, and, as a result, these borrowers default at twice the rate of their white peers.³

¹ U.S. Dep’t of Educ., Federal Student Aid Default Management, Official Cohort Default Rates for Schools, available at <https://www2.ed.gov/offices/OSFAP/defaultmanagement/cdr.html>.

² For more stories from borrowers experiencing offset see Persis Yu, National Consumer Law Center, Voices of Despair: How Seizing the Eitc is Leaving Student Loan Borrowers Homeless and Hopeless During a Pandemic (July 2020) available at <https://bit.ly/Road-to-Relief-Student-Debt>.

³ Judith Scott-Clayton, The looming student loan default crisis is worse than we thought, Economic Studies at Brookings (Jan. 2018), available at <https://www.brookings.edu/research/the-looming-student-loan-default-crisis-is-worse-than-we-thought/>; Ben Miller, The Continued Student Loan Crisis for Black Borrowers, Center for American Progress (Dec. 2019), available at <https://www.americanprogress.org/issues/education-postsecondary/reports/2019/12/02/477929/continued-student-loan-crisis-black-borrowers>.

Borrowers in default who are subject to the government's vast extra-judicial collection powers often pay thousands of dollars more per year than if they were in an income-driven repayment plan.⁴ For example, a single parent with two children who works full time earning minimum wage was eligible for a \$5,800 Earned Income Tax Credit payment in 2020, which would add 39% to the family's pretax income and lift their family just above the poverty line.⁵ If the parent were in IDR, she would not owe anything on her loans that year due to her income level. Yet if she were instead in default, the entire EITC credit could be seized, forcing the family to pay a huge portion of their poverty-level income for the year toward student debt instead of necessities. Similarly, the GAO has reported on borrowers whose social security benefits are offset to collect on student loans yet live below the poverty line,⁶ these borrowers may have \$0 a month payments if instead enrolled in IDR. The effect of these involuntary collection tactics can have devastating effects on borrowers, their children, and, in aggregate, their communities.

The limited programs currently available to help borrowers in default are not sufficient to guard against financial devastation for borrowers. Through this rulemaking, the Department has the opportunity to rethink how it treats defaulted student loan borrowers. The Department should not impose so many barriers to orders for them to be in good standing on their loans and avoid harsh punishment.

The Department of Education has the authority to do more for defaulted borrowers, including authority under the Higher Education Act to eliminate some of the most harmful collection practices and to provide more options for defaulted borrowers. Specifically, through this rulemaking, the Department should amend its regulations in order to:

- Create additional pathways out of default; and
- Eliminate the acceleration clause upon default; and
- Limit the amount collected to the IDR amount when involuntary collection is used.

Proposal 1: Create additional pathways out of default

Statutory cites: §455(d)(5) of the Higher Education Act of 1965, as amended;

Regulatory cites: 34 CFR § 685.211(d)(3)(ii))

Currently, there are only four pathways out of default: rehabilitation, consolidation, settlement, and payment in full. Our low-income clients can rarely afford to settle their loans under current Department settlement guidelines, nor can they afford to pay their loans in full. Thus, for most borrowers, rehabilitation and consolidation are the only two viable paths for getting out of

⁴ See Consumer Financial Protection Bureau, Annual report of the CFPB Student Loan Ombudsman (Oct. 2016), available at https://files.consumerfinance.gov/f/documents/102016_cfpb_Transmittal_DFA_1035_Student_Loan_Ombudsman_Report.pdf.

⁵ Economic Policy Institute, The EITC and minimum wage work together to reduce poverty and raise incomes (Jan. 2020), available at <https://www.epi.org/publication/eitc-and-minimum-wage-work-together/>.

⁶ U.S. Gov't Accountability Office, Social Security Offsets: Improvements to Program Design Could Better Assist Older Student Loan Borrowers with Obtaining Permitted Relief, GAO-17-45 (Dec. 2016), available at <https://www.gao.gov/products/gao-17-45>.

default. Unfortunately, borrowers are limited in the number of times that they are allowed to consolidate or rehabilitate their loans, leaving many borrowers stuck in default with no way out. Concerningly, the CFPB found that the “vast majority (greater than 90 percent) of borrowers who rehabilitated one or more defaulted loans were not subsequently enrolled and making IDR payments within the first nine months after ‘curing’ a default.”⁷

The HEA does not limit the pathway out of default to rehabilitation and consolidation. Rather, it defines how a borrower gets into default, but is *silent* on getting out

The Department has the authority to create additional pathways for borrowers to exit default. In particular, the Department should utilize the authority in 20 U.S.C. § 1087e(d)(5), authorizing the Secretary to place “any borrower who has defaulted on a loan made under this part to ... repay the loan pursuant to an” income-driven repayment plan, to create a pathway out of default for borrowers who opt into an income-driven repayment plan. There is no requirement under the HEA which requires that once the defaulted borrower is placed into an IDR plan that their loans be treated as if they are still in default. Selecting this option would effectively cure the borrower’s default. Then these payments should all be qualifying payments towards forgiveness and there should be no limit to the number of times a borrower can get out of default.

Proposal 2: Eliminate the acceleration clause and limit involuntary collection to the income-driven repayment amount

Statutory cites: §§455(d)(5) & 493C of the Higher Education Act of 1965, as amended;

Regulatory cites: 34 CFR §§ 682.215, 685.209, & 685.221

Currently, when a borrower is more than 270 days behind, the loan goes into default and the Department accelerates it (i.e, the entire loan balance becomes due and payable in full).. This is why borrowers in default can face seizure of their entire tax refund, including thousands of dollars in EITC and CTC funds intended to lift families out of poverty, even if the borrower only missed a few hundred dollars worth of payments. Borrowers who default are almost always financially distressed and struggling with the affordability of their loans. Utilizing involuntary collection tools such as administrative wage garnishment, administrative offsets, and tax refund offset (including, for many of our clients, their Earned Income Tax Credit and this year the Child Tax Credit), student loan borrowers in default pay significantly more than they would under an Income-Driven Repayment (IDR) plan. This inequitable result causes significant financial distress.

IDR has the potential to ensure that federal loan repayment will be affordable regardless of one’s income after graduation. But acceleration has the effect of making borrowers responsible for payment of their entire loan balance at a time when they can least afford it. The HEA does

⁷ 1 Consumer Financial Protection Bureau, Update from the CFPB Student Loan Ombudsman (May 16, 2017), https://files.consumerfinance.gov/f/documents/201705_cfpb_Update-from-Student-Loan-Ombudsman-on-Redefaults.pdf.

not require acceleration and, where discussed in the master promissory note, it is discretionary.⁸ The government should not expect or require these struggling borrowers to pay more toward their loans than borrowers who have been able to stay current on their loans.

To remedy this situation, the Department should end its policy of accelerating the entire loan balance when a borrower defaults on their loan. The Department should then use its authority to require defaulted borrowers to repay pursuant to an IDR plan, thus limiting any amounts certified for involuntary collection to be capped at the amount not paid under an IDR plan.⁹

⁸ 20 U.S.C. § 1087dd(c)(1)(B) (loan terms “shall include provision[s] for acceleration of repayment of the whole, or any part, of such loan, at the option of the borrower[.]”).

⁹ 20 USC § 1087e(d)(5) (“Repayment after default. The Secretary may require any borrower who has defaulted on a loan made under this part to... (B) repay the loan pursuant to an income contingent repayment plan.”).