DELIVERING DISTRESS TO BORROWERS IN DEFAULT

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Introduction

Over seven million Americans are in default on their federal student loans, and over two million of those borrowers have struggled under the weight of this debt for over 20 years, with no hope in sight.[1] Student loan default both results from financial distress and exacerbates it. Many borrowers in default are simply unable to pay their loans in full, and continued collection efforts are doomed to fail—while inflicting needless economic pain on millions of low-income Americans and their families. The government's collection efforts, including seizures of poverty-level wages and Social Security benefits, interfere with many families' ability to pay for necessities and keep them trapped in cycles of poverty.

Further, although there are a variety of safety net programs intended to prevent default and to cancel the debts of certain distressed borrowers, many people eligible for those programs have nonetheless defaulted because the companies paid to service their loans failed to connect them to these programs, wrongly denied them access, or actually steered them away. As discussed throughout this paper series, servicers have an obligation to help borrowers access the relief they are entitled to under law. Defaulted borrowers have paid the ultimate price for these servicing failures.

Fortunately, the U.S. Department of Education (ED) can choose to end this suffering. This paper starts by grounding readers in the consequences of student loan default, who is in default and why, and why so many borrowers remain in default for years. It then identifies legal authority, under existing regulations, that empowers the Secretary of Education to compromise student loan debts and so end collection from defaulted borrowers where such efforts would be futile or unreasonable. Now—before the suspension of federally-held student loan collection ends next year—is the time to act on that authority.

The Consequences of Student Loan Default

Borrowers default on their federal loans after 270 days of nonpayment. Following default, ED notifies credit reporting agencies and accelerates the debt—meaning the full balance becomes immediately due in full. It then begins attempting to collect the full amount of the debt as quickly as possible through a variety of means. During this time, borrowers continue to be charged interest along with potentially significant collection fees and penalties that can cause their debt to balloon.[2]

To collect the debt, the federal government can extra-judicially garnish wages, seize tax refunds—including refunds attributable to anti-poverty tax credits like the Earned Income Tax Credit and Child Tax Credit[3]—and seize a portion of some federal benefits, including Social Security benefits. While there are limits on how much the government can seize from a borrowers' wages or Social Security, such seizure can result in the borrower being left with income that is well below the poverty line.[4]

These collection practices have a disastrous impact on the financial security of low-income borrowers, who report that these seizures interfere with their ability to pay for necessities like housing, transportation to work, food, and medication.[5] There is no statute of limitations on the collection of federal student loan debt, so the government's collection practices often keep borrowers in an indefinite cycle of debt and obstruct their pathway out of poverty.

Who Defaults on Federal Loans?

A growing body of research demonstrates that borrowers default not because they are attempting to shirk payment, but because they simply cannot afford to pay and have been unable to access or are not served by existing debt relief programs.[6]

Borrowers who are most likely to default are those who entered school with limited financial resources and those whose investment in education has not paid off. Borrowers in default overwhelmingly come from low-income families and are first-generation college students.[7] Nearly half of borrowers with loans in default did not finish their degree[8] and as a result do not have improved employment prospects when they enter repayment. Further, people who attended for-profit colleges account for half of federal student loan defaults.[9] These borrowers are more likely to have higher debt burdens and a low-value credential that makes it difficult to pay off their debt.[10]

Default is also racialized: Borrowers of color, and especially Black borrowers, are disproportionately likely to experience default.[11] In one longitudinal study, nearly a third of all Black graduates reported having defaulted at least once, as opposed to one-tenth of white graduates,[12] whereas another study found that one in two Black borrowers and two in five Hispanic borrowers, regardless of graduation status, would default over a 20 year repayment period, as opposed to less than a third of white borrowers.[13] This is due, in part, to the persistent racial wage and wealth gaps—realities that are exacerbated by unequal levels of student loan debt.[14] Similarly, researchers estimate that twice as many Black Parent PLUS borrowers—who are often pressured to take on federal loans for their children despite having low-incomes and no realistic ability to repay—will default on their loans as white Parent PLUS borrowers.[15]

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Finally, other economically vulnerable populations are also more likely to be in default. This includes older Americans, many of whom rely on Social Security disability and retirement benefits that are subject to partial seizure following default.[16] It also includes people with disabilities, who are more likely to have lower-incomes than their non-disabled peers and may have larger medical bills.[17] While some disabled borrowers may be eligible for totally and permanently disabled discharges, many are ineligible for the program, are unaware that they may be eligible, or cannot navigate the application process.

