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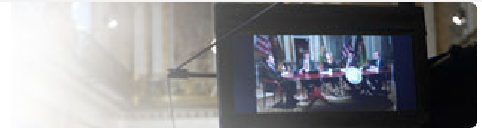

Remarks of Deputy Secretary Raskin on Student Loans at the National Consumer Law Center's Annual Consumer Rights Litigation Conference

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As prepared for delivery

TAMPA, FLORIDA - Good morning, everyone. Thank you very much for inviting me to speak here at the National Consumer Law Center's Consumer Rights Litigation Conference. The work of the National Consumer Law Center, and the work that many of you in this room do to directly help consumers deal with the legal dimensions of their financial lives, is of great importance. I commend you for your ongoing and persistent efforts and insights on behalf of consumers.

The last time I joined this gathering it was 2010 and we met in Boston. It was my first year at the Federal Reserve and my remarks—which were my first set of public remarks as a Federal Reserve Governor—focused on problems in mortgage servicing. Now, during my first year at the Treasury Department, I want to focus on issues in student loan servicing and, in particular, how we are working across the Obama Administration to drive improvements in the servicing of student loans.

As you well know, millions of student loan borrowers are in default on their student loans; many more could face default in the near future; and countless others are struggling to keep their payments current.

Looking at just the federal student loan portfolio, the Department of Education's recently released cohort default rates indicate that 13.7 percent of borrowers that entered repayment in FY 2011 defaulted within three years [1]. For borrowers that entered repayment in FY 2011, 10% defaulted within two years. If we look at default rates for borrowers who attended for-profit colleges, the cohort default rates are even higher at 19.1 percent this year. While students at for-profit colleges represent only 11 percent of the higher education population, they accounted for 32 percent of borrowers in the most recently released cohort and 44 percent of those who had defaulted.

In total, there were approximately seven million federal borrowers in default as of June 30th, and that has increased by approximately 200,000 borrowers in just the first half of this year.

In addition, while the Department of Education doesn't publish delinquency data on the guaranteed portion of the federal student loan portfolio, nearly 1.7 million federal direct student loan borrowers are 90 days or more past due, and hence at serious risk of default.

These numbers have caught your attention, my attention, the attention of the Administration and the attention of regulatory agencies like the Consumer Financial Protection Bureau, as well as a significant number of market participants. Today there is a significant and necessary focus on how we can prevent delinquencies and defaults and improve outcomes for borrowers. There are many facets to the work the Department of Education is doing in this regard, to more effectively reach borrowers and strengthen servicing in the federal student loan portfolio. I want to spend our time today focusing on the importance of effective student loan servicing and debt collection.

From our experience in the mortgage market, we know the importance of servicers informing borrowers and guiding them through the process of identifying the best repayment options. Yet we also know that absent proper supervision, enforcement, and well-structured incentives, servicers can fall far short performing these functions well.

We are hearing about poor servicing tactics such as:

- servicers allocating partial payments proportionally across a borrower's loans, causing all the loans to be considered delinquent;
- private student loan servicers charging late fees when payments are received during the grace period after the due date [2]; and
- servicers failing to provide student loan borrowers with sustainable repayment options, which only compounds financial struggle instead of controlling it.

Theoretically, it is possible that these failures may turn out to be short-term technical problems that will soon be fixed. Nevertheless, with so many student loan borrowers interacting with servicers on a daily basis, servicer actions matter.

Federal student loans present demands for servicing that are different from private student loans, given that they are subject to different terms and offer different borrower protections. However, borrowers have made similar complaints with federal student loan servicers as with private servicers which essentially are the same entities [3]. Servicers have provided inadequate information on repayment options and failed to enroll them in an income-driven repayment plan. With more than 40 million federal student loan borrowers interacting with servicers and debt collectors, servicer and debt collector actions heavily influence the ability of students to complete their higher education, avoid the consequences of delinquency and default, and achieve their educational potential to the benefit of themselves and to the benefit of the country. In short: a lot is riding on the content of servicer actions.

As we know from experiences of mortgage servicing in 2010, servicing loans involves far more than sending statements and processing payments.

Student loan servicing cannot be one-size-fits-all. Placing student loan borrowers in an appropriate and sustainable repayment plan is time-consuming, detailed work. The structural incentives under which the servicers operate must be aligned with the interests of student loan borrowers and the public mission.

