MEMORANDUM

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To: U.S. Department of Education

From: Persis Yu and Joshua Rovenger, Negotiators for Legal Assistance Organizations that Represent Students and/or Borrowers

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Re: Proposal to Provide Defaulted Borrowers with the Benefits of Income-Driven Repayment

Despite the wide availability of income-driven repayment (IDR) plans—and significant improvements to program design and generosity over time—too many borrowers continue to struggle with repayment, with some even defaulting despite being enrolled in IDR.

One-quarter (25%) of all Direct Loan borrowers were either delinquent or in default at the end of 2019; over a million Direct Loan borrowers entered default in 2019 alone. Too many of these borrowers are never making it into IDR—which is a proven path to help many avoid delinquency and default—and even for some who do, income-based payments can still be too high. In addition, not all borrowers—including those who struggle most with repayment—have access to the program.

Meanwhile, borrowers who default face devastating consequences—including wage garnishment and tax refund offsets—as well as significant hurdles in curing their default and restoring their loans to good standing. 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.

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. If the parent were in IDR, they would not owe anything on their loans that year due to their income level. Yet if that borrower 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 they live below the poverty line. 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.

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.

Through the current negotiated rulemaking process, the Department of Education has the opportunity to make borrower-centered reforms to the student loan repayment system by creating a more generous and accessible income-driven repayment (IDR) plan (as outlined in an issue paper from the Department). The Department's implementation of the FUTURE Act also has the potential to help keep borrowers on track by making it easier to get into and stay in an IDR plan.

To complement those efforts, the Department can also create additional pathways for borrowers to get out of default and access this improved plan and ensure that repayment regulations are consistent for borrowers whose loans are in good standing and those whose loans are in default.

We propose that the Department—in addition to the reforms that will be made to income-driven repayment—also consider modifying income-driven repayment- and default-related regulations in several key areas. While each of these is necessary to help struggling borrowers, neither is sufficient on its own: They should be implemented together to holistically improve the repayment system.

(1) **Create additional pathways for borrowers to get out of default and into an improved IDR plan:** For most borrowers, rehabilitation and consolidation are the only two viable paths for getting out of 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. 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." Some indications suggest that the implementation of a "warm transfer" may improve borrower outcomes. However, even with the "warm transfer" from rehabilitation to repayment, there are still several steps between default and income-driven repayment in which borrowers may fall through the cracks. We believe the Department can solve this problem by amending 34 C.F.R. § 685.211(d)(ii) by adding a new subpart:

> (B) A borrower may request that the Secretary designate the income-contingent repayment plan or the income-based repayment plan to repay the borrower's defaulted Direct Loans. Upon making a payment under § 685.209 or § 685.221, the loan will not be considered in default and will no longer be subject to the penalties of default.

(2) **Ensure that repayment regulations are consistent for borrowers whose loans are in good standing and those whose loans are in default.** Even with improved opportunities for borrowers to exit default, some borrowers may still struggle to navigate the system, or may not know or

understand their options, and will likely remain in default. Borrowers who do not take affirmative steps to exit default must still be able to access income-driven payments—and those payments must count toward forgiveness—while in default. Currently, not only do borrowers in default not have access to income-driven repayment (statute allows this, but current regulatory language does not) but they also are often required to pay more in default than they ever would while in repayment. We believe the Department can solve this problem by amending 34 C.F.R. § 685.211(d) as follows:

(d) Default—

~~(1) Acceleration. If a borrower defaults on a Direct Loan, the entire unpaid balance and accrued interest are immediately due and payable.~~

...

(~~3~~2) Collection of a defaulted loan.

(i) The Secretary may take any action authorized by law to collect a defaulted Direct Loan including, but not limited to, filing a lawsuit against the borrower, reporting the default to nationwide consumer reporting agencies, requesting the Internal Revenue Service to offset the borrower's Federal income tax refund, and garnishing the borrower's wages. Any amount collected per month through this section shall be determined by taking the lesser of the amount calculated under § 685.208 (b) or (c), § 685.209, or § 685.221.

In addition to these regulatory changes, the eligibility and forgiveness sections of § 685.209 and § 685.221 would need to be amended to eliminate barriers for borrowers with defaulted loans.