Many Vulnerable Borrowers Default Because They Could Not Access Relief Programs

As a result of past policy failures and servicer misconduct, millions of borrowers are currently in default who not only should not be in default, but should have had their loans discharged already through either the income-driven repayment programs or the various discharge programs available to borrowers whose investment in education did not pay off due to school closure or misconduct or a physical or mental condition.

As ED recognized in 2022, longstanding and widespread servicing failures and misconduct resulted in millions of financially-distressed borrowers missing out on the full benefits of the Income-Driven Repayment (IDR) program, which promises participants discharge of their remaining loan balance after 20 to 25 years in repayment.[18] Among other problems, instead of enrolling cash-strapped borrowers into IDR, servicers steered them into forbearances, which would lead their loans to accrue interest and drive up their outstanding debt.[19] Eventually, those forbearances would end, and the borrowers, still unable to pay, would default on the now larger loans. This problem was particularly acute for the lowest-income borrowers, who would be eligible for $0 payments in IDR while making progress toward having their debt discharged. One study found that less than half of borrowers who received means-tested government benefits, like SNAP or SSI, were enrolled in IDR, even though IDR would entitle them to a $0 payment.[20]

These practices catalyzed the Biden Administration's IDR Account Adjustment. However, time in default has been excluded from receiving relief, even though borrowers in default suffered the most severely from those practices, and some paid much more in default than if they had been in IDR. If servicers had effectively connected financially-distressed borrowers to IDR, or if the Biden Administration were to include time in default as part of its IDR Account Adjustment, then many of the over two million Americans with loans in default that are over 20 years old[21] would be eligible for automatic discharge of their loans now.

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Additional borrowers wind up in default due to systemic failures to connect them to other Congressionally-created discharge programs. For example, a review by ED in 2016 found that almost half of disabled borrowers eligible for a Total and Permanent Disability Discharge were in default on their loans.[22] Similarly, when reviewing ED's practices and rules governing Closed School Discharges, a Government Accountability Office (GAO) report found that half of the borrowers that would receive an automatic discharge three years after their school closed were in default on their loans.[23] While ED is making important progress in delivering discharges to eligible borrowers by expanding the use of automatic discharges, it is without question that many borrowers still remain in default despite being eligible for discharge.

Many Borrowers in Default, Particularly Those That Are Older or Are Persistently Low-Income, Will Never Be Able to Repay Their Loans

Just as many borrowers in IDR programs will never repay their loans in full, and rely on IDR forgiveness to put an end to their indebtedness, many borrowers in default will never be able to repay their loans in full. While the premise behind the student loan system is that the investment in education will pay off in increased earnings, allowing for successful repayment over time, it is clear that is not the case for some borrowers.

This is particularly problematic for borrowers who subsist on income near or below the poverty line for a number of years. Poverty in the United States is sticky: Recent research found that 44 percent of people in poverty for a year will not be able to exit poverty, and that portion jumps to 87 percent for people who are in poverty for seven years.[24] Many borrowers in poverty simply lack sufficient income or assets to collect to repay their student loans in full despite the government's powerful collection apparatus. And what little is available to collect from them—generally only certain anti-poverty benefits like the Earned Income Tax Credit, the Child Tax Credit, or a portion of poverty-level Social Security benefits or wages—likely should not be collected, and would not be considered available for student loan payment in income-driven repayment.

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While public data on long-term default is limited, information that ED has made available in recent years demonstrates both that a sizeable portion of borrowers currently in default have been unable to repay their loans in full despite decades in repayment and default, and that for some persistently low-income borrowers, enforced collection does not result in progress toward paying down the debt.