While our country has an interest in reducing barriers to higher education, and the federal government has a responsibility to taxpayers that is tied to the performance of the loans, the interests of federal student loan servicers are not going to be tied to these outcomes unless the terms of their contracts are structured correctly. To oversimplify a bit, the servicers make money by maximizing revenue earned and minimizing expenses while performing the actions spelled out in their contracts with the government. So this begs the question: how can contracts be optimally structured in such a way that a profit-maximizing servicer will be motivated to meet the needs of borrowers and the federal government?

Absent proper contractual incentives, proactive measures by the servicer to prevent borrower defaults—which could be a win-win for the student loan borrower and the government—might result in the servicer losing money. Why? Because the servicer must do a substantial amount of work with a student loan borrower to find the option that best meets the borrower’s needs before the borrower becomes delinquent or in default. Loss mitigation options, such as enrolling borrowers in income-driven repayment plans, require individualized case work. Thus, the servicer needs to invest in resources, including trained personnel who can deal with often complex one-off transactions. The incentives created by the contract with the lender—be it a private lender or the federal government—will matter to the ultimate performance of the servicer in dealing with the borrower.

And so, this is an important consideration that has guided the Department of Education’s recent efforts to restructure its contracts for federal student loan servicers. In August of this year, the Department of Education used contractual terms and obligations to direct the ways in which servicer actions optimize the performance of the federal loan portfolio by paying for better outcomes. They have increased the amount that servicers are paid for keeping borrowers current, placed greater weight both on helping borrowers avoid delinquency and on borrower feedback when allocating new loans to servicers, and added incentive payments for servicers who are able to drive down borrower delinquency rates.

Given that these contracts have only been in place for two months, we cannot yet evaluate how they will affect student borrowers. But, we do know that without incentives for high-touch servicing, the standard business model for the servicing industry would seem to put a thumb on the scale in favor of delinquency and default. The renegotiated contracts are a useful step to shape and improve the incentives in student loan servicing and drive better borrower outcomes. And the Department of Education will monitor how servicers perform under these new incentives and metrics to reassess how they can be strengthened.

With regular monitoring, evaluation, and ultimately enforcement, we can determine what refinements are needed to ensure that incentives are not being “gamed” and that they are driving improvements in servicer performance and better borrower outcomes. The benefit of proper incentives will not be realized if they are not rigorously enforced and adjusted. We can reward servicers who excel at serving students and sanction servicers who do not meet the contracts’ standards.

Now let’s turn from delinquency to default. When federal student loans enter default status, they move from a servicer to a debt collector. The Department of Education has contracts for debt collection with 22 student loan debt collection entities, often referred to as private collection agencies.

In the case of federal student loans, the Department of Education assigns defaulted loans to debt collectors based on their relative performance. This is measured on a quarterly basis across five metrics, with the largest emphasis for performance placed on the amount of money that an agency is able to recover and the value of loans rehabilitated from its assigned borrower accounts [4].

However, as I previously discussed, incentives may be misaligned here as well. Unlike most forms of consumer debt, defaulted federal student loans can be rehabilitated and returned to good standing, and debt collectors currently receive significant compensation for this service. Yet many close observers and practitioners, like you, have suggested that private collection agencies are not doing enough to help borrowers accomplish this goal and are otherwise thwarting good borrower outcomes.

This is a troubling sign and may suggest that the incentives should be refined, just as the Department of Education has recently refined its contracts with servicers. Federal student loan debt collectors need to be encouraged to remove loan accounts from default when possible, as well as deal fairly with borrowers, and the incentive structures in debt collector contracts should convey these priorities.

After the Department of Education refers the defaulted loans to a private debt collector to engage in collection efforts, the loans are also referred to the Treasury Offset Program, as required under the Debt Collection Improvement Act. This mandatory, last-resort program for federal debts will withhold certain federal benefits due to borrowers until a loan is repaid or satisfactory payment arrangements are made.

In the case of federal student loans, this typically does not occur until after at least 420 days from when a borrower first became delinquent. Prior to being placed in the Treasury Offset Program, borrowers receive a written notice indicating the balance of the defaulted debt, the plan to move the debt into the Offset Program, and a notice of borrower rights. If the borrower does not repay, the debt is placed in the Offset Program and the borrower is informed when a payment is withheld. Servicers' actions themselves are critically determinative of whether the loan moves into the Treasury Offset Program, and whether accordingly, the federal government's strong tools of collection are triggered.

Withholding payments — Social Security, Earned Income Tax Credits, a tax refund—are a last resort in recouping federal debt precisely because they can have severe effects on borrowers. For this reason alone, the objective in demanding effective servicing is to prevent borrowers from ever reaching this point.

This is why Department of Education Under Secretary Ted Mitchell is in the process of identifying additional actions that the Department can take to strengthen the outcomes for federal student loan borrowers. This work is focused on ensuring that all students have access to high-quality servicing and effective collections to prevent and remediate defaults.