First, ED data released in 2021 revealed that over two million borrowers were in or close to default on loans that were over 20 years old, and over three million additional borrowers were in or close to default on loans that were 10 to 20 years old.[25]

Second, a 2016 GAO report revealed that many older borrowers subject to Social Security offset to collect their defaulted student loans had sufficiently low income that the collection failed to result in any progress in reducing their debt.[26] The GAO report highlighted that nearly three quarters of the amounts collected through Social Security offset were applied to interest and fees and did not touch principal.[27] A third of these borrowers remained in default for five years after becoming subject to offset, and many saw their loan balances increase over time despite the offsets.[28] Thus, ED pursued collection and deprived these borrowers of basic subsistence income for years, pushing many borrowers' benefits below or further below the poverty level in doing so,[29] even though it did not result in meaningful repayment.

The Biden Administration Promised Relief to Borrowers in Default

In April 2022, the U.S. Department of Education announced that it would provide a "Fresh Start" to millions of borrowers with loans that entered default under prior administrations. The Biden Administration's Fresh Start program has temporarily suspended default consequences, including collection, for federal student loans in default and allows borrowers to request to be fully removed from default, and returned to "good standing" in repayment, through September 2024.

The Fresh Start program has provided critical relief to financially-distressed borrowers in default, among other things protecting their income and benefits from seizure so they can put those funds toward their and their families' basic needs.[30] But unfortunately, uptake in the program has been low, likely due to insufficient communication to borrowers about the program.[31] As a result, for most borrowers with loans in default, the harsh consequences of default will resume later next year.

The Administration Should Act to Cancel Eligible Defaulted Loans Before Collection Resumes

The Biden Administration has a pivotal window of opportunity to act on the default crisis between now and fall 2024, when forced collection activities resume on roughly seven million Americans with student loans in default. Fortunately, ED has tools available to provide relief to many of these borrowers, and in particular to those who have experienced significant financial distress and who are unlikely to be able to successfully repay their student loans. There are at least two potential avenues that ED should consider:

- First, under current regulations, the Secretary has authority to compromise federal student loan debts that it is "unable to collect . . . in full within a reasonable time."[32] This may encompass a large number of defaulted federal student loan debts, including debts that have already been in collection for a significant amount of time without collection in full, and additional debts that are unlikely to be collectible in full within a reasonable amount of time based on data readily available to the Secretary. Exercising this authority could allow the Secretary to discharge a substantial number of outstanding student loan debts that the government is unlikely to be able to collect in full and that will otherwise continue to inflict needless financial hardship on low-income Americans.
- Second, the Secretary could extend the current IDR Account Adjustment to provide credit towards loan forgiveness for past time in default, on a one-time basis, just as it is already providing credit for past time in delinquency and several other statuses indicative of financial distress and systemic failures to connect eligible borrowers to IDR.

This paper focuses on the first path–compromising uncollectible debts–with extension of the IDR Account Adjustment discussed in detail elsewhere.[33] But the two approaches are not mutually exclusive; pursuing both could maximize relief to borrowers who have experienced extended financial distress and as a result have been unable to repay their loans in a reasonable amount of time.

Starting from the legal framework for compromise, current Department regulations provide that "under the provisions of 31 CFR part 902 or 903, the Secretary may compromise a debt in any amount, or suspend or terminate collection of a debt in any amount, if the debt arises under the Federal Family Education Loan Program . . . , the William D. Ford Federal Direct Loan Program . . . , or the Perkins Loan Program." 34 C.F.R. § 30.70(e)(1). Part 902, in turn, authorizes the Secretary to compromise a debt if "[t]he Government is unable to collect the debt in full within a reasonable time by enforced collection proceedings." 31 C.F.R § 902.2(a)(2).

In summary, current regulations authorize the Secretary to compromise a Direct, Federal Family Education Loan (FFEL), or Perkins Loan that the Secretary determines that the government is unable to collect in full within a reasonable amount of time through enforced collections.[34]

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The question then arises: How does the Secretary determine which loans it is unable to collect in full within a reasonable amount of time through enforced collections? To our knowledge, ED has not published any guidance as to how it makes such a determination or what it considers a "reasonable" amount of time to collect a student loan debt in full. Indeed, the discussion of compromise in the Private Collection Agency (PCA) Procedures Manual—which set out the policies for the private collection agencies that ED until recently contracted with to collect on defaulted debts and to handle requests to compromise defaulted loans—does not address this basis for compromise at all. In the absence of existing subregulatory policy guidance for compromise of old defaulted debts in the student loan program, ED could establish new guidance starting from a blank slate or could act to offer compromise relief consistent with the discretion afforded under the regulations on a one-time basis.

In identifying loans that the government is unable to collect in full in a reasonable amount of time, there are at least two categories that ED could consider:

1. **Defaulted loans that the government has already been unable to collect in full in a reasonable amount of time.** For such loans, eligibility for compromise should be clear cut, and no additional assessment should be needed because the debt has already met the standard for compromise through demonstrated government inability to collect in full in a reasonable amount of time. In setting the number of years considered "reasonable" to expect collection in full, ED could look to the practices of other agencies or to actors in the private marketplace. Alternatively, ED could look to its internal data, which should reveal, for example, the number of years that most loans spend in default before either being collected in full or returning to good standing, as well as the number of years in default after which loans are unlikely to be successfully repaid or collected in full. Then putting this into practice, the Secretary may determine, for example, that three years is a reasonable amount of time to pursue debts

in default, and that loans that remain in default after three years are unlikely to be successfully repaid or collected in full and should be discharged.[35]

ED might also reasonably decide that the amount of time that it is reasonable to attempt collection in full could also depend on the total, cumulative period the loan has been outstanding, including both time in repayment and time in default. Under this approach, ED could, for example, determine that outstanding loans in default that entered repayment 20 or more years ago are debts that the government cannot collect in full a reasonable amount of time, and should be discharged. There are potentially a large number of low-income and financially-distressed borrowers who would meet this criteria for having their debt compromised, and for whom debt relief would offer tremendous benefit to their financial security. As discussed above, approximately two million borrowers are in or near default on very old loans that entered repayment over 20 years earlier.[36] Many older and disabled Americans subject to offset have loans that fall into this category; according to a 2016 GAO report, 43 percent of older borrowers subject to Social Security offset had loans over 20 years old (and 10.6 percent had loans that were at least 30 years old).[37]

2. **Defaulted loans that the government will be unable to collect in full because the amount that the government is able to collect is insufficient to reduce borrowers' balances.** Despite ED's tremendous collection powers, including the authority to seize tax refunds in full and to garnish wages and Social Security benefits without a court order, there are some borrowers in default who are simply so poor that enforced collection is fruitless. The government cannot draw blood from a stone. For many low-income borrowers, the amount that is available and can legally be collected from them via wage garnishment, Social Security offset, and tax refund offset is not enough to even cover collection fees and ongoing interest charges, and thus does not reduce principal. As a result, the government will be unable to collect the debt "in full" in a reasonable amount of time because the collection will only service interest and collection charges, with the principal untouched. Continued collection will leave the debt balance the same or cause it to increase as unaffordable interest continues to accrue.

Loans in this category include defaulted loans that are subject to Social Security offset but do not have decreasing principal because the borrower's Social Security income is so low that it is either fully protected from offset or the amount that can be seized is less than the interest and fees that accrue each month. For example, the 2016 GAO report found that roughly half of borrowers who were subject to Social Security offset had no portion of the amount collected via offset applied to their principal—it all went to interest and fees.[38] Application of the compromise standard to this group of borrowers is particularly compelling as most Social Security recipients are unlikely to experience the type of significant income increases that would improve the likelihood of collection in full, and because for many, the offset pushes the remaining Social Security payment below—or further below—the poverty level.[39]

In addition to providing relief to millions of the most financially-distressed borrowers at little actual cost to the government, both of these categories have the advantage of presenting clear, bright-line rules that can be used to determine loans eligible for compromise relief. Further, all of the information needed to assess eligibility for relief is within ED's possession, as ED has data at the individual borrower level reflecting the amount of time in default, the amount of time since loans entered repayment, and whether a borrower in collection has a balance that is decreasing (indicating that it is making at least some progress toward collection in full) versus remaining flat or increasing (indicating that the government is not making progress toward collection and is unlikely to successfully collect in full in a reasonable amount of time). Thus, ED could provide this relief to eligible borrowers, on an opt-out basis, without requiring borrowers to apply or submit evidence of their eligibility—an important advantage, considering the difficulty ED continues to have with reaching defaulted borrowers and the burden that application-based relief programs place on borrowers and ED alike.