I also want to briefly mention a final risk that arises with failed servicing.

In 2009 and 2010, during the height of the mortgage crisis, I often saw signs plastered on telephone poles that read: "Mortgage relief now!" or "Need to refinance?" or "We buy houses!" followed by a catchy 1-800 number to call. We knew then that these were not advertisements, but were scams, and that they were emblematic of the desperation that borrowers were experiencing with mortgage servicers.

Remembering these telephone poles is like the re-run of a bad movie: will student loans fuel the next onslaught of shadowy, fee-ridden offers that claim to provide borrowers with the elusive opportunity to eliminate their debt? I worry about the emergence of a student loan "debt relief" industry. When student loan servicing fails to work for borrowers, vulnerable borrowers turn to the friendly phone number on the telephone pole.

Players in the debt relief field are typically for-profit companies that claim to offer various ways for borrowers to consolidate or rehabilitate their existing student loans. These companies do not operate on behalf of the federal government and, as recent work by the National Consumer Law Center has noted, these firms can pose serious threats to consumer protection because they engage in questionable practices and charge egregious and unnecessary fees. Borrower complaints show that misleading claims are used to trick borrowers into paying unreasonable amounts to enroll in options that may not even exist or to access repayment options they are entitled to without charge [5].

As you well know, these are not the only consequences student loan borrowers confront when their loans become delinquent or enter default status. Delinquencies are reported to the private credit bureaus and can inhibit a borrower's access to future credit for buying a home, starting a business, or completing or furthering education. Borrowers may also have a portion of their wages taken directly from their paychecks. In other words, they may disengage from personal and professional development, and may drop into the ranks of those preyed upon by scams. Additionally, the fresh start afforded by bankruptcy is not available for student loan debt, unless student loan debtors mount a case that proves undue hardship.

Given the weight of these and all the consequences I've discussed, as well as the importance of higher education in our nation's prosperity, it is imperative that we structure an effective servicing and collection regime focused on helping borrowers avoid default and delinquency.

Conclusion

Actions in this vein have already begun. The recently renegotiated servicer contracts are a critical step in aligning servicer compensation to outcomes that enhance borrowers' ability to take advantage of sustainable payment plans that minimize delinquency and default. And while the Department of Education has made crucial strides to improve student loan servicing and debt collection, we must stay focused.

As I've said before, the United States has a world-class higher education system that is the envy of the world, and our system of federal student lending should be world-class and world-famous as well. Driving improvements in our student loan servicing and debt collection systems are an essential part of this aspiration.

Because so much is riding on getting these systems right, and because student loan borrowers have such little measure of individual choice or recourse, we know there is more work to be done. Many of you have been doing a lot to point out problems we face and to give student loan borrowers some protection and redress when wronged, and we rely on you for this advocacy.

I also would like to see a more detailed review of default and delinquency data and differential borrower outcomes by type of institution. This may present opportunities on the next frontier of improving borrower outcomes.

The Administration has enhanced and will continue to enhance its ability to drive improvements in servicer and debt collector actions and systems. We need to continue close scrutiny of the issues I've discussed, and, as necessary, adapt the servicer contracts to require such improvements as well as follow through with appropriate enforcement action that addresses them.

Thank you very much for your continued attention to this topic, and for the invitation to speak with you today.

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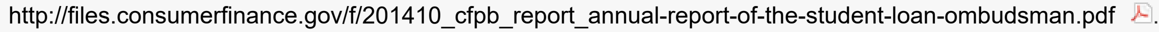
[1] Three-year Official Cohort Default Rates for Schools, Federal Student Aid, available at:

http://www2.ed.gov/offices/OSFAP/defaultmanagement/cdrschooltype2yr.pdf

[2] Annual Report of the CFPB Student Loan Ombudsman, October 16, 2014.

http://files.consumerfinance.gov/f/201410_cfpb_report_annual-report-of-the-student-loan-ombudsman.pdf.

[3] For federal student loans, the loan holder is the federal government, and servicing is primarily contracted to the Title IV Additional Servicers (TIVAS). The TIVAS are Great Lakes Educational Loan Services, NelNet, FedLoan Servicing, and Navient, (which was formerly Sallie Mae).

[4] Private Collection Agency Contracts, Federal Student Aid, https://studentaid.ed.gov/about/data-center/business-info/contracts/collection-agency.

[5] NCLC, Searching for Relief: Desperate Borrowers and the Growing Student Loan "Debt Relief" Industry, June 2013.