Ultimately, ED and the companies it pays to collect student loans cannot draw blood from a stone, and continuing to try is not only futile but inflicts needless suffering on low-income borrowers and their families, too often trapping them in poverty. This practice is unnecessary and counter to the purpose of the federal student loan system, which aims to deliver economic mobility to low-income Americans by providing access to education. Now, before collection resumes in 2024, is the time for the Secretary of Education to reevaluate ED's practice of continuing to pursue financially-distressed Americans for student debts past the point that collection is futile, and to use available authority to change course.

Endnotes

1 *Educ. Dept. Responses to Data Request by Senator Warren* (Apr. 2, 2021), https://www.warren.senate.gov/imo/media/doc/Education%20Department%20Response%20to%20Sen%20Warren%20-%204-8-21.pdf; Federal Student Loan Portfolio, Fed. Student Aid https://studentaid.gov/data-center/student/portfolio.

2 Nat'l Consumer Law Ctr., *Student Loan Law*, Chap. 8, 9 (6th ed. 2019), updated online at https://library.nclc.org/SL/subscribe.

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5 Yu, *supra* note 3.

6 *See, e.g.*, Sarah Sattleymeyer, *Trapped by Default*, New America (July 27, 2022), https://www.newamerica.org/education-policy/briefs/trapped-by-default/; Brian Delton & Shelbe Klebs, *Key Facts About Student Loan Default as Payment Pause Nears End*, PEW (July 2023).

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28 *Id.*

29 *Id.* (under "What GAO Found").

30 Notably, while the Fresh Start program is providing important relief to borrowers in default, it does not provide a complete remedy to borrowers who would not have defaulted in the first place, or who would have had their loans cancelled, but for past servicing failures.

31 In several states, sending borrowers bills and/or collection notices without informing them of their rights to utilize the Fresh Start program may constitute a violation of state consumer protection laws. See e.g., Cal. Civ. Code § 1788.102(r)(2); Colo. Rev. Stat. § 5-20-109(1)(b); Va. Code Ann. § 6.2-2610(A)(2)(i). For further discussion of the history and application of consumer law to student loan servicers, see infra, Berkman-Breen, Delivering Distress and Breaking the Law: How Sending Bills Violates Consumer Protection Laws at p. 96.

32 34 C.F.R. § 30.70(e)(1); 31 C.F.R. § 902.2(a)(2).

33 *See* Student Borrower Prot. Ctr., *Defaulted Borrowers Must Be Included in the Income-Driven Repayment Account Adjustment* (Jan. 27, 2023), https://protectborrowers.org/wp-content/uploads/2023/02/SBPC-IDR-Account-Adjustment-Legal-Memo-for-Defaulted-Borrowers-01-27-23.pdf; *see also* Kyra Taylor & Winston Berkman-Breen, *A Major Flaw in the IDR Account Adjustment: Excluding Time in Default* (June 23, 2023), https://www.studentloanborrowerassistance.org/a-major-flaw-in-the-idr-account-adjustment-excluding-time-in-default/.

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35 ED has access to, but has not made public, information sufficient to determine these cut-offs and the number of borrowers who would currently be eligible for relief under these standards.

36 *Educ. Dept. Responses to Data Request by Senator Warren*, *supra* note 1.

37 Social Security Offsets, supra note 26.

38 Among borrowers 50 or older at the time of initial offset, 53 percent had no portion of their offset payments applied to principal. Among borrowers under age 50 at the time of initial offset, 47 percent had no portion of their offset payments applied to principal. *Social Security Offsets*, *supra* note 26, at 19.

39 Social Security Offsets, s*upra* note 